# Proposed Rules

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## FEDERAL DEPOSIT INSURANCE CORPORATION

### 12 CFR Parts 303, 337 and 362

**RIN 3064–AC12**

## Activities of Insured State Banks and Insured Savings Associations

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** As part of the FDIC's systematic review of its regulations and written policies under section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI), the FDIC is seeking public comment on its proposal to revise and consolidate its rules and regulations governing activities and investments of insured state banks and insured savings associations. The FDIC proposes to combine its regulations governing the activities and investments of insured state banks with those governing insured savings associations. In addition, the proposal updates the FDIC's regulations governing the safety and soundness of securities activities of subsidiaries and affiliates of insured state nonmember banks. The FDIC's proposal modernizes this group of regulations and harmonizes the provisions governing activities that are not permissible for national banks with those governing the securities activities of state nonmember banks. The proposed regulation will make a number of substantive changes and will revise the regulations by deleting obsolete provisions, rewriting the regulatory text to make it more readable, conforming the treatment of state banks and savings associations to the extent possible given the underlying statutory and regulatory scheme governing the different charters. The proposal establishes a number of new exceptions and will allow institutions to conduct certain activities after providing the FDIC with notice rather than filing an application. The proposal also will revise these regulations by deleting obsolete provisions, rewriting the regulatory text to make it more readable, removing a number of the current restrictions on those activities and conforming the disclosures required under the current regulation to an existing interagency statement concerning the retail sales of nondeposit investment products.

**DATES:** Comments must be received by December 11, 1997.

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

**FOR FURTHER INFORMATION CONTACT:** Curtis Vaughn, Examination Specialist, (202/898–6759) or John Jilovec, Examination Specialist, (202/898–8958) Division of Supervision; Linda L. Stamp, Counsel, (202/ 898–7310) or Jamey Basham, Counsel, (202/ 898–7265), Legal Division, FDIC, 550 17th Street, N.W., Washington, D.C. 20429.

**SUPPLEMENTARY INFORMATION:**

## I. Background

Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) requires that the FDIC review its regulations for the purpose of streamlining those regulations, reducing any unnecessary costs and eliminating unwarranted constraints on credit availability while faithfully implementing statutory requirements. Pursuant to that statutory direction the FDIC has reviewed part 362 ''Activities and Investments of Insured State Banks,'' § 303.13 ''Applications and Notices by Savings Associations,'' and § 337.4 ''Securities Activities of Subsidiaries of Insured State Banks: Bank Transactions with Affiliated Securities Companies' and proposes to make a number of changes to those regulations. The proposal is described in more detail below. In brief, however, the proposal would restructure existing part 362, placing the substance of the text of the current regulation into new subpart A. Subpart A would address the Activities of Insured State Banks which implements section 24 of the Federal Deposit Insurance Act (FDI Act). 12 U.S.C. 1831a. Section 24 restricts and prohibits insured state banks and their subsidiaries from engaging in activities and investments of a type that are not permissible for national banks and their subsidiaries. In addition, the proposal would move the FDIC's regulations governing the securities activities of subsidiaries of insured state nonmember banks (currently at 12 CFR 337.4) into subpart A of part 362 and revise those regulations by deleting obsolete provisions, rewriting the regulatory text to make it more readable, removing a number of the obsolete current restrictions on those activities, and removing the disclosures required under the current regulation to conform the required disclosures to the Interagency Statement on the Retail Sale of Nondeposit Investment Products (Interagency Statement).

Safety and Soundness Rules Governing Insured State Nonmember Banks would be set out in new subpart B. Subpart B would establish modern standards for insured state nonmember banks to conduct real estate investment activities through a subsidiary and for those insured state nonmember banks that are not affiliated with a bank holding company (nonbank banks) to conduct securities activities in an affiliated organization. The existing restrictions on these securities activities are found in § 337.4 of this chapter.

Existing § 303.13 of this chapter which relates to activities of state savings associations and filings by all savings associations would be revised in a number of ways and primarily placed in new subpart C of part 362. Procedures to be used by all savings associations when Acquiring, Establishing, or Conducting New Activities through a Subsidiary would be placed in new subpart D. Subpart E would contain the revised provisions concerning application and notice procedures as well as delegations for insured state banks. Subpart F would contain the revised provisions concerning application and notice procedures as well as delegations for insured savings associations.

In addition, the FDIC is processing a complete revision of part 303 of the FDIC's rules and regulations. Part 303 contains the FDIC's applications procedures and delegations of authority. As a part of that process and for ease of reference, the FDIC is proposing to remove the applications procedures relating to activities and investments of insured state banks from part 362 and place them in subpart G of part 303. The procedures applicable to insured savings associations will be consolidated in subpart H of part 303. We anticipate that the proposed changes to part 303 will be published for comment within 90 days of today's publication. At that time, subparts G and H of part 303 will be designated as the place where the text of subparts E and F of this proposed rule eventually will be located.

Part 362 of the FDIC's regulations implements the provisions of section 24 of the FDI Act (12 U.S.C. 1831a). Section 24 was added to the FDI Act by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). With certain exceptions, section 24 limits the direct equity investments of state chartered insured banks to equity investments of a type permissible for national banks. In addition, section 24 prohibits an insured state bank from directly, or indirectly through a subsidiary, engaging as principal in any activity that is not permissible for a national bank unless the bank meets its capital requirements and the FDIC determines that the activity will not pose a significant risk to the appropriate deposit insurance fund. The FDIC may make such determinations by regulation or order. The statute requires institutions that held equity investments not conforming to the new requirements to divest no later than December 19, 1996. The statute also requires that banks file certain notices with the FDIC concerning grandfathered investments.

Part 362 was adopted in two stages. The provisions of the current regulation concerning equity investments appeared in the **Federal Register** on November 9, 1992, at 57 FR 53234. The provisions of the current regulation concerning activities of insured state banks and their majority-owned subsidiaries appeared in the **Federal Register** on December 8, 1993, at 58 FR 64455.

Section 303.13 of the FDIC's regulations (12 CFR 303.13) implements sections 28 and 18(m) of the FDI Act. Both sections were added to the FDI Act by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). While section 28 of the FDI Act and section 24 of the FDI Act are similar, there are a number of fundamental differences in the two provisions which caused the implementing regulations to differ in some respects.

Section 18(m) of the FDI Act (12 U.S.C. 1828(m)) requires state and federal savings associations to provide the FDIC with notice 30 days before establishing or acquiring a subsidiary or engaging in any new activity through a subsidiary. Section 28 (12 U.S.C. 1831e) governs the activities and equity investments of state savings associations and provides that no state savings association may engage as principal in any activity of a type or in an amount that is impermissible for a federal savings association unless the FDIC determines that the activity will not pose a significant risk to the affected deposit insurance fund and the savings association is in compliance with the fully phased-in capital requirements prescribed under section 5(t) of the Home Owners' Loan Act (HOLA, 12 U.S.C. 1464(t)). Except for its investment in service corporations, a state savings association is prohibited from acquiring or retaining any equity investment that is not permissible for a federal savings association. A state savings association may acquire or retain an investment in a service corporation of a type or in an amount not permissible for a federal savings association if the FDIC determines that neither the amount invested in the service corporation nor the activities of the service corporation pose a significant risk to the affected deposit insurance fund and the savings association continues to meet the fully phased-in capital requirements. A savings association was required to divest itself of prohibited equity investments no later than July 1, 1994. Section 28 also prohibits state and federal savings associations from acquiring any corporate debt security that is not of investment grade (commonly known as ''junk bonds'').

Section 303.13 of the FDIC's regulations was adopted as an interim final rule on December 29, 1989 (54 FR 53548). The FDIC revised the rule after reviewing the comments and the regulation as adopted appeared in the **Federal Register** on September 17, 1990 (55 FR 38042). The regulation establishes application and notice procedures governing requests by a state savings association to directly, or through a service corporation, engage in activities that are not permissible for a federal savings association; the intent of a state savings association to engage in permissible activities in an amount exceeding that permissible for a federal savings association; or the intent of a state savings association to divest corporate debt securities not of investment grade. The regulation also establishes procedures to give prior notice for the establishment or acquisition of a subsidiary or the conduct of new activities through a subsidiary.

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

On August 23, 1996, the FDIC published a notice of proposed rulemaking (61 FR 43486, August 23, 1996) (August proposed rule) to amend part 362. Under the proposed rule a notice procedure would have replaced the application currently required in the case of real estate investment, life insurance and annuity investment activities provided certain conditions and restrictions were met. The proposed rule set forth notice processing procedures for real estate, life insurance policies and annuity contract investments for well-capitalized, well-managed insured state banks. Under the proposal, all real estate activities would be required to be conducted in a majority-owned subsidiary, while life insurance policies and annuity contracts could be held directly or through a majority-owned subsidiary. Notices would have been filed with the appropriate FDIC regional office. The FDIC regional office would have had 60 days to process a notice under the proposal, with a possible extension of 30 days. If the FDIC did not object to the notice prior to the expiration of the notice period (or any extension), the bank could have proceeded with the investment activity. In the event a bank fell out of compliance with any of the eligibility conditions after starting the activity, it would have been required to report the noncompliance to the appropriate FDIC regional office within 10 business days of the occurrence.

With respect to investments in real estate activities, the August proposed rule set forth 9 conditions which banks would have had to meet to be ''eligible'' for the notice procedure. These 9 conditions addressed the bank's capital levels and financial condition (must be well-capitalized after deducting investment in real estate and must have a Uniform Financial Institutions Rating System (UFIRS) rating of 1 or 2), how the real estate activity would be conducted (a ''bona fide'' subsidiary which only engages in real estate activities), management experience and independence of the real estate subsidiary (subsidiary must have management with real estate experience, a written business plan, and at least one director with real estate experience who is not an employee, officer or director of the bank), and placed limits on bank transactions with the subsidiary and customers (sections 23A and 23B of the Federal Reserve Act applied to transactions between the bank and its subsidiary and tying and insider transactions were prohibited). The August proposed rule also set forth the contents of the notice that was to be sent to the FDIC regional office. The required information included 7 items; information regarding the proposed activity (general description of proposed real estate activity, a copy of the written business plan, and a description of the subsidiary's operations including management's expertise), the amount of investment and impact on bank capital (aggregate amount of investment in activity and pro forma effect of deducting such investments on the bank's capital levels) and the bank's authority to engage in such activity (copy of the board of directors' resolution authorizing activity and identification of state law permitting the activity). Under the August proposal, the regional office could have requested additional information.

After considering the comments to the August proposed rule and reconsidering the issues underlying the current regulation, we have restructured the approach we are taking under part 362. As a result, the FDIC withdrew the August proposed rule, which is published elsewhere in today's **Federal Register** in favor of the more comprehensive approach presently proposed.

While the August proposed rule amended existing part 362, the current proposal would replace existing part 362. Unlike the rule proposed in August, the current proposal is not limited to considering the notice procedure used under part 362. In drafting the current proposal, we have deleted items that are either duplicative, unnecessary due to the passage of time, or have proven unwarranted given our experience in implementing section 24 over the last five years. In addition, we have refined the notice procedure that was proposed in August. We are no longer recommending a life insurance policy and annuity contract investment notice due to recent guidance provided by the Office of the Comptroller of the Currency (OCC). The OCC's guidance appears to eliminate the necessity for an application with respect to virtually all of the life insurance and annuity investments received by the FDIC in the past. While Section 24 and the part 362 application process would continue to apply to those life insurance and annuity investments which are impermissible for national banks, the FDIC has decided that there is no need to adopt a notice process that specifically addresses what we expect to be an extremely small number of situations. We invite comment on whether we are correct in concluding that there is no longer a need for a notice process for life insurance and annuity investments which are impermissible for national banks.

## II. Description of Proposal

The FDIC proposes to divide part 362 into six subparts. Before describing the reorganization of part 362, we would like to make a few general comments concerning the proposal. First, we moved substantive aspects of the regulation that were formerly found in the definitions of terms like ''bona fide subsidiary'' to the applicable regulation text. This reorganization should assist the reader in understanding and applying the regulation. Second, current part 362 contains a number of provisions relating to divesture. We have deleted any divestiture provisions in the current proposal that we found to be unnecessary due to the passage of time. Third, we are proposing to combine the rules covering the equity investments of banks and savings associations into part 362 and to regulate these investments as consistently as possible given the limitations imposed by statute. Fourth, unlike the regulations promulgated by the Office of Thrift Supervision we do not distinguish between activities carried out by a first tier subsidiary of a savings association versus a lower-tier subsidiary. Finally, although the FDIC agrees with the principles applicable to transactions between insured depository institutions and its affiliates contained in sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1), our experience over the last five years in applying section 24 has led us to conclude that extending 23A and 23B by reference to bank subsidiaries is inadvisable. For that reason, the proposed regulation does not incorporate sections 23A and 23B of the Federal Reserve Act by cross-reference; rather, the proposal adapts the principles set forth in sections 23A and 23B to the bank/subsidiary relationship as appropriate. In drafting the proposed revision to part 362, we have considered each of the requirements contained in sections 23A and 23B in the context of transactions between an insured institution and its subsidiary and refined the restrictions appropriately. The FDIC requests comment on whether these proposals assist in the application of the principles of 23A and 23B to the subsidiaries of insured depository institutions. We also request comment on all aspects of these restrictions including whether this approach strikes a better balance between caution and commercial reality by harmonizing the capital deductions and the principles of 23A and 23B.

Subpart A of the proposed regulation would deal with the activities and investments of insured state banks. Except for those sections pertaining to the applications, notices and related delegations of authority (procedural provisions), existing part 362 would essentially become subpart A under the current proposal. The procedural provisions of existing part 362 have been transferred to subpart E. As proposed, subpart A addresses the activities of the insured state bank in § 362.3. The activities carried on in a subsidiary of the insured state bank are addressed in a separate section (see § 362.4 in the proposed regulation). We are soliciting comment on whether this reorganization of part 362 is helpful.

The ability of insured state banks to engage in activities as principal is directly linked to the ability of a national bank to engage in the same type of activity. National banks have a limited ability to hold equity investments in real estate. Even so, if a particular real estate investment has been determined to be permissible for a national bank, an insured state bank only needs to document that determination to undertake the investment. Insured state banks that want to undertake a real estate investment which is impermissible for a national bank (or continue to hold the real estate investment in the case of investments acquired before enactment of section 24 of the FDI Act), must file an application with the FDIC for consent. The FDIC may approve such applications if the investment is made through a majority-owned subsidiary, the institution meets the applicable capital standards set by the appropriate Federal banking agency and the FDIC determines that the activity does not pose a significant risk to the appropriate deposit insurance fund.

The FDIC has determined that real estate investment activities may pose significant risks to the deposit insurance funds. For that reason, the FDIC is proposing to establish standards that an insured state nonmember bank must meet before engaging in real estate investment activities that are not permissible for a national bank. Under a safety and soundness standard, subpart B of the proposed regulation requires insured state nonmember banks to meet the standards established by the FDIC, even if the Comptroller of the Currency determines that those activities are permissible for a national bank subsidiary. Subpart B also would establish modern standards for insured state nonmember banks to govern transactions between those insured state nonmember banks that are not affiliated with a bank holding company (nonbank banks) and affiliated organizations conducting securities activities. The existing restrictions on these securities activities are found in § 337.4 of this chapter. The new rule will only cover those entities not covered by orders issued by the Board of Governors of the Federal Reserve System (FRB) governing the securities activities of those banks that are affiliated with a bank holding company or a member bank.

Subpart B prohibits an insured state nonmember bank not affiliated with a company that is treated as a bank holding company (see section 4(f) of the Bank Holding Company Act, 12 U.S.C. 1843(f)), from becoming affiliated with a company that directly engages in the underwriting of securities not permissible for a national bank unless the standards established under the proposed regulation are met.

Subpart C of the proposed regulation concerns the activities and investments of insured state savings associations. The provisions applicable to activities of savings associations currently appearing in § 303.13 would be revised in a number of ways and placed in new subpart C. To the extent possible, activities and investments of insured state savings associations would be treated consistently with the treatment provided insured state banks. Thus, we revised a number of definitions currently contained in § 303.13 to track the definitions used in subpart A. We request comment on whether the revisions made in subpart C contribute to the efficient operation of savings associations and their service corporations while continuing to implement the statutory requirements.

Subpart D of the proposal requires that an insured savings association provide a 30 day notice to the FDIC whenever the institution establishes or acquires a subsidiary or conducts a new activity through a subsidiary. This provision does not alter the notice required by statute. We moved this requirement to a new subpart to accommodate Federally chartered savings associations by limiting the amount of regulation text they would have to read to comply with this statutory notice. Comment is invited on whether this separation avoids confusion, enhances readability and simplifies compliance.

Subparts E and F of the proposal each contain the notice and application requirements and the delegations of authority for the substantive matters covered by the proposal for insured state banks and state savings associations, respectively.

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

## III. Section by Section Analysis

### *A. Subpart A—Activities of Insured State Banks*

#### Section 362.1 Purpose and Scope

The purpose and scope of subpart A is to ensure that the activities and investments undertaken by insured state banks and their subsidiaries do not present a significant risk to the deposit insurance funds, are not unsafe and are not unsound, are consistent with the purposes of federal deposit insurance and are otherwise consistent with law. This subpart implements the provisions of section 24 of the FDI Act that restrict and prohibit insured state banks and their subsidiaries from engaging in activities and investments of a type that are not permissible for national banks and their subsidiaries. The phrase ''activity permissible for a national bank'' means any activity authorized for national banks under any statute including the National Bank Act (12 U.S.C. 21 *et seq.*), as well as activities recognized as permissible for a national bank in regulations, official circulars, bulletins, orders or written interpretations issued by the OCC. This subpart governs activities conducted ''as principal'' and therefore does not govern activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee. We moved this language from § 362.2(c) of the current version of part 362 where the term ''as principal'' is defined to mean acting other than as agent for a customer, acting as trustee, or conducting an activity in a brokerage, custodial or advisory capacity. The FDIC previously described this definition as not covering, for example, acting as agent for the sale of insurance, acting as agent for the sale of securities, acting as agent for the sale of real estate, or acting as agent in arranging for travel services. Likewise, providing safekeeping services, providing personal financial planning services, and acting as trustee were described as not being ''as principal'' activities within the meaning of this definition. In contrast, real estate development, insurance underwriting, issuing annuities, and securities underwriting would constitute ''as principal'' activities. Further, for example, travel agency activities have not been brought within the scope of part 362 and would not require prior consent from the FDIC even though a national bank is not permitted to act as travel agent. This result obtains from the fact that the state bank would not be acting ''as principal'' in providing those services. Thus, the fact that a national bank may not engage in travel agency activities would be of no consequence. Of course, state banks would have to be authorized to engage in travel agency activities under state law. We intend to continue to interpret section 24 and part 362 as excluding any coverage of activities being conducted as agent. To highlight this issue, provide clarity and alert the reader of this rule that activities being conducted as agent are not within the scope of section 24 and part 362, we have moved this language to the purpose and scope paragraph. We request comment on whether moving this language to the purpose and scope paragraph assists users of this rule in interpreting its parameters. We also invite comment on whether the ''as principal'' definition still would be necessary.

Equity investments acquired in connection with debts previously contracted (DPC) that are held within the shorter of the time limits prescribed by state or federal law are not subject to the limitations of this subpart. The exclusion of equity investments acquired in connection with DPC has been moved from the definition of ''Equity investment'' to the purpose and scope paragraph to highlight this issue, provide clarity and alert the reader of this rule that these investments are not within the scope of section 24 and part 362. However, the intent of the insured state bank in holding equity investments acquired in connection with DPC continues to be relevant to the analysis of whether the equity investment is permitted. Interests taken as DPC are excluded from the scope of this regulation provided that the interests are not held for investment purposes and are not held longer than the shorter of any time limit on holding such interests (1) set by applicable state law or regulation or (2) the maximum time limit on holding such interests set by applicable statute for a national bank. The result of the modification would be to make it clear, for example, that real estate taken DPC may not be held for longer than 10 years (*see* 12 U.S.C. 29) or any shorter period of time set by the state. In the case of equity securities taken DPC, the bank must divest the equity securities ''within a reasonable time'' (i.e, as soon as possible consistent with obtaining a reasonable return) (see OCC Interpretive Letter No. 395, August 24, 1987, (1988–89 Transfer Binder) Fed Banking L. Rep. (CCH) p. 85,619, which interprets and applies the National Bank Act) or no later than the time permitted under state law if that time period is shorter.

In addition, any interest taken DPC may not be held for investment purposes. For example, while a bank may be able to expend monies in connection with DPC property and/or take other actions with regard to that property, if those expenditures and actions are speculative in nature or go beyond what is necessary and prudent in order for the bank to recover on the loan, the property will not fall within the DPC exclusion. The FDIC expects that bank management will document that DPC property is being actively marketed and current appraisals or other means of establishing fair market value may be used to support management's decision not to dispose of property if offers to purchase the property have been received and rejected by management.

Similarly to highlight this issue, provide clarity and alert the reader of this rule, we have moved to the purpose and scope paragraph the language governing any interest in real estate in which the real property is (a) used or intended in good faith to be used within a reasonable time by an insured state bank or its subsidiaries as offices or related facilities for the conduct of its business or future expansion of its business or (b) used as public welfare investments of a type permissible for national banks. In the case of real property held for use at some time in the future as premises, the holding of the property must reflect a bona fide intent on the part of the bank to use the property in the future as premises. We are not aware of any statutory time frame that applies in the case of a national bank which limits the holding of such property to a specific time period. Therefore, the issue of the precise time frame under which future premises may be held without implicating part 362 must be decided on a case-by-case basis. If the holding period allowed for under state law is longer than what the FDIC determines to be reasonable and consistent with a bona fide intent to use the property for future premises, the bank will be so informed and will be required to convert the property to use, divest the property, or apply for consent to hold the property through a majority-owned subsidiary of the bank. We note that the OCC's regulations indicate that real property held for future premises should ''normally'' be converted to use within five years after which time it will be considered other real estate owned and must be actively marketed and divested in no later than ten years. (12 CFR 34). We understand that the time periods set forth in the OCC's regulation reflect safety and soundness determinations by that agency. As such, and in keeping with what has been to date the FDIC's posture with regard to safety and soundness determinations of the OCC, the FDIC will substitute its own judgment to determine when a reasonable time has elapsed for holding the property.

A subsidiary of an insured state bank may not engage in real estate investment activities not permissible for a subsidiary of a national bank unless the bank is in compliance with applicable capital standards and the FDIC has determined that the activity poses no significant risk to the deposit insurance fund. Subpart A provides standards for real estate investment activities that are not permissible for a subsidiary of a national bank. Because of safety and soundness concerns relating to real estate investment activities, subpart B reflects special rules for subsidiaries of insured state nonmember banks that engage in real estate investment activities of a type that are not permissible for a national bank but may be otherwise permissible for a subsidiary of a national bank.

The FDIC intends to allow insured state banks and their subsidiaries to undertake safe and sound activities and investments that do not present a significant risk to the deposit insurance funds and that are consistent with the purposes of federal deposit insurance and other applicable law. This subpart does not authorize any insured state bank to make investments or to conduct activities that are not authorized or that are prohibited by either state or federal law.

Section 362.2 Definitions

Revised subpart A § 362.2 contains— definitions. We have left most of the definitions unchanged or edited them to enhance clarity or readability without changing the meaning.

To standardize as many definitions as possible, we have incorporated several definitions from section 3 of the FDI Act (12 U.S. C. 1813). These definitions are ''Bank,'' ''State bank,'' ''Savings association,'' ''State savings association,'' ''Depository institution,'' ''Insured depository institution,'' ''Insured state bank,'' ''Federal savings association,'' and ''Insured state nonmember bank.'' This standardization required that we delete the definitions of ''depository institution'' and ''insured state bank''currently found in part 362. No substantive change was intended by this change. The definitions that were added by this change are ''Bank,'' ''State bank,'' ''Savings association,'' ''State savings association,'' ''Insured depository institution,'' ''Federal savings association,'' and ''Insured state nonmember bank.'' These definitions were added to provide clarity throughout the proposed part 362 because we are incorporating so many definitions from subpart A into subpart B governing safety and soundness concerns of insured state nonmember banks, subpart C governing the activities of state savings associations, and subpart D governing subsidiaries of all savings associations. We invite comment on whether readers view these definitions as needing further changes to enhance clarity and readability. We also invite comment on whether any of the changes we have made may have changed the substance of the regulation in ways that we may not have intended.

The definitions that have been left unchanged or edited to enhance clarity or readability without changing the meaning are the following: ''Control,'' ''Extension of credit,'' ''Executive officer,'' ''Director,'' ''Principal shareholder,'' ''Related interest,'' ''National Securities exchange,'' ''Residents of state,'' ''Subsidiary,'' and ''Tier one capital.'' We invite comment on whether readers view these definitions as needing further changes to enhance clarity and readability. We also invite comment on whether any of the changes we have made may have changed the substance of the regulation in ways that we may not have intended.

The name of one definition has been simplified without substantively changing the meaning of the definition. That definition is currently found in § 362.2(g) and is described as follows ''An insured state bank will be considered to convert its charter.'' We moved this definition to § 362.2(e) and call this definition, ''Convert its charter.'' The substance of the definition is intended to remain unchanged by this revised language. We invite comment on whether readers view the change in this definition as needing any further changes to enhance clarity and readability. We also invite comment on whether any of the changes we have made to this definition may have changed the substance of the regulation in ways that we may not have intended.

Although most of the definitions as set out in the proposal are the same or virtually unchanged, a few of the definitions in the proposal have been substantively revised. The proposed changes to these definitions are discussed below.

We deleted the definitions of ''Activity permissible for a national bank,'' ''An activity is considered to be conducted as principal,'' and ''Equity investment permissible for a national bank.'' We moved the substance of the information that was contained in these definitions into the scope paragraph in § 362.1. We thought that including the information that was in these definitions in the scope paragraph made the coverage of the rule clearer to the reader and was consistent with the purpose of the scope paragraph. We expect that some readers may save time by realizing sooner that the regulation may be inapplicable to conduct contemplated by a particular bank. We also thought that the reader might be more likely to consider the scope paragraph than to consider the definition section when reading the rule to determine its applicability. We concluded that it would be unnecessary to duplicate this same information in the definition section. We invite comment on whether readers prefer to see these concepts in the scope paragraph and whether readers also would prefer to see these concepts defined.

We deleted the definition of ''Equity interest in real estate'' and moved the recitation of the permissibility of owning real estate for bank premises and future premises, owning real estate for public welfare investments and owning real estate from DPC to the scope paragraph for the reasons stated in the preceding paragraph. These activities are permissible for national banks and we thought that it was unnecessary to continue to restate this information in the definition section of the regulation. No substantive change is intended by this simplification of the language. In addition, we determined that the remainder of the definition of ''Equity interest in real estate'' did little to enhance clarity or understanding; therefore, we are relying on the language defining ''Equity investment'' to cover real estate investments. We conformed the definition of ''Equity investment'' by deleting the reference to the deleted definition of ''Equity interest in real estate.'' No substantive change is intended by shortening this language. We invite comment on whether the readers view the definition of ''Equity interest in real estate'' as necessary to enhance clarity and readability on these issues as well as whether readers prefer seeing these concepts in the scope paragraph.

The remainder of the definition of ''Equity investment'' has been shortened and edited to enhance readability. We intend no substantive change by shortening this language. This concept is intended to encompass an investment in an equity security or real estate as it does in the current definition. We invite comment on the changes to this definition and whether any further changes are needed.

With regard to the definition of ''Equity security,'' we modified this definition by deleting the references to permissible national bank holdings such as equity securities being held as a result of a foreclosure or other arrangements concerning debt previously contracted. Language discussing the exclusion of DPC and other investments that are permissible for national banks has been relocated to the scope paragraph for the reasons stated above. Thus, the equity investment definitions no longer include these references. We intend no substantive change through the deletion of this redundant language. We invite comment on whether any ambiguity or unintended change in the meaning may be created by removing this language from the definition.

We added a shorter definition of ''Real estate investment activity'' meaning any interest in real estate held directly or indirectly that is not permissible for a national bank. This term is used in § 362.4(b)(5) of subpart A and in § 362.7 of subpart B which contains safety and soundness restrictions on real estate activities of subsidiaries of insured state nonmember banks that may be deemed to be permissible for operating subsidiaries of national banks that would not be permissible for a national bank, itself. We invite comment on this definition, including its meaning and clarity as well as the underlying safety and soundness proposal in subpart B. We specifically invite comment on the exclusion of real estate leasing from the definition of real estate investment activity. The proposal has eliminated real estate leasing from the definition of real estate investment activity in order to assure that banks using the notice procedure are not getting involved in a commercial business. The notice procedures are designed for institutions that wish to hold parcels of real estate for ultimate sale. If an institution wishes to hold the property to lease it for ongoing business purposes, we believe the proposal should be considered under the application process.

We deleted the definitions of ''Investment in department'' and ''Department'' because we thought they were no longer needed in the revised regulation text. The core standards applicable to a department of a bank are set out in detail in § 362.3(c) and defining the term ''Department'' no longer seems to be necessary. Regarding the definition of ''Investment in department,'' we also considered this definition unnecessary. We believe that if a calculation of ''Investment in department'' needs to be made, we will defer to state law on this issue. We invite comment on whether the readers view these definitions as necessary to enhance clarity and readability on these issues. We also request comment on whether deference to state law on this investment issue would cause any unintended consequences that we have not foreseen.

Similarly, we deleted the definition of ''Investment in subsidiary'' because the definition is no longer needed in the revised regulation text. The core standards applicable to an insured state bank and its subsidiary make a definition of ''Investment in subsidiary'' superfluous. The core standards contained in § 362.4(c) set out the requirements in detail. Therefore, defining the term ''Investment in subsidiary'' no longer seems to be necessary. We invite comment on whether the readers view this definition or a similar definition as necessary to enhance clarity and readability on these issues.

We deleted the definition of ''bona fide subsidiary'' and chose to make similar characteristics part of the eligible subsidiary criteria in § 362.4(c)(2). We thought that including these criteria as a part of the substantive regulation text in that subsection, rather than as a definition, makes reading the rule easier and the meaning clearer. We invite comment on whether readers prefer to see this concept set forth in the substantive section of the rule or the definition section and whether readers believe any additional definition is necessary to enhance clarity and readability.

The proposal substitutes the current definition of ''Lower income'' with a cross reference in § 362.3(a)(2)(ii) to the definition of ''low income'' and ''moderate income'' as used for purposes of part 345 of the FDIC's regulations (12 CFR 345) which implements the Community Reinvestment Act (CRA). 12 U.S.C. 2901, *et seq.* Under part 345, ''low income'' means an individual income that is less than 50 percent of the area median income or a median family income that is less than 50 percent in the case of a census tract or a block numbering area delineated by the United States Census in the most recent decennial census. ''Moderate income'' means an individual income that is at least 50 percent but less than 80 percent of the area median or a median family income that is at least 50 but less than 80 percent in the case of a census tract or block numbering area.

The definition ''Lower income'' is relevant for purposes of applying the exception in the regulation which allows an insured state bank to be a partner in a limited partnership whose sole purpose is direct or indirect investment in the acquisition, rehabilitation, or new construction of qualified housing projects (housing for lower income persons). As we anticipate that insured state banks would seek to use such investments in meeting their community reinvestment obligations, the FDIC is of the opinion that conforming the definition of lower income to that used for CRA purposes will benefit banks. We note that the change will have the effect of expanding the housing projects that qualify for the exception. We invite comment on this change.

We have simplified the definition of the term ''Activity.'' As modified the definition includes all investments. Where equity investments are intended to be excluded, we expressly exclude those investments in the regulation text. We invite comment on whether the modification to the definition enhances clarity or whether the longer definition found in the current regulation should be reinstated. In particular, we invite comment on whether the definition should be modified to take into account in some fashion a recent interpretation by the agency under which it was determined that the act of making a political campaign contribution does not constitute an ''activity'' for purposes of part 362. The interpretation uses a three prong test to help determine whether particular conduct should be considered an activity and therefore subject to review under part 362 if the conduct is not permissible for a national bank. If at least two of the tests yield a conclusion that the conduct is part of the authorized conduct of business by the bank, the better conclusion is that the conduct is an activity. First, any conduct that is an integral part of the business of banking as well as any conduct which is closely related or incidental to banking should be considered an activity . In applying this test it is important to focus on what banks do that makes them different from other types of businesses. For example, lending money is clearly an ''activity'' for purposes of part 362. The second test asks whether the conduct is merely a corporate function as opposed to a banking function. For example, paying dividends to shareholders is primarily a general corporate function and not one associated with banking because of some unique characteristic of banking as a business. Generally, activities that are not general corporate functions will involve interaction between the bank and its customers rather than its employees or shareholders. The third test asks whether the conduct involves an attempt by the bank to generate a profit. For example, banks make loans and accept deposits in an effort to make money. However, contracting with another company to generate monthly customer statements should not be considered to be an activity unto itself as it simply is entered into in support of the ''activity'' of taking deposits. We also invite any other comments that would make this definition easier to understand and apply.

The proposal modifies the definition of ''Company'' to add limited liability companies to the list of entities that will be considered a company. This change in the definition is being proposed in recognition of the creation of limited liability companies and their growing prevalence in the market place. We invite comment on whether this addition to the list of forms of business enterprise is appropriate and whether we should add any more forms of business enterprise.

The FDIC has changed the definition of ''Significant risk to the fund'' by adding the second sentence that clarifies that this definition includes the risk that may be present either when an activity or an equity investment contributes or may contribute to the decline in condition of a particular state-chartered depository institution or when a type of activity or equity investment is found by the FDIC to contribute or potentially contribute to the deterioration of the overall condition of the banking system. We invite comment on whether the definition should be modified in some other manner and if so how. Our interpretation of the definition remains unchanged. Significant risk to the deposit insurance fund shall be understood to be present whenever there is a high probability that any insurance fund administered by the FDIC may suffer a loss. The preamble accompanying the adoption of this definition in final indicated that the FDIC recognized that no investment or activity may be said to be without risk under all circumstances and that such fact alone will not cause the agency to determine that a particular activity or investment poses a significant risk of loss to the fund. The emphasis rather is on whether there is a high degree of likelihood under all of the circumstances that an investment or activity by a particular bank, or by banks in general or in a given market or region, may ultimately produce a loss to either of the funds. The relative or absolute size of the loss that is projected in comparison to the fund will not be determinative of the issue. The preamble indicated that the definition is consistent with and derived from the legislative history of section 24 of the FDI Act. Previously, the FDIC rejected the suggestion that risk to the fund only be found if a particular activity or investment is expected to result in the imminent failure of a bank. The suggestion was rejected as the FDIC determined at that time that it was appropriate to approach the issue conservatively. We think that this conservatism is more clearly articulated in this modification to the definition. We invite comments on whether this additional language is necessary and whether any other language should be added.

We re-defined the term ''Well-capitalized'' to incorporate the same meaning set forth in part 325 of this chapter for an insured state nonmember bank. For other state-chartered depository institutions, the term ''well-capitalized'' has the same meaning as set forth in the capital regulations adopted by the appropriate Federal banking agency. We decided that it would simplify the calculations for the various state-chartered depository institutions if the capital definition imported the definitions used by those institutions when they deal with their appropriate Federal banking agency. We deleted the other terms defined under § 362.2(x) as unnecessary due to the changes in the regulation text. We invite comment on whether we have missed an item that still needs to be included in this definition.

We added definitions of the following terms: ''Change in control,'' ''Institution,'' ''Majority-owned subsidiary,'' ''Security'' and ''State-chartered depository institution.''

Under section 24 of the FDI Act, the grandfather with respect to common or preferred stock listed on a national securities exchange and shares of registered investment companies ceases to apply if the bank undergoes a change in control. The phrase ''Change in control'' is defined for the purposes of part 362 in what is currently § 362.3(b)(4)(ii) of the regulation. Under the proposal, the definition is relocated into the definitions section and modified.

Under the current regulation a ''Change in control'' that will result in the loss of the grandfather is defined to mean a transaction in which the bank converts its charter, undergoes a transaction which requires a notice to be filed under section 7(j) of the FDI Act (12 U.S.C. 1817(j)) except a transaction which is presumed to be a change in control for the purposes of that section under FDIC's regulations implementing section 7(j), any transaction subject to section 3 of the Bank Holding Company Act ( 12 U.S.C. 1842) other than a one bank holding company formation, a transaction in which the bank is acquired by or merged into a bank that is not eligible for the grandfather, or a transaction in which control of the bank's parent company changes. The proposal would narrow the definition of ''Change in control'' by defining the phrase to only encompass transactions subject to section 7(j) of the FDI Act (except for transactions which trigger the presumptions under FDIC's regulations implementing section 7(j) or the FRB's regulations implementing section 7(j)) and transactions in which the bank is acquired by or merged into a bank that is not eligible for the grandfather. This definition change will narrow the instances in which a bank may lose its grandfathered ability to invest in common or preferred stock listed on a national securities exchange and shares of registered investment companies. It is our belief that the revised definition, if adopted, will more closely approximate when a true change in control has occurred.

We added a definition of ''Institution'' and defined it to mean the same as a ''state-chartered depository institution'' to shorten the drafting of the rule, particularly for those items that are applicable to both insured state banks and insured state savings associations. This definition is intended to enhance readability. We invite comment on whether this definition creates any confusion or ambiguity.

We added a definition of ''Majority-owned subsidiary'' and defined it to mean any corporation in which the parent insured state bank owns a majority of the outstanding voting stock. We added this definition to clarify our intention that the expedited notice procedures only be available when an insured state bank interposes an entity that gives limited liability to the parent institution. We interpret Congress's intention in imposing the majority-owned subsidiary requirement in section 24 of the FDI Act to generally require that such a subsidiary provide limited liability to the insured state bank. Thus, except in unusual circumstances, we have and will require majority-owned subsidiaries to adopt a form of business that provides limited liability to the parent bank. In assessing our experience with applications, we have determined that the notice procedure will be available only to banks that engage in activities through a majority-owned subsidiary that takes the corporate form of business. We welcome applications that may take a different form of business such as a limited partnership or limited liability company, but would like to develop more experience with appropriate separations to protect the bank from liability under these other forms of business enterprise through the application process before including these entities in a notice procedure. We have decided that there may have been an ambiguity in the notice provisions we proposed for comment and published August 23, 1996, in the **Federal Register** at 61 FR 43486. We intended that an entity eligible for the notice procedure be in corporate form and implied that requirement by incorporating the bona fide subsidiary requirements that included references to a board of directors. The addition of this definition should make our intention clear that the notice procedure requires a majority-owned subsidiary to take the corporate form. We invite comment on this definition, our substantive decision to require the corporate form for a majority-owned subsidiary of an insured state bank using the notice procedures, and our decision to exclude other limited liability business forms from the notice procedure. We also invite comment on any ambiguities or questions that this definition may create.

We adopted the definition of ''Security'' from part 344 of this chapter to eliminate any ambiguity over the coverage of this rule when securities activities and investments are contemplated. We invite comment on any ambiguities or questions that this definition may create.

We defined ''State-chartered depository institution'' to mean any state bank or state savings association insured by the FDIC to eliminate confusion and ambiguity. We invite comment on any ambiguities or questions that this definition may create.

We invite any general comment on the proposed definitions and invite any suggestions for additional definitions that would be helpful to the reader of the regulatory text.

Section 362.3 Activities of Insured State Banks

Equity Investment Prohibition

Section 362.3(a) of the proposal restates the statutory prohibition on insured state banks making or retaining any equity investment of a type that is not permissible for a national bank. The prohibition does not apply if one of the statutory exceptions contained in section 24 of the FDI Act (restated in the current regulation and carried forward in the proposal) applies. The provision is being retained. The proposal eliminates the reference to amount that is contained in the current version of § 362.3(a). We have reconsidered our interpretation of the language of section 24 where paragraph (c) prohibits an insured state bank from acquiring or retaining any equity investment of a type that is impermissible for a national bank and paragraph (f) prohibits an insured state bank from acquiring or retaining any equity investment of a type or in an amount that is impermissible for a national bank. We previously interpreted the language of paragraph (f) as controlling and read that language into the entire statute. We reconsidered this approach, decided that it was not the most reasonable construction of this statute and determined that the language of paragraph (c) is controlling. Thus, the language of paragraph (c) controls when any other equity investment is being considered. Therefore, we deleted the amount language from prohibition in the regulation. We request comment on this change.

Exception for Majority-Owned Subsidiary

The FDIC proposes to retain the exception which allows investment in majority-owned subsidiaries as currently in effect without any substantive change. However, the FDIC has modified the language of this section to remove negative inferences and make the text clearer. Rather than stating that the bank may do what is not prohibited, the FDIC is affirmatively stating that an insured state chartered bank may acquire or retain investments through a majority-owned subsidiary. If an insured state bank holds less than a majority interest in the subsidiary, and that equity investment is of a type that would be prohibited to a national bank, the exception does not apply and the investment is subject to divestiture.

Majority ownership for the exception is understood to mean ownership of greater than 50 percent of the outstanding voting stock of the subsidiary. It is our understanding that national banks may own a minority interest in certain types of subsidiaries. (See 12 CFR 5.34(1997)). Therefore, an insured state bank may hold a minority interest in a subsidiary if a national bank could do so. Thus, the statute does not necessarily require a state bank to hold at least a majority of the stock of a company in order for the equity investment in the company to be permissible under the regulation. Only investments that would not be permissible for a national bank must be held through a majority-owned subsidiary.

The regulation defines the business form of a majority-owned subsidiary to be a corporation. There may be other forms of business organization that are suitable for the purposes of this exception such as partnerships or limited liability companies. The FDIC does not wish to give blanket authorization to a non-corporate form of organization since these forms may not provide for the same separations the FDIC believes to be necessary to protect the insured bank from assuming the liabilities of its subsidiary. The proposal anticipates that the Board will review alternate forms of organization to assure that appropriate separation between the insured depository institution and the subsidiary is in place. We are soliciting comment on other forms of business organization which the FDIC may allow. Please provide a discussion of the separations inherent in alternate forms of business organization.

To qualify for this exception, the majority-owned subsidiary must engage in activities that are described in § 362.4(b). The allowable activities include both statutory and regulatory exceptions to the general prohibitions of the regulation.

Investments in Qualified Housing Projects

The FDIC proposes to combine the language found in two paragraphs of the current regulation. The FDIC proposes to retain the combined paragraphs of the regulation with substantially the same language as currently in effect. The changes that have been made reflect practical clarifications resulting from the implications of the technical way the qualified housing rules work and are not intended to be substantive. In addition, the FDIC has modified the language of the text to remove negative inferences and make the text clearer. Section 362.3(a)(2)(ii) of the proposal provides an exception for qualified housing projects. Under the exception, an insured state bank is not prohibited from investing as a limited partner in a partnership, the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation, or new construction of a residential housing project intended to primarily benefit lower income persons throughout the period of the bank's investment. The bank's investments, when aggregated with any existing investment in such a partnership or partnerships, may not exceed 2 percent of the bank's total assets. The FDIC expects that banks use the figure reported on the bank's most recent consolidated report of condition prior to making the investment as the measure of their total assets. If an investment in a qualified housing project does not exceed the limit at the time the investment was made, the investment shall be considered to be a legal investment even if the bank's total assets subsequently decline.

The current exception is limited to instances in which the bank invests as a limited partner in a partnership. Comment is invited on (1) whether the FDIC should expand the exception to include limited liability companies and (2) whether doing so is permissible under the statute. (Section 24(c)(3) of the FDI Act provides that a state bank may invest ''as a limited partner in a partnership.'')

Grandfathered Investments in Listed Common or Preferred Stock and Shares of Registered Investment Companies

The current regulation restates the statutory exception for investments in common or preferred stock listed on a national securities exchange and for shares of investment companies registered under the Investment Company Act of 1940 that is available to certain state banks if they meet the requirements to be eligible for the grandfather. The statute requires, among other things, that a state bank file a notice with the FDIC before relying on the exception and that the FDIC approve the notice. The notice requirement, content of notice, presumptions with respect to the notice, and the maximum permissible investment under the grandfather also are set out in the current regulation. The FDIC proposes to retain the regulatory language as currently in effect without any substantive change. The exception is found in § 362.3(a)(2)(iii) of the proposal. Although there would be no substantive change, the FDIC has modified the language of this section to remove negative inferences and make the text clearer.

We deleted the reference in the current regulation describing the notice content and procedure because we believe that most, if not all, of the banks eligible for the grandfather already have filed notices with the FDIC. Thus, we shortened the regulation by eliminating language governing the specific content and processing of the notices. Investment in common or preferred stock listed on a national securities exchange or shares of an investment company is governed by the language of the statute. Notices must conform to the statutory requirements whether filed previously or filed in the future. Any bank that has filed a notice need not file again. Comment is invited on whether the regulatory filing requirements should be retained and eventually moved into part 303 of this chapter.

Section 362.3(a)(2)(iii)(A) of the proposal implements the grandfathered listed stock and registered shares provision found in section 24(f)(2) of the FDI Act. Paragraph (B) of this section of the proposal provides that the exception for listed stock and registered shares ceases to apply in the event that the bank converts its charter or the bank or its parent holding company undergoes a change in control. This language restates the statutory language governing when grandfather rights terminate. State banks should continue to be aware that, depending upon the circumstances, the exception may be considered lost after a merger transaction in which an eligible bank is the survivor. For example, if a state bank that is not eligible for the exception is merged into a much smaller state bank that is eligible for the exception, the FDIC may determine that in substance the eligible bank has been acquired by a bank that is not eligible for the exception.

The regulation continues to provide that in the event an eligible bank undergoes any transaction that results in the loss of the exception, the bank is not prohibited from retaining its existing investments unless the FDIC determines that retaining the investments will adversely affect the bank and the FDIC orders the bank to divest the stock and/or shares. This provision has been retained in the regulation without any change except for the deletion of the citation to specific authorities the FDIC may rely on to order divestiture. Rather than containing specific citations, the proposal merely references FDIC's ability to order divestiture under any applicable authority. State banks should continue to be aware that any inaction by the FDIC would not preclude a bank's appropriate banking agency (when that agency is an agency other than the FDIC) from taking steps to require divestiture of the stock and/or shares if in that agency's judgment divestiture is warranted.

Finally, the FDIC has moved, simplified and shortened the limit on the maximum permissible investment in listed stock and registered shares. The proposal limits the investment in grandfathered listed stock and registered shares to a maximum of one hundred percent (100 percent) of tier one capital as measured on the bank's most recent consolidated report of condition. The FDIC continues to use book value as the measure of compliance with this limitation. Language indicating that investments by well-capitalized banks in amounts up to 100 percent of tier one capital will be presumed not to present a significant risk to the fund is being deleted as is language indicating that it will be presumed to present a significant risk to the fund for an undercapitalized bank to invest in amounts that high. In addition, we deleted the language stating the presumption that, absent some mitigating factor, it will not be presumed to present a significant risk for an adequately capitalized bank to invest up to 100 percent of tier one capital. At this time we believe that it is not necessary to expressly state these presumptions in the regulation.

Language in the current regulation concerning the divestiture of stock and/or shares in excess of that permitted by the FDIC (as well as such investments in excess of 100 percent of the bank's tier one capital) is deleted under the proposal as no longer necessary due to the passage of time. In both instances the time allowed for such divestiture has passed.

Comment is invited on whether this grandfather exception for investment in listed stock and registered shares should be applied by the FDIC as an exception that is separate and distinct from any other exception under the regulation that would allow a subsidiary of an insured state bank to hold equity securities. In short, should we allow this exception in addition to the exception for stock discussed below or should the FDIC consider any listed stock held by a subsidiary of the bank pursuant to an exception in the regulation toward the 100 percent of tier one capital limit under this exception? We note that the statute does not itself impose any conditions or restrictions on a bank that enjoys the grandfather in terms of per issuer limits. Comment is sought on whether it is appropriate to impose restrictions under the regulation that would, for example, limit a bank to investing in less than a controlling interest in any given issuer. Is there some other limit or restriction the FDIC should consider imposing by regulation that is important to ensuring that the grandfathered investments do not pose a risk? Should this be done, if at all, solely through the notice and approval process?

### Stock Investment in Insured Depository Institutions Owned Exclusively by Other Banks and Savings Associations

The content of the proposed regulation reflects the statutory exception that an insured state bank is not prohibited from acquiring or retaining the shares of depository institutions that engage only in activities permissible for national banks, are subject to examination and are regulated by a state bank supervisor, and are owned by 20 or more depository institutions not one of which owns more than 15 percent of the voting shares. In addition, the voting shares must be held only by depository institutions (other than directors' qualifying shares or shares held under or acquired through a plan established for the benefit of the officers and employees). Section 24(f)(3)(B) of the FDI Act does not limit the exception to voting stock. We are not proposing to eliminate the reference to ''voting'' in the current regulation when referencing control of the insured depository institution. Any other reference to voting stock has been eliminated in the exception to allow holding of non-voting stock. The FDIC seeks comment concerning retaining the reference to ''voting'' stock when calculating the 15 percent ownership limitation contained in the statute.

### Stock Investments in Insurance Companies

Section 362.3(b)(2)(v) of the proposal contains exceptions that permit state banks to hold equity investments in insurance companies. The exceptions are provided by statute and implemented in the current version of part 362. For the most part, we brought the exceptions forward into this proposal with no substantive editing. The exceptions are discussed separately below.

### Directors and Officers Liability Insurance Corporations

The first statutory exception permits insured state banks to own stock in corporations that solely underwrite or reinsure financial institution directors' and officers' liability insurance or blanket bond group insurance. A bank's investment in any one corporation is limited to 10 percent of the outstanding stock. We eliminated the present limitation of 10 percent of the ''voting'' stock and changed the present reference from ''company'' to ''corporation,'' conforming the language to the statutory exception.

While the statute and regulation provide a limit on a bank's investment in the stock of any one insurance company, there is no statutory or regulatory ''aggregate'' investment limit in all insurance companies nor does the statute combine this equity investment with any other exception under which a state bank may invest in equity securities. In the past, the FDIC has addressed investment concentration and diversification issues on a case-by-case basis. The FDIC is not at this time proposing to impose aggregate investment limits on equity investments which have specific statutory carve outs nor are we proposing to combine those investments with other equity investments made under the exceptions to the regulation for which aggregate investments are being proposed. The FDIC would like to receive comment, however, on whether there should be an ''aggregate'' investment limit for equity investments in insurance companies.

Stock of Savings Bank Life Insurance Company

The second statutory exception for equity investments in insurance companies permits any insured state bank located in the states of New York, Massachusetts and Connecticut to own stock in savings bank life insurance companies provided that consumer disclosures are made. Again, this regulatory provision mirrors the specific statutory carve out found in Section 24 and is contained in the present regulation. We have carried this provision forward into the proposal with some changes.

The savings bank life insurance investment exception is broader than the director and officer liability insurance company exception discussed above. There are no individual or aggregate investment limitations for investments in savings bank life insurance companies. The proposed language is shorter than the existing regulation and makes a substantive change by clarifying what the required disclosures are for insured banks selling these products. As was indicated above, insured banks located in New York, Massachusetts and Connecticut are permitted to invest in the stock of a savings bank life insurance company as long as certain disclosure requirements are met. The FDIC proposes to amend the regulatory language to specifically require compliance with the Interagency Statement in lieu of the disclosures presently set out in the regulation. Insured banks selling savings bank life insurance policies, other insurance products and annuities will be required to provide customers with written disclosures that are consistent with the Interagency Statement which include a statement that the products are not insured by the FDIC, are not guaranteed by the bank, and may involve risk of loss. The last disclosure—that such products may involve risk of loss—is not currently required under the regulation.

The FDIC would like to request comment regarding the disclosure obligations of insured banks. It is the FDIC's view that savings bank life insurance, other insurance products and annuities are ''nondeposit investment products'' as that term is used in the Interagency Statement. The FDIC is aware that insurance companies typically offer annuity products and that many states regulate annuities through their insurance departments. However, the FDIC agrees with the Comptroller of the Currency that annuities are financial products and not insurance. Nevertheless, annuities are nondeposit investment products and are therefore subject to the requirements found in the Interagency Statement when sold to retail customers on bank premises as well as in other instances. On this basis, all the requirements in the Interagency Statement should apply to the marketing and sale of annuities by a financial institution.

While the existing regulatory language is similar to the Interagency Statement in what it requires to be disclosed, it is not identical. The FDIC believes the proposed changes will clarify the standards which are to be followed by insured state banks.

It could be argued that the regulatory language in this part repeats existing guidance and is unnecessary. We note, however, that the statute requires that disclosures be made in order for the exception to be available. While the Interagency Statement is enforceable in the sense that noncompliance may constitute an unsafe or unsound banking practice that may give rise to a cease and desist action, the Interagency Statement is not itself a regulation with the force and effect of law.

We seek comments on whether it would be preferable for the regulation to fully set out the disclosure requirements rather than cross referencing the Interagency Statement. Commenters should address these points, as well as discuss the differences between enforcing specific regulatory language versus enforcing a policy statement. We invite comments on the applicability of the Interagency Statement in the absence of the language referencing it in this regulation. We invite comment on whether using the Interagency Statement makes compliance easier for banks as it provides uniform standards applicable to multiple products. We also invite comment on any other issues that are of concern to the industry or the public in using these particular disclosures when selling insurance and annuity products.

Other Activities Prohibition

Section 362.3(b) of the proposal restates the statutory prohibition on insured state banks directly or indirectly engaging as principal in any activity that is not permissible for a national bank. Activity is defined in this proposal as the conduct of business by a state-chartered depository institution, including acquiring or retaining any investment. Because acquiring or retaining an investment is an activity by definition, language has been added to make clear that this prohibition does not supersede the equity investment exception of § 362.3(b). The prohibition does not apply if one of the statutory exceptions contained in section 24 of the FDI Act (restated in the current regulation and carried forward in the proposal) applies. The FDIC has provided two regulatory exceptions to the prohibition on other activities.

Consent Through Application

The limitation on activities contained in the statute states that an insured state bank may not engage as principal in any type of activity that is not permissible for a national bank unless the FDIC has determined that the activity would pose no significant risk to the appropriate deposit insurance fund, and the bank is and continues to be in compliance with applicable capital standards prescribed by the appropriate federal banking agency. Section 362.3(b)(2)(i) establishes an application process for the FDIC to make the determination concerning risk to the funds. The substance of this process is unchanged from the current regulation.

Insurance Underwriting

This exception tracks the statutory exception in section 24 of the FDI Act which grandfathers (1) an insured state bank engaged in the underwriting of savings bank life insurance through a department of the bank; (2) any insured state bank that engaged in underwriting of insurance on or before September 30, 1991, which was reinsured in whole or in part by the Federal Crop Insurance Corporation; and (3) well-capitalized banks engaged in insurance underwriting through a department of a bank. The exception is carried over from the current regulation with a number of proposed modifications.

To use the savings bank life insurance exception, an insured state bank located in Massachusetts, New York or Connecticut must engage in the activity through a department of the bank that meets core standards discussed below. The standards for conducting this activity are taken from the current regulation with the exception of disclosure standards which are discussed below. We have moved the requirements for a department from the definitions to the substantive portion of the regulation text.

The exception for underwriting federal crop insurance reflects the statutory exception. This exception is unchanged from the current regulation, and there are no regulatory limitations on the conduct of the activity.

An insured state bank that wishes to use the grandfathered insurance underwriting exception may do so only if the insured state bank was lawfully providing insurance, as principal, as of November 21, 1991. Further, an insured state bank must be well-capitalized if it is to engage in insurance underwriting, and the bank must conduct the insurance underwriting in a department that meets the core standards described below.

Banks taking advantage of this grandfather provision only may underwrite the same type of insurance that was underwritten as of November 21, 1991 and only may operate and have customers in the same states in which it was underwriting policies on November 21, 1991. The grandfather authority for this activity does not terminate upon a change in control of the bank or its parent holding company.

Both savings bank life insurance activities and grandfathered insurance underwriting must take place in a department of the bank which meets certain core standards. The core operating standards for the department require the department to provide customers with written disclosures that are consistent with those in the Interagency Statement. Consistent with the disclosure requirements of the current regulation, the proposed rule requires the department to inform its customers that only the assets of the department may be used to satisfy the obligations of the department. Note that this language does not require the bank to say that the bank is not obligated for the obligations of the department. The bank and the department constitute one corporate entity. In the event of insolvency, the insurance underwriting department's assets and liabilities would be segregated from the bank's assets and liabilities due to the requirements of state law.

The FDIC views any financial product that is not a deposit and entails some investment component to be a ''nondeposit investment product'' subject to the Interagency Statement. Part 362 was promulgated in 1992 before the Interagency Statement was issued in February of 1994. While the disclosures currently required by part 362 are similar to the disclosures set out in the Interagency Statement, they are not identical. Banks that engage in insurance underwriting are thus covered by the Interagency Statement and part 362 and must comply with similar but somewhat different requirements. We are proposing to cross reference the Interagency Statement in part 362 to make compliance clearer. We believe that using the uniform standards set forth in the Interagency Statement will make compliance easier.

In the case of insurance underwriting activities conducted by a department of the bank, the disclosure required by the Interagency Statement that the product is not an obligation of the bank is not correct as noted above, and the suggested language in the regulation does not require this disclosure. This clarification is consistent with other interpretations of the Interagency Statement which stated that disclosures should be consistent with the types of products offered. The FDIC would like to receive comment on whether such clarification is necessary or whether the regulation language is seen as duplicating other guidance.

The FDIC notes that the consumer disclosures are statutorily required for savings bank life insurance. The Interagency Statement is joint supervisory guidance issued by the Federal Banking Agencies, not a regulation. The FDIC requests comment regarding the enforceability of the Interagency Statement versus a regulation promulgated under the rulemaking requirements of the Administrative Procedures Act.

The core separation standards restate the requirements currently found in the definition of department. These standards require that the department (1) be physically distinct from the remainder of the bank, (2) maintain separate accounting and other records, (3) have assets, liabilities, obligations and expenses that are separate and distinct from those of the remainder of the bank; and (4) be subject to state statutes that require the obligations, liabilities and expenses be satisfied only with the assets of the department. The standards in the proposed regulation are not changed from the current regulation, but have been moved from the definitions section of the regulation to ensure that requirements of the rule are shown in connection with the appropriate regulatory exception.

### Acquiring and Retaining Adjustable Rate and Money Market Preferred Stock by the Bank

The proposal provides an exception that allows a state bank to invest in up to 15 percent of the bank's tier one capital in adjustable rate preferred stock and money market (auction rate) preferred stock without filing an application with the FDIC. The exception was adopted when the 1992 version of the regulation was adopted in final form. At that time after reviewing comments, the FDIC found that adjustable rate preferred stock and money market (auction rate) preferred stock were essentially substitutes for money market investments such as commercial paper and that their characteristics are closer to debt than to equity securities. Therefore, money market preferred stock and adjustable rate preferred stock were excluded from the definition of equity security. As a result, these investments are not subject to the equity investment prohibitions of the statute and of the regulation and are considered to be an ''other activity'' for the purposes of this regulation.

This exception focuses on two categories of preferred stock. This first category, adjustable rate preferred stock refers to shares where dividends are established by contract through the use of a formula based on Treasury rates or some other readily available interest rate levels. Money market preferred stock refers to those issues where dividends are established through a periodic auction process that establishes yields in relation to short term rates paid on commercial paper issued by the same or a similar company. The credit quality of the issuer determines the value of the security, and money market preferred shares are sold at auction.

We have modified the exception under the proposal by limiting the 15 percent measurement to tier one capital, rather than total capital. Throughout the current proposal, we have measured capital-based limitations against tier one capital. We changed the base in this provision to increase uniformity within the regulation. We recognize that this change may lower the permitted amount of these investments held by institutions already engaged in the activity. An insured state bank that has investments exceeding the proposed limit, but within the total capital limit, may continue holding those investments until they are redeemed or repurchased by the issuer. The 15 percent of tier one capital limitation should be used in determining the allowable amount of new purchases of money market preferred and adjustable rate preferred stock. Of course, any institution that wants to increase its holding of these securities may submit an application to the FDIC.

The FDIC seeks comment on whether this treatment of money market preferred stock and adjustable rate preferred stock is still appropriate. Comment is requested concerning whether other similar types of investments should be given similar treatment. Comments also are requested on whether the reduced capital base affects any institution currently holding these investments or is likely to affect the investment plans of any institution.

### Activities That Are Closely Related to Banking Conducted by Bank or Its Subsidiary

The proposed regulation continues the language found in the current regulation titled, ''Activities that are closely related to banking.'' This section permits an insured state bank to engage as principal in any activity that is not permissible for a national bank provided that the FRB by regulation or order has found the activity to be closely related to banking for the purposes of section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)). This exception is subject to the statutory prohibition that does not allow the FDIC to permit the bank to directly hold equity securities that a national bank may not hold and which are not otherwise permissible investments for insured state banks pursuant to § 362.3(b).

Additional language has been added to clarify that this subsection does not authorize an insured state bank engaged in real estate leasing to hold the leased property for more than two years at the end of the lease unless the property is re-leased. This language is added to ensure that this provision does not allow an insured state bank to hold an equity interest in real estate after the end of the lease period. The FDIC has decided to provide a two-year period for the bank to divest the property if the bank cannot lease the property again. Comment is invited on the reasonableness of this approach. Should the FDIC consider an alternative approach that a bank may not enter a non-operating lease unless title reverts to the lessee at the end of the lease period? Are there other standards that the FDIC should consider in this matter?

As does the current regulation, these provisions allow a state bank to directly engage in any ''as principal'' activity included on the FRB's list of activities that are closely related to banking (found at 12 CFR 225.28) and ''as principal'' in any activity with respect to which the FRB has issued an order finding that the activity is closely related to banking.

However, the consent to engage in real estate leasing directly by an insured state bank has been modified. Comment is requested on whether there are any additional activities permitted under the proposed language that should be modified. Comment is requested on the effect of the proposed treatment of real estate leasing activities on banks that may want to engage in this activity in the future. Comment also is requested on the perceived risks of leasing activities and whether we should impose standards to address those risks. Comment is requested on whether we should consider any other approach, including returning to the language in the current regulation or deleting the references to the Bank Holding Company Act (12 U.S.C. 1843(c)(8) and the activities that the FRB by regulation or order has found to be closely related to banking for the purposes of section 4(c)(8).

Guarantee Activities by Banks

The current regulation contains a provision that permits a state bank with a foreign branch to directly guarantee the obligations of its customers as set out in § 347.3(c)(1) of the FDIC's regulations without filing any application under part 362. It also permits a state bank to offer customer-sponsored credit card programs in which the bank guarantees the obligations of its retail banking deposit customers. This provision has been deleted as unnecessary since we understand that these activities are permissible for a national bank. In its current rule, the FDIC added this provision to clarify that part 362 does not prohibit these activities; however to shorten the regulation, such clarifying language has been deleted since the activity is permissible for a national bank. The FDIC seeks comment as to whether the deletion of this language has an adverse impact on insured state depository institutions and if there are specific activities that this provision allowed that are not permissible for a national bank.

In the FDIC's proposal regarding the consolidation and simplification of its international banking regulations found in the **Federal Register** on July 15, 1997, at 62 FR 37748, a technical amendment to the current version of part 362 is found. This amendment updates the reference to § 347.103(a)(1) of this chapter in § 362.4(c)(3)(I)(A). This amendment may become final as a part of the consolidation and simplification of the FDIC's international banking regulations to reflect the correct citation in the current version of part 362. Nevertheless, we propose to eliminate the references to guarantee activities in this proposal because we consider them unnecessary as they duplicate powers granted to national banks. As previously stated, we invite comment on the necessity of including specific language dealing with the power to guarantee customer obligations in the regulatory text of part 362.

Section 362.4 Subsidiaries of Insured State Banks

General Prohibition

The regulatory language implementing the statutory prohibition on ''as principal'' activities that are not permissible for a subsidiary of a national bank has been separated from the prohibition on activities which are not permissible for a national bank conducted in the bank. By separating bank and subsidiary activities, § 362.4 now deals exclusively with activities that may be conducted in a subsidiary of an insured state bank. We believe that separating the activities that may be conducted at the bank level from the activities that must be conducted by a subsidiary makes it easier for the reader to understand the intent of the regulation. We invite comment on whether this structure is more useful to the reader. We also invite comment on whether any additional changes would make it easier for the reader to interpret the regulation text.

Exceptions

Prohibited activities may not be conducted unless one of the exceptions in the regulation applies. This language is similar to the current part 362 and results in no substantive change to the prohibition.

Consent Obtained Through Application

The proposal continues to allow approval by individual application provided that the insured state bank meets and continues to meet the applicable capital standards and the FDIC finds there is no significant risk to the fund. The proposal would delete the language expressly providing that approval is necessary for each subsidiary even if the bank received approval to engage in the same activity through another subsidiary. Deleting this language will not automatically permit a state bank to establish a second subsidiary to conduct the same activity that was approved for another subsidiary of the same bank. Deleting the language leaves the issue to be handled on a case-by-case basis by the FDIC pursuant to order. For example, if the FDIC approves an application by a state bank to establish a majority-owned subsidiary to engage in real estate investment activities, the order may (in the FDIC's discretion) be written to allow additional such subsidiaries or to require that any additional real estate subsidiaries must be individually approved.

The notice procedures described herein requires that the subsidiary must take the corporate organizational form. Insured state banks that organize subsidiaries in a form other than a corporation may make application under this section. Any bank that does not meet the notice criteria or that desires relief from a limit or restriction included in the notice criteria may also file an application under this section and are encouraged to do so.

Application instructions have been moved to subpart E.

Language has been eliminated that prohibited an insured state bank from engaging in insurance underwriting through a subsidiary except to the extent that such activities are permissible for a national bank. Eliminating this language does not result in any substantive change as section 24 of the FDI Act clearly provides that the FDIC may not approve an application for a state bank to directly or indirectly conduct insurance underwriting activities that are not permissible for a national bank. We invite comment on whether the language should be retained in the regulation to make it clear to state banks that applications to conduct such activities will not be approved.

The current part 362 allows state banks that do not meet their minimum capital requirements to gradually phase out otherwise impermissible activities that were being conducted as of December 19, 1992. These provisions are eliminated under the proposal due to the passage of time. The relevant outside dates to complete the phase out of those activities have passed (December 19, 1996, for real estate activities and December 8, 1994, for all other activities).

Grandfathered Insurance Underwriting

The proposed regulation provides for three statutory exceptions that allow subsidiaries to engage in insurance underwriting. Subsidiaries may engage in the same grandfathered insurance underwriting as the bank if the bank or subsidiary was lawfully providing insurance as principal on November 21, 1991.

The limitations under which this subsidiary may operate have been changed. Under the current regulation, the bank must be well-capitalized. Under the proposal, the bank must be well-capitalized after deducting its investment in the insurance subsidiary. The FDIC believes that the capital deduction is an important element in separating the operations of the bank and the subsidiary. This deduction clearly delineates the capital that is available to support the bank and the capital that is available to support the subsidiary. Capital standards for insurance companies are based on different criteria from bank capital requirements. Most states have minimum capital requirements for insurance companies. The FDIC believes that a bank's investment in an insurance underwriting subsidiary is not actually ''available'' to the bank in the event the bank experiences losses and needs a cash infusion. As a result, the bank's investment in the insurance subsidiary should not be considered when determining whether the bank has sufficient capital to meet its needs. Comment is invited on whether the capital deduction is appropriate or necessary. If the FDIC requires a capital deduction, should it be required in the case of any insurance underwriting subsidiary that is given a statutory grandfather, e.g., should title insurance subsidiaries also be subject to the capital deduction? Should the capital deduction treatment depend upon what type of insurance is underwritten (if there is a greater risk associated with the insurance, should the capital deduction be required)? Is the phase-in period appropriate and clearly written?

The proposed regulation requires a subsidiary engaging in grandfathered insurance underwriting to meet the standards for an ''eligible subsidiary'' discussed below. This standard replaces the ''bona fide'' subsidiary standard in the current regulation. The ''eligible subsidiary'' standard generally contains the same requirements for corporate separateness as the ''bona fide'' subsidiary definition but adds the following provisions: (1) the subsidiary has only one business purpose; (2) the subsidiary has a current written business plan that is appropriate to its type and scope of business; (3) the subsidiary has adequate management for the type of activity contemplated, including appropriate licenses and memberships, and complies with industry standards; and (4) the subsidiary establishes policies and procedures to ensure adequate computer, audit and accounting systems, internal risk management controls, and the subsidiary has the necessary operational and managerial infrastructure to implement the business plan. The FDIC requests comment on the effect of these additional requirements on banks engaged in insurance underwriting. We invite comment on whether these requirements appropriately separate the subsidiary from the bank. We request comment on whether the restrictions are appropriate to the identified risks being undertaken by these banks.

In lieu of the prescribed disclosures contained in the current regulation, the proposal prescribes that disclosures consistent with the Interagency Statement be made. The proposal also eliminates the acceptance of disclosures that are required by state law. While the current regulation requires disclosures, those disclosures are similar but not identical to the disclosures required by the Interagency Statement. Again, this proposed change is intended to make compliance with the Interagency Statement and the regulation easier. Comment is sought on whether the disclosure requirements in the regulation are necessary now that the Interagency Statement has been adopted. Any retail sale of nondeposit investment products to bank customers is subject to the Interagency Statement. The FDIC recognizes that some grandfathered insurance underwriting subsidiaries may have a line of business and customer base which is completely separate from the bank's operations. The Interagency Statement would not normally apply as the Statement does not technically apply unless there is a ''retail sale'' to a ''bank customer.'' If the FDIC were to rely wholly upon the Interagency Statement there would be a gap from the current coverage of the disclosure requirements. Should that be of concern to the FDIC?

Banks with subsidiaries engaged in grandfathered insurance underwriting activities are expected to meet the new requirements of this proposal. Banks which are not in compliance with the requirements should provide a notice to the FDIC pursuant to § 362.5(b). The FDIC will consider the notices on a case-by-case basis.

The regulation provides that a subsidiary may continue to underwrite title insurance based on the specific statutory authority from section 24. This provision is currently in part 362 and is carried forward into the proposal with no substantive change. The insured state bank is only permitted to retain the investment if the insured state bank was required, before June 1, 1991, to provide title insurance as a condition of the bank's initial chartering under state law. The authority to retain the investment terminates if a change in control of the grandfathered bank or its holding company occurs after June 1, 1991. There are no statutory or regulatory investment limits on banks holding these types of grandfathered investments.

The exception for subsidiaries engaged in underwriting crop insurance is continued. Under section 24, insured state banks and their subsidiaries are permitted to continue underwriting crop insurance under two conditions: (1) they were engaged in the business on or before September 30, 1991, and (2) the crop insurance was reinsured in whole or in part by the Federal Crop Insurance Corporation. While this grandfathered insurance underwriting authority requires that the bank or its subsidiary had to be engaged in the activity as of a certain date, the authority does not terminate upon a change in control of the bank or its parent holding company.

Majority-owned Subsidiaries Which Own a Control Interest in Companies Engaged in Permissible Activities

The FDIC has found that it is not a significant risk to the deposit insurance funds if a majority-owned subsidiary holds stock of a company that engages in (1) any activity permissible for a national bank; (2) any activity permissible for the bank itself (except engaging in insurance underwriting and holding grandfathered equity investments); (3) activities that are not conducted ''as principal;'' or (4) activity that is not permissible for a national bank provided the Federal Reserve Board by regulation or order has found the activity to be closely related to banking, if the majority-owned subsidiary exercises control over the issuer of the stock purchased by the subsidiary. These exceptions are found in the current regulation but do not contain the provision that the majority-owned subsidiary must exercise control.[1] This change clarifies that this exception is intended only for subsidiaries that are operating a business that is either permissible for the bank itself or is considered to be operated other than ''as principal.'' As rewritten, the proposal differentiates between the types of stock held by a majority-owned subsidiary—having a controlling interest and simply investing in the shares of a company. The FDIC intends that this provision cover lower level subsidiaries that are engaged in activities that the FDIC has found present no significant risk to the fund. The FDIC expects lower level subsidiaries that engage in other activities to conform to the application or notice procedures of this regulation. The FDIC recognizes that changing the level of ownership permissible for these activities may adversely affect some insured state bank. We invite comment on the effect of this change. The FDIC invites comment on whether this language change was necessary, whether it should be concerned about lower level subsidiaries, whether this approach is appropriate to the risks inherent in the activities and whether any other approach, including returning to the language in the current regulation should be considered.

We deleted one other form of stock ownership at the majority subsidiary level from the current regulation by deleting the language now found in § 362.4(c)(3)(iv)(C) of the current regulation titled, ''Stock of a corporation that engages in activities permissible for a bank service corporation.'' Through a majority-owned subsidiary, this section of the current regulation allows an insured state bank to invest in 50% or less of the stock of a corporation which engages solely in any activity that is permissible for a bank service corporation. Since bank service corporations may engage in any activity that is closely related to banking, this exception also allowed majority-owned subsidiaries to own stock in those entities that solely engaged in activities that were closely related to banking. This exception has been deleted in this proposal because the coverage of the proposed exceptions in § 362.4(b)(3) would duplicate the coverage of the existing exception.

Comment is requested on whether the proposed language clearly sets forth the coverage of these exceptions. Comment is requested on whether the proposed language clearly allows the same activities that the current exception allows by permitting majority-owned subsidiaries to hold stock of a company engaged in activities permissible for a bank service corporation. The FDIC seeks comment on whether any inadvertent substantive change has been made by eliminating the specific references permitting the ownership of bank service company stock. We seek comment on the use of the control test for defining activities for lower level subsidiaries. We invite comment on whether any other approach, including returning to the language in the current regulation should be reconsidered. Should the FDIC use a majority-owned test for defining when a lower level subsidiary exists?

We added clarifying language to the exception governing activities closely related to banking. The first exception states that this section does not authorize a subsidiary engaged in real estate leasing to hold the leased property for more than two years at the end of the lease unless the property is re-leased. This provision is the same at the bank level. The second provision is that this section does not authorize a subsidiary to acquire or hold the stock of a savings association other than as allowed in § 362.4(b)(4). As is discussed below, this subsection does not allow a majority-owned subsidiary to have a control interest in a savings association. Comment is requested concerning the effect of this change.

Majority-Owned Subsidiaries Ownership of Equity Securities That Do Not Represent a Control Interest

The proposed regulation significantly changes the exception in the current regulation involving the holding of equity securities that do not represent a control interest. The FDIC has determined that the activity of holding the equity securities at the majority-owned subsidiary level, subject to certain limitations, does not present a significant risk to the deposit insurance funds.

This provision replaces two exceptions contained in the current regulation: (1) grandfathered investments in common or preferred stock and shares of investment companies, and (2) stock of insured depository institutions. The proposed regulation adds an expanded exception allowing the holding of other corporate stock.

The current regulation provides that an insured state bank that has obtained approval to hold listed common or preferred stock and/or shares of registered investment companies under the statutory grandfather (discussed above) may hold the stock and/or shares through a majority-owned subsidiary provided that any conditions imposed in connection with the approval are met. The FDIC previously determined that a majority-owned subsidiary could be accorded the same treatment under the grandfather provided for by section 24(f) of the FDI Act without risk to the fund. Thus, the bank should be permitted to invest in those securities and investment company shares through a majority-owned subsidiary.

The current regulation requires that each bank file a notice with the FDIC of the bank's intent to make such investments and that the FDIC determine that such investments will not pose a significant risk to the deposit insurance fund before any insured state bank may take advantage of the ''grandfather'' allowing investments in common or preferred stock listed on a national securities exchange and shares of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1, *et seq.*). In no event may the bank's investments in such securities and/or investment company shares, plus those of the subsidiary, exceed one hundred percent of the bank's tier one capital. The FDIC may condition its finding of no risk upon whatever conditions or restrictions it finds appropriate. The

[1] The current regulatory exception for activities conducted not as principal provides for a test of 50% or less of the stock of a corporation which engages solely in activities which are not considered to be as principal. The term ''corporation'' is being changed to ''company'' to accommodate the other forms of business enterprise listed in the definition. The reference to 50% or less is being deleted in order to avoid the confusion generated by that limitation.

''grandfather'' will be lost if the events occur that are discussed above.

The proposed regulation eliminates the notice for these activities and the specific reference to grandfathered activity and allows similar activity for all insured state banks provided that the bank's investment in the majority-owned subsidiary is deducted from capital and the activity is subject to the eligibility requirements and transaction limitations discussed below. Comment is invited on whether this exception is more appropriately applied by the FDIC as an exception that is separate and distinct from any other exception under the regulation that would allow a subsidiary of an insured state bank to hold equity securities. In short, should this exception be in addition to any other exception for holding stock?

The FDIC proposes to expand the current regulatory exception from the acquisition of stock in another insured bank through a majority-owned subsidiary to an exception for the acquisition of stock of insured banks, insured savings associations, bank holding companies, and savings and loan holding companies. The exception would continue to be limited to the acquisition of no more than 10 percent of the outstanding voting stock of any one issuer. The acquisition would be through a majority-owned subsidiary which was organized for the purpose of holding such stock.

This exception is being expanded to cover savings association stock, bank holding company stock and savings and loan holding company stock in response to the FDIC's experience with applications that have been presented to the FDIC in which insured state banks have sought approval for these kinds of investments. In acting upon those applications it has been the opinion of the FDIC to date that investments in bank holding company stock should not present a risk to the fund given the fact that bank holding companies are subject to a very strong regulatory and supervisory scheme and are limited, for the most part, to engaging in activities that are closely related to banking. The FDIC proposes to allow investment in savings association stock for similar reasons. Comment is invited on whether the exception should allow investments in savings and loan holding company stock in view of the broad range of activities in which savings and loan holding companies may engage.

The FDIC has become aware that some insured state banks own a sufficient interest in the stock of other insured state banks to cause the bank which is so owned to be considered a majority-owned subsidiary under part 362. It is the FDIC's position that such an owner bank does not need to file a request under part 362 seeking approval for its majority-owned subsidiary that is an insured state bank to conduct as principal activities that are not permissible for a national bank. As the majority-owned subsidiary is itself an insured state bank, that bank is required under part 362 and section 24 of the FDI Act to request consent on its own behalf for permission to engage in any as principal activity that is not permissible for a national bank.

The proposal encompasses the exceptions contained in the previous regulation and expands the exception to a majority-owned subsidiary of other insured state bank to acquire corporate stock. In order for an insured state bank to use the exception, the bank must be well-capitalized exclusive of the bank's investment in the subsidiary and must make the capital deduction for purposes of reporting capital on the bank's Call Report. For insured state banks that are using the current exception for grandfathered equities and holding bank stock, the capital deduction requirement is new. This requirement is similar to that found in the proposed notice procedures for state nonmember banks to engage in activities not permissible for national banks and recognizes the level of risk present in securities investment activities. Insured state banks that are currently engaging in these activities but are not in compliance with the requirements contained in the proposal should provide notice under § 362.5(b).

The subsidiary may only invest in corporate equity securities if the bank and subsidiary meet the eligibility requirements. Those requirements are: (1) the state-chartered depository institution may have only one majority-owned subsidiary engaging in this activity; (2) the majority-owned subsidiary's investment in equity securities (except stock of an insured depository institution, a bank holding company or a savings and loan holding company) must be limited to equity securities listed on a national securities exchange; (3) the state-chartered depository institution and majority-owned subsidiary may not have control over any issuer of stock purchased; and (4) the majority-owned subsidiary's equity investments (except stock of an insured depository institution, a bank holding company or a savings and loan holding company) must be limited to equity securities listed on a national securities exchange.

The requirement that the subsidiary's investment be limited to 10 percent of the outstanding voting stock of any company. This limitation reflects the FDIC's intent that this exception be used only as a vehicle for investment in equity securities. The 10 percent limitation was chosen because it reflects a level of investment that is generally recognized as not involving control of the business. This requirement is to be read together with the eligibility requirement that the depository institution may not exercise control over any issuer of stock purchased by the subsidiary. These requirements reflect the FDIC's intent that the depository institution is not operating a business through investments in equity securities. Comment is requested as to the appropriateness of the 10 percent limitation.

The FDIC believes that only listed securities should be allowed under this exception. Listed securities are more liquid than nonlisted securities and companies whose stock is listed must meet capital and other requirements of the exchange. These requirements provide some assurances as to the quality of the investment. The requirement that securities be listed is not extended to bank and savings association stock, bank holding company stock, or stock of a savings association holding company. These companies are part of a highly regulated industry which provides some investment quality assurance. Banks that may want to invest in unlisted securities in other industries should be subject to the scrutiny of the application process.

To qualify for this exception, the state-chartered depository institution may not extend credit to the majority-owned subsidiary, purchase any debt instruments from the majority-owned subsidiary, or originate any other transaction that is used to benefit the majority-owned subsidiary which invests in stock under this subpart. As noted above, the depository institution may have only one subsidiary engaged in this activity. These requirements reflect the FDIC's desire that the scope of the exception be limited. Institutions that wish to have multiple subsidiaries engaged in holding equity securities and wish to extend credit to finance these transactions should use the applications procedures to request consent.

We added a provision relating to portfolio management. The FDIC is concerned that a majority-owned subsidiary not engage in activities which the FDIC has identified as speculative. Therefore for the purposes of this subsection, investment in the equity securities of any company does not include pursuing short-term trading activities. The exception has been created to facilitate holding of corporate equity securities that are within the overall investment strategies of the state-chartered depository institution and its subsidiaries. It is expected that these investment strategies take account of such factors as quality, diversification and marketability as well as income. Short term trading that emphasizes income over other investment factors is speculative and may not be pursued through this exception.

In addition to requesting comment on the particular exception as proposed, the FDIC requests comment on whether it is appropriate for the regulation to contain any exception that would allow an insured state bank to hold equity securities at the subsidiary level. The FDIC also requests comment on the adequacy of the restrictions and constraints that it has proposed for the banks and subsidiaries that would hold these investments. What additional constraints, if any, should we consider adding for the banks and subsidiaries that would hold these investments? We note that the statute does not itself impose any conditions or restrictions on a bank that enjoys the grandfather for investment in equity securities in terms of per issuer limits. Comment is sought on whether it is appropriate to impose the restriction that limits a bank and its subsidiary to investing in less than a controlling interest in any given issuer. Is there some other limit or restriction the FDIC should consider imposing by regulation that is important to ensuring that the grandfathered investments do not pose a risk?

Majority-owned Subsidiaries Conducting Real Estate Investment Activities and Securities Underwriting

The FDIC has determined that real estate investment and securities underwriting activities do not represent a significant risk to the deposit insurance funds, provided that the activities are conducted by a majority-owned subsidiary in compliance with the requirements set forth. These activities require the insured state banks to file a notice. Then, as long as the FDIC does not object to the notice, the bank may conduct the activity in compliance with the requirement. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

Engage in Real Estate Investment Activities

Under section 24 of the FDI Act and the current version of part 362, an insured state bank may not directly or indirectly engage in real estate investment activities not permissible for a national bank. Section 24 does not grant FDIC authority to permit an insured state bank to directly engage in real estate investment activities not permissible for a national bank. The circumstances under which national banks may hold equity investments in real estate are limited. If a particular real estate investment is permissible for a national bank, an insured state bank only needs to document that determination. If a particular real estate investment is not permissible for a national bank and an insured state bank wants to engage in real estate investment activities (or continue to hold the real estate investment in the case of investments acquired before enactment of section 24 of the FDI Act), the insured state bank must file an application with FDIC for consent. The FDIC may approve such applications if the investment is made through a majority-owned subsidiary, the institution is well capitalized and the FDIC determines that the activity does not pose a significant risk to the deposit insurance fund.

The FDIC approved 92 of 95 applications from December 1992 through June 30, 1997, involving real estate investment activities. The FDIC denied one application, approved one in part, and one bank withdrew its application. The real estate investment applications generally have fallen into three categories: (1) requests for consent to hold real estate at the subsidiary level while liquidating the property where the bank expects that liquidation will be completed later than December 19, 1996; (2) requests for consent to continue to engage in real estate investment activity in a subsidiary, where such activities were initiated prior to enactment of section 24 of the FDI Act; and (3) requests for consent to initiate for the first time real estate investment activities through a majority-owned subsidiary.

The approved applications have involved investments which have ranged from less than 1 percent to over 70 percent of the bank's tier one capital. The majority of the investments, however, involved investments of less than 10 percent of tier one capital with only seven applications involving investments exceeding 25 percent of tier one capital. The applications filed with the FDIC have involved a range of real estate investments including holding residential properties, commercial properties, raw land, the development of both residential and commercial properties, and leasing of previously improved property. The applications approved by the FDIC include 33 residential properties, 39 commercial properties and 20 applications covering a mix of commercial and residential properties. The assets of the institutions that submitted approved applications ranged from $1 million to $6.7 billion. The institutions which have been approved to continue or commence new real estate investment activity primarily have had composite ratings of 1 or 2 ratings under the UFIRS. However, 6 institutions were rated 3, and 3 institutions were rated 4. The 4-rated institutions submitted applications to continue an orderly divestiture of real estate investments after December 19, 1996. Of the approved applications, 9 were to conduct new real estate investment activities, while 80 were submitted to continue holding existing real estate or to hold existing real estate after December 19, 1996, to pursue an orderly liquidation. The remaining 3 approved applications asked for consent to continue existing holdings and conduct new real estate activities. One application was partially approved and partially denied. This application involved a bank that applied for consent to continue direct real estate activities and consent to continue indirect real estate investment activities through a subsidiary. The FDIC approved the application to continue the real estate investment activity through the subsidiary and denied the application for the bank to engage directly in real estate investment activities.

To date, the FDIC has evaluated a number of factors when acting on applications for consent to engage in real estate investment activities. Where appropriate, the FDIC has fashioned conditions designed to address potential risks that have been identified in the context of a given application. In evaluating an application to conduct equity real estate investment activity, the FDIC considers the type of proposed real estate investment activity to determine if the activity is unsuitable for an insured depository institution. The FDIC also reviews the proposed subsidiary structure and its management policies and practices to determine if the insured state bank is adequately protected and analyzes capital adequacy to ensure that the insured institution has sufficient capital to support its more traditional banking activities.

In every instance in which the FDIC has approved an application to conduct a real estate investment activity, we have determined that it was necessary to impose a number of conditions in granting the approval. In short, the FDIC has determined on a case-by-case basis that the conduct of certain real estate investment activities by a majority-owned corporate subsidiary of an insured state bank will not present a significant risk to the deposit insurance fund provided certain conditions are observed. In drafting this proposed regulation, we have evaluated the conditions usually imposed when granting such approval to insured state banks and incorporated these conditions within the proposal where appropriate. The FDIC requests general comment on whether the conditions imposed under the proposed regulation are appropriate. Comments are invited on each condition, especially on the requirements that the subsidiary have an independent chief executive officer and that a majority of its board be composed of individuals who are not directors, officers, or employees of the insured institution.

The proposed rule would allow majority-owned subsidiaries to invest in and/or retain equity interests in real estate not permissible for a national bank provided that the insured state bank qualifies as an ''eligible depository institution,'' as that term is defined within the proposed regulation, and the majority-owned subsidiary qualifies as an ''eligible subsidiary,'' which is also defined within the proposed rule. The insured state bank must also abide by the investment and transaction limitations set forth in the proposed regulation. Under the proposed regulation, the insured state bank may not invest more than 10 percent of the bank's tier one capital in any one majority-owned real estate subsidiary. In addition, the total of the insured state bank's investment in all of its majority-owned subsidiaries which are conducting real estate activities may not exceed 20 percent of its tier one capital under the proposed regulation. Under the proposed rule, the 20 percent aggregate investment limit applies to subsidiaries engaged in the same activity.

For the purpose of calculating the dollar amount of the investment limitations, the bank would calculate 10 percent and 20 percent of its tier one capital after deducting all amounts required by the proposed regulation or any FDIC order. We request comment on all aspects and any implications of this proposal.

Under the proposed regulation, the insured state bank must file a notice with the FDIC providing a description of the proposed activity and the manner in which it will be conducted. A description of the other items required to be contained in the notice under this proposal are contained in subpart E of the proposed regulation.

The FDIC recognizes that some real estate investments or activities are more time, management and capital intensive than others. Our experience in reviewing the applications filed under section 24 has led us to conclude that extremely small equity investments in real estate—held under certain conditions—do not pose a significant risk to the deposit insurance fund. As a result, the proposed regulation provides relief to insured state banks having such small investments in a majority-owned subsidiary engaging in real estate investment activities. The FDIC is attempting to strike a reasonable balance between prudential safeguards and regulatory burden in its proposed regulation. As a result, the proposed regulation establishes certain exceptions from the requirements necessary to establish an eligible subsidiary whenever the insured state bank's investment is of a de minimis nature and meets certain other criteria. Under the proposal, whenever the bank's investment in its majority-owned subsidiary conducting real estate activities does not exceed 2 percent of the bank's tier one capital and the bank's investment in the subsidiary does not include extensions of credit from the bank to the subsidiary, a debt instrument purchased from the subsidiary or any other transaction originated from the bank to the benefit of the subsidiary, the subsidiary is relieved of certain of the requirements that must be met to establish an eligible subsidiary under the regulation. Under the proposed regulation, an insured state bank with a limited investment in a majority-owned subsidiary need not adhere to the requirements that the subsidiary be physically separate from the insured state bank; the chief executive officer of the subsidiary is not required to be an employee separate from the bank; a majority of the board of directors of the subsidiary need not be separate from the directors or officers of the bank; and the subsidiary need not establish separate policies and procedures as described in the proposed regulation in § 362.4(c)(2)(xi). The FDIC requests comment on the exceptions being proposed for establishing an eligible subsidiary whenever the bank's investment is of such a limited nature. Are there any of the other requirements necessary to establish an ''eligible subsidiary'' that should be excepted for banks with such limited investments? Commenters should keep in mind that the FDIC's goal is to reduce regulatory burden while maintaining adequate protection of the deposit insurance funds. Comment is requested on all aspects of this real estate investment activity authority.

Under current law, an insured state bank must apply to the FDIC prior to engaging in real estate investment activities that are impermissible for a national bank. The proposed regulation contains a procedure under which certain insured state banks may participate in real estate investment activity under specific circumstances by filing a notice with the FDIC. To qualify for the notice procedure proposed under § 362.4(b)(5), the real estate investment activities must be conducted by a majority-owned subsidiary that further qualifies as an ''eligible subsidiary'' under the proposal. The characteristics of an eligible subsidiary are set forth in § 362.4(c)(2) of the regulation and further described below. If the institution or its investment does not meet the criteria established under the proposed regulation for using the notice procedure, an application may be filed with the FDIC under § 362.4(b)(1). The FDIC encourages institutions to file an application if the institution wishes to request relief from any of the requirements necessary to be considered an eligible depository institution or an eligible subsidiary. The FDIC recognizes that not all real estate investment requires a subsidiary to be established exactly as outlined under the eligible subsidiary definition.

Section 362.4(b)(5) of the proposal permits certain highly rated banks (defined in § 362.4(c)(1) of the proposal as eligible depository institutions) to engage, through a majority-owned subsidiary, in real estate investment activities not otherwise permissible for a national bank by filing a notice according to the procedures set forth in subpart E of the proposed regulation.

Comment is requested on all aspects of this proposal to allow real estate activities through a notice procedure.

Engage in the Public Sale, Distribution or Underwriting of Securities That Are Not Permissible for a National Bank Under Section 16 of the Banking Act of 1933

The current regulation provides that an insured state nonmember bank may establish a majority-owned subsidiary that engages in the underwriting and distribution of securities without filing an application with the FDIC if the requirements and restrictions of § 337.4 of the FDIC's regulations are met. Section 337.4 governs the manner in which subsidiaries of insured state nonmember banks must operate if the subsidiaries engage in securities activities that would not be permissible for the bank itself under section 16 of the Banking Act of 1933, commonly known as the Glass-Steagall Act. In short, the regulation lists securities underwriting and distribution as an activity that will not pose a significant risk to the fund if conducted through a majority-owned subsidiary that operates in accordance with § 337.4. The proposed regulation makes significant changes to that exception.

Due to the existing cross reference to § 337.4, FDIC reviewed § 337.4 as a part of its review of part 362 for CDRI. The purpose of the review was to streamline and clarify the regulation, update the regulation as necessary given any changes in the law, regulatory practice, and the marketplace since its adoption, and remove any redundant or unnecessary provisions. As a result of that review, the FDIC proposes making a number of substantive changes to the rules which govern securities sales, distribution, or underwriting by subsidiaries of insured state nonmember banks and eliminating § 337.4 as a separate regulation. The revised language would be relocated to part 362 and would become what is proposed § 362.4(b)(5)(ii). Although the FDIC has chosen to place the exception in the part of the regulation governing activities by insured state banks, by law, only subsidiaries of state nonmember banks may engage in securities underwriting activities that are not permissible for national banks. As we have previously stated, subpart A of this regulation does not grant authority to conduct activities or make investments, subpart A only gives relief from the prohibitions of section 24 of the FDI Act. We placed the exception for securities underwriting with the real estate exception in the structure of the regulation to promote uniform standards across activities, even though it is possible that a state member bank could qualify for the real estate exception and not the securities exception. We request comment on whether this placement causes any confusion. Of course, as the appropriate Federal banking agency for state member banks, the FRB may impose more stringent restrictions on any activity conducted by a state member bank.

The following discussion describes the purpose and background of § 337.4, the conditions and restrictions imposed by that rule on securities activities, the language of the exception in proposed part 362 and the proposed revisions to the conditions and restrictions governing this activity.

History of Section 337.4

On August 23, 1982, the FDIC adopted a policy statement on the applicability of the Glass-Steagall Act to securities activities of insured state nonmember banks (47 FR 38984). That policy statement expressed the opinion of the FDIC that under the Glass-Steagall Act: (1) Insured state nonmember banks may be affiliated with companies that engage in securities activities, and (2) securities activities of bona fide subsidiaries of insured state nonmember banks are not prohibited by section 21 of the Glass-Steagall Act (12 U.S.C. 378) which prohibits deposit taking institutions from engaging in the business of issuing, underwriting, selling, or distributing stocks, bonds, debentures, notes, or other securities.

The policy statement applies solely to insured state nonmember banks. As noted in the policy statement, the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et. seq.) places certain restrictions on non-banking activities. Insured state nonmember banks that are members of a bank holding company system need to take into consideration sections 4(a) and 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843 (a) and (c)) and applicable Federal Reserve Board regulations before entering into securities activities through subsidiaries.

The policy statement also expressed the opinion of the Board of Directors of the FDIC that there may be a need to restrict or prohibit certain securities activities of subsidiaries of state nonmember banks. As the policy statement noted, ''the FDIC * * * recognizes its ongoing responsibility to ensure the safe and sound operation of insured state nonmember banks, and depending upon the facts, the potential risks inherent in a bank subsidiary's involvement in certain securities activities.''[2]

In November 1984, after notice and comment proceedings, the FDIC adopted a final rule regulating the securities activities of affiliates and subsidiaries of insured state nonmember banks under the FDI Act. 49 FR 46709 (Nov. 28, 1984), regulations codified at 12 CFR 337.4 (1986).[3] Although the rule does not prohibit such securities activities outright, it does restrict that activity in a number of ways and only permits the activities if authorized under state law. Banks only could maintain ''bona fide'' subsidiaries that engaged in securities work. The rule defined ''bona fide subsidiary'' so as to limit the extent to which banks and their securities affiliates and subsidiaries could share company names or logos, as well as places of business. 12 CFR 337.4(a)(2)(ii), (iii); 49 FR 46710. The definition required banks and subsidiaries to maintain separate accounting records and to observe separate corporate formalities. 12 CFR 337.4(a)(2)(iv), (v). The two entities were required not to share officers and to conduct business pursuant to independent policies and procedures, including the maintenance of separate employees and payrolls. *Id.* § 337.4(a)(2)(vi), (vii), (viii); 49 FR 46711–12. Finally, and perhaps most importantly, the rule required a subsidiary to be ''adequately capitalized.'' 12 CFR 337.4(a)(2)(i).

The rule has been amended several times since its adoption.[4] The last amendment to this rule was in 1988. When the FDIC initially implemented

[2] Representatives of mutual fund companies and investment bankers brought action challenging the Federal Deposit Insurance Corporation Policy Statement. Their suit was dismissed without prejudice, pending the outcome of FDIC's rulemaking process. *Investment Company Institute v. United States,* D.D.C. Civil Action No. 82–2532, filed September 8, 1982.

[3] After the regulations were adopted, the representatives of mutual fund companies and investment bankers brought another action challenging the regulations allowing insured banks, which are not members of the Federal Reserve System, to have subsidiary or affiliate relationships with firms engaged in securities work. The United States District Court for the District of Columbia, Gerhard A. Gesell, J., 606 F.Supp. 683, upheld the regulations, and representatives appealed and also petitioned for review. The Court of Appeals held that: (1) representatives had standing to challenge regulations under both the Glass-Steagall Act and the FDI Act, but (2) regulations did not violate either Act. *Investment Company Institute, v. Federal Deposit Insurance Corporation,* 815 F.2d 1540 (U.S.C.A. D.C.1987).

A trade association representing Federal Deposit Insurance Corporation-insured savings banks also brought suit challenging FDIC regulations respecting proper relationship between FDIC-insured banks and their securities-dealing ''subsidiaries'' or ''affiliates.'' On cross motions for summary judgment, the District Court, Jackson, J., held that: (1) trade association had standing, and (2) regulations were within authority of FDIC. *National Council of Savings Institutions v. Federal Deposit Insurance Corporation,* 664 F.Supp. 572 ( D.C. 1987).

[4] 50 FR 2274, Jan. 16, 1985; 51 FR 880, Jan. 9, 1986; 51 FR 23406, June 27, 1986; 51 FR 45756, Dec. 22, 1986; 52 FR 23544, June 23, 1987; 52 FR 39216, Oct. 21, 1987; 52 FR 47386, Dec. 14, 1987; 53 FR 597, Jan. 8, 1988; 53 FR 2223, Jan. 27, 1988. The FDIC amended the regulations governing the securities activities of certain subsidiaries of insured state nonmember banks and the affiliate relationships of insured state nonmember banks with certain securities companies to make technical corrections, delete the requirement that the offices of securities subsidiaries and affiliates must be accessed through a separate entrance from that used by the bank (the existing requirement for physically separate offices was retained), delete the prohibition against securities subsidiaries and affiliates sharing a common name or logo with the bank, and to establish a number of affirmative disclosure requirements regarding securities recommended, offered, or sold by or through a securities subsidiary or affiliate are not FDIC insured deposits unless otherwise indicated and that such securities are not obligations of, nor are guaranteed by the bank.

its regulation on securities activities of subsidiaries of insured state nonmember banks and bank transactions with affiliated securities companies, the FDIC determined that some risk may be associated with those activities. To address that risk, the FDIC regulation: (1) Defined bona fide subsidiary, (2) required notice of intent to acquire or establish a securities subsidiary, (3) limited the permissible securities activities of insured state nonmember bank subsidiaries, and (4) placed certain other restrictions on loans, extensions of credit, and other transactions between insured state nonmember banks and their subsidiaries or affiliates that engage in securities activities.

As defined in § 337.4, the term ''bona fide'' subsidiary means a subsidiary of an insured state nonmember bank that at a minimum: (1) Is adequately capitalized, (2) is physically separate and distinct in its operations from the operations of the bank, (3) maintains separate accounting and other corporate records, (4) observes separate corporate formalities such as separate board of directors' meetings, (5) maintains separate employees who are compensated by the subsidiary, (6) shares no common officers with the bank, (7) a majority of the board of directors is composed of persons who are neither directors nor officers of the bank, and (8) conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the bank and that investments recommended, offered or sold by the subsidiary are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are otherwise obligations of the bank.

This definition was imposed to ensure the separateness of the subsidiary and the bank. This separation is necessary as the bank would be prohibited by the Glass-Steagall Act from engaging in many activities the subsidiary might undertake and the separation safeguards the soundness of the parent bank.

The regulation provides that the insured state nonmember bank must give the FDIC written notice of intent to establish or acquire a subsidiary that engages in any securities activity at least 60 days prior to consummating the acquisition or commencement of the operation of the subsidiary. These notices serve as a supervisory mechanism to apprise the FDIC that insured state nonmember banks are conducting securities activities through their subsidiaries that may expose the banks to potential risks.

The regulation adopted a tiered approach to the activities of the subsidiary and limited the underwriting of securities that would otherwise be prohibited to the bank itself under the Glass-Steagall Act unless the subsidiary met the bona fide definition and the activities were limited to underwriting of investment quality securities. A subsidiary may engage in additional underwriting if it meets the definition of bona fide and the following additional conditions are met:

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

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

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

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

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

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

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

An insured state nonmember bank that has a subsidiary or affiliate engaging in the sale, distribution, or underwriting of stocks, bonds, debentures or notes, or other securities, or acting as an investment advisor to any investment company is prohibited under § 337.4 from engaging in any of the following transactions:

(1) Purchasing in its discretion as fiduciary any security currently distributed, underwritten or issued by the subsidiary unless the purchase is authorized by a trust instrument or is permissible under applicable law;

(2) Transacting business through the trust department with the securities firm unless the transactions are at least comparable to transactions with an unaffiliated company;

(3) Extending credit or making any loan directly or indirectly to any company whose obligations are underwritten or distributed by the securities firm unless the securities are of investment quality;

(4) Extending credit or making any loan directly or indirectly to any investment company whose shares are underwritten or distributed by the securities company;

(5) Extending credit or making any loan where the purpose of the loan is to acquire securities underwritten or distributed by the securities company;

(6) Making any loans or extensions of credit to a subsidiary or affiliate of the bank that distributes or underwrites securities or advises an investment company in excess of the limits and restrictions set by section 23A of the Federal Reserve Act;

(7) Making any loan or extension of credit to any investment company for which the securities company acts as an investment advisor in excess of the limits and restrictions set by section 23A of the Federal Reserve Act; and

(8) Directly or indirectly conditioning any loan or extension of credit to any company on the requirement that the company contract with the bank's securities company to underwrite or distribute the company's securities or condition a loan to a person on the requirement that the person purchase any security underwritten or distributed by the bank's securities company.

An insured state nonmember bank is prohibited under § 337.4 from becoming affiliated with any company that directly engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities unless: (1) The securities business of the affiliate is physically separate and distinct from the operation of the bank; (2) the bank and the affiliate share no common officers; (3) a majority of the board of directors of the bank is composed of persons who are neither directors nor officers of the affiliate; (4) any employee of the affiliate who is also an employee of the bank does not conduct any securities activities of the affiliate on the premises of the bank that involve customer contact; and (5) the affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank and that investments recommended, offered or sold by the affiliate are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are otherwise obligations of the bank. The FDIC chose not to require notices relative to affiliates because it would normally find out about the affiliation in a deposit insurance application or a change of bank control notice.

The FDIC created an atmosphere where bank affiliation with entities engaged in securities activities is very controlled. The FDIC has examination authority over bank subsidiaries. Under section 10(b) of the FDI Act, the FDIC has the authority to examine affiliates to determine the effect of that relationship on the insured institution. Nevertheless, the FDIC generally has allowed these entities to be functionally regulated, that is FDIC usually examines the insured state nonmember bank and primarily relies on SEC and NASD oversight of the securities subsidiary or affiliate.

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

The number of banks which have subsidiaries engaging in securities activities that can not be conducted in the bank itself is very small. These subsidiaries engage in the underwriting of debt and equity securities and distribution and management of mutual funds. The FDIC has received notices from 444 banks that have subsidiaries that engage in activities that do not require the subsidiary to meet the definition of bona fide such as investment advisory activities, sale of securities, and management of the bank's securities portfolio.

Since implementation of the FDIC's § 337.4 regulation, the relationships between banks and securities firms have not been a matter of supervisory concern due to the protections FDIC has in place. However, the FDIC realizes that in a time of financial turmoil these protections may not be adequate and a program of direct examination could be necessary to protect the insurance fund. Thus, the continuation of the FDIC's examination authority in that area is important.

The FRB permits a nonbank subsidiary of a bank holding company to underwrite and deal in securities through its orders under the Bank Holding Company Act and section 20 of the Glass-Steagall Act. The FDIC has reviewed its securities underwriting activity regulations in light of the FRB recently adopted operating standards that modify the FRB's section 20 orders.[5] The FDIC also reviewed the comments received by the FRB. The FRB conducted a comprehensive review of the prudential limitations established in its decisions. The FRB sought comment on modifying these limitations to allow section 20 subsidiaries to operate more efficiently and serve their customers more effectively.[6] The FDIC found the analysis of the FRB instructive and has determined that its regulation already incorporates many of the same modifications that the FRB has made. The FDIC is proposing other changes consistent with the FRB approach and will endeavor to explain the differences in the approach taken by the FDIC. Consistent with the approach adopted by the FRB, the FDIC proposes to have the securities underwriting subsidiaries and the insured state nonmember banks use the disclosures adopted in the Interagency Statement where applicable. Thus, the Interagency Statement will be applicable when sales of these products occur on bank premises. The FDIC agrees with the FRB that using these interagency disclosure standards promotes uniformity, makes it easier for banks to train their employees, and enhances compliance.

In contrast, FDIC will be taking a different approach on some of these safeguards because it is not proposing a separate statement of operating standards. Thus, the FDIC will retain safeguards in its rule that FRB is shifting to or handling in a different way through the FRB's still to be released statement of operating standards. With respect to other safeguards that the FDIC is proposing to continue to apply to the securities underwriting activities conducted by insured state nonmember banks through their ''eligible subsidiaries,'' FDIC has determined that each of these safeguards provides appropriate protections for bank subsidiaries engaged in underwriting activities.

For these purposes, the FDIC has modified the safeguard requiring that banks and their securities underwriting subsidiaries maintain separate officers and employees. As discussed below, that modification would be consistent with the Interagency Statement. However, the chief executive officer of the subsidiary may not be an employee of the bank and a majority of its board of directors must not be directors or officers of the bank. This standard is the same as the operating standard on interlocks adopted by the FRB to govern its section 20 orders.

One of the reasons for these safeguards involves the FDIC's continuing concerns that the bank should be protected from liability for the securities underwriting activities of the subsidiary. Under the securities laws, a parent company may have liability as a ''controlling person.''[7] The FDIC views management and board of director separation as enhanced protection from controlling person liability as well as protection from disclosures of material nonpublic information. Protection from disclosures of material nonpublic information also may be enhanced by the use of appropriate policies and procedures.[8]

[5] August 21, 1997.

[6] 61 FR 57679, November 7, 1996, and 62 FR 2622, January 17, 1997.

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

[8] *See* ''Anti-manipulation Rules Concerning Securities Offerings,'' Regulation M, 17 CFR 200

Continued

The FDIC requests comment on the retention of these safeguards, the utility of management and board separations to limit controlling person liability and the inappropriate disclosure of material nonpublic information, the extent that any securities underwriting liability may have been reduced due to the enactment of The Private Securities Litigation Reform Act of 1995, P.L. 104–67, the efficacy of more limited restrictions on officer and director interlocks to prevent both liability and information sharing and any related issues.

Substantive Changes to the Subsidiary Underwriting Activities

Generally, the regulations governing the securities underwriting activity of state nonmember banks have been streamlined to make compliance easier. In addition, state nonmember banks that deem any particular constraint to be burdensome may file an application with the FDIC to have the constraint removed for that bank and its majority-owned subsidiary. The FDIC has eliminated those constraints that were deemed to overlap other requirements or that could be eliminated while maintaining safety and soundness standards. For example, the FDIC proposes to eliminate the notice requirement for all state nonmember banks subsidiaries that engage in any securities activities that are permissible for a national bank. Under the proposal, a notice would be required only of state nonmember bank subsidiaries that engage in securities activities that would be impermissible for a national bank. The FDIC has determined that it can adequately monitor the other securities activities through its regular reporting and examination processes.

(1997) where the SEC grapples with limiting trading advantages that might otherwise accrue to affiliates by limiting trading in prohibited securities by affiliates. The SEC is attempting to prevent trading on material nonpublic information. To reduce the danger of such trading, the SEC has a broad ban on affiliated purchasers. To narrow that exception while continuing to limit access to the nonpublic information that might otherwise occur, the SEC has limited access to material nonpublic information through restraints on common officers. Alternatively, the SEC could prohibit trading by affiliates that shared any common officers or employees. In narrowing this exception to ''those officers or employees that direct, effect or recommend transactions in securities,'' the SEC stated that it ''believes that this modification will resolve substantially commenters'' concerns that sharing one or more senior executives with a distribution participant, issuer, or selling security holder would preclude an affiliate from availing itself of the exclusion.'' 62 FR 520 at 523, fn. 22 (January 3, 1997). As the SEC also stated, the requirement would not preclude the affiliates from sharing common executives charged with risk management, compliance or general oversight responsibilities.

We invite comment on whether the elimination of these notices is appropriate.

As indicated in the following discussion on core eligibility requirements, the proposed regulation establishes new criteria which must be met to qualify for the notice procedures to conduct, as principal, activities through a subsidiary that are not permissible for a national bank. The insured state bank must be an ''eligible depository institution'' and the subsidiary must be an ''eligible subsidiary.'' The terms are defined below but to summarize briefly, an ''eligible depository institution'' must be chartered and operating for at least three years, have satisfactory composite and management ratings under the Uniform Financial Institution Rating System (UFIRS) as well as satisfactory compliance and CRA ratings, and not be subject to any formal or informal corrective or supervisory order or agreement. These requirements would be uniform with other part 362 notice procedures for insured state banks to engage in activities not permissible for national banks and recognize the level of risk present in securities underwriting activities. These requirements are not presently found in § 337.4 but the FDIC believes that only banks that are well-run and well-managed should be given the opportunity to engage in securities activities that are not permissible for a national bank under the streamlined notice procedures. Other banks that want to enter these activities should be subject to the scrutiny of the application process. Although management and operations not permissible for a national bank are conducted by a separate majority-owned subsidiary, such activities are part of the analysis of the consolidated financial institution. The condition of the institution and the ability of its management are an important component in determining if the risks of the securities activities will have a negative impact on the insured institution.

One of the other notable differences in the proposed regulation is the substitution of the ''eligible subsidiary'' criteria for that of the ''bona fide subsidiary'' definition contained in § 337.4(a)(2). The definitions are similar, but changes have been made to the existing capital and physical separation requirements. Also, new requirements have been added to ensure that the subsidiary's business is conducted according to independent policies and procedures. With regard to those subsidiaries which engage in the public sale, distribution or underwriting of securities that are not permissible for a national bank, additional conditions must also be met. The conditions are that (1) the state-chartered depository institution must adopt policies and procedures, including appropriate limits on exposure, to govern the institution's participation in financing transactions underwritten or arranged by an underwriting majority-owned subsidiary; (2) the state-chartered depository institution may not express an opinion on the value or the advisability of the purchase or sale of securities underwritten or dealt in by a majority-owned subsidiary unless the state-chartered depository institution notifies the customer that the majority-owned subsidiary is underwriting, making a market, distributing or dealing in the security; (3) the majority-owned corporate subsidiary is registered and is a member in good standing with the appropriate SROs, and promptly informs the appropriate regional director of the Division of Supervision (DOS) in writing of any material actions taken against the majority-owned subsidiary or any of its employees by the state, the appropriate SROs or the SEC; and (4) the state-chartered depository institution does not knowingly purchase as principal or fiduciary during the existence of any underwriting or selling syndicate any securities underwritten by the majority-owned subsidiary unless the purchase is approved by the state-chartered depository institution's board of directors before the securities are initially offered for sale to the public. These requirements are also similar to but simplify the requirements currently contained in § 337.4.

In addition, the FDIC proposes to eliminate the five-year period limiting the securities activities of a state nonmember bank's underwriting subsidiary's business operations. Rather, with notice and compliance with the safeguards, a state nonmember bank's securities subsidiary may conduct any securities business set forth in its business plan after the notice period has expired without an objection by the FDIC. The reasons the FDIC initially chose the more conservative posture are rooted in the time they were adopted. When the FDIC approved establishment of the initial underwriting subsidiaries, it had no experience supervising investment banking operations in the United States. Because affiliation between banks and securities underwriters and dealers was long considered impractical or illegal, banks had not operated such entities since enactment of the Glass-Steagall Act in

1933. Moreover, pre-Glass-Steagall affiliations were considered, rightly or wrongly, to have caused losses to the banking industry and investors, although some modern research questions this view.[9] Thus, the affiliation of banks and investment banks presented unknown risks that were considered substantial in 1983. In addition, although the FDIC recognized that supervision and regulation of broker-dealers by the SEC provided significant protections, the FDIC had little experience with how these protections operated. The FDIC has now gained experience with supervising the securities activities of banks and is better able to assess the appropriate safeguards to impose on these operations to protect the bank and the deposit insurance funds. For those reasons, the limitations and restrictions contained in § 337.4 on underwriting other than ''investment quality debt securities'' or ''investment quality equity securities'' have been eliminated from the proposed regulation. It should also be noted that certain safeguards have been added to the system since § 337.4 was adopted. These safeguards include risk-based capital standards and the Interagency Statement. The FDIC proposes the removal of the disclosures currently contained in § 337.4. Instead, the FDIC will be relying on the Interagency Statement for the appropriate disclosures on bank premises. The FDIC requests comment on whether the Interagency Statement provides adequate disclosures for retail sales in a securities subsidiary and whether required compliance with that policy statement needs to be specifically mentioned in the regulatory text. Comment is invited on whether any other disclosures currently in § 337.4 should be retained or if any additional disclosures would be appropriate.

Finally, the FDIC proposes to continue to impose many of the safeguards found in section 23A of the Federal Reserve Act (12 U.S.C. 371c) and to impose the safeguards of section 23B of the Federal Reserve Act (12 U.S.C. 371c–1). Although section 23B did not exist until 1987 [10] and only covers transactions where banks and their subsidiaries are on one side and other affiliates are on the other side, the FDIC had included some similar constraints in the original version of § 337.4. Now, most of the transaction restrictions imposed by section 23B are being added to promote consistency with the restrictions imposed by other banking agencies on similar activities. Briefly, section 23B requires inter-affiliate transactions to be on arm's length terms, prohibits representing that a bank is responsible for the affiliate's (in this case subsidiary's) obligations, and prohibits a bank from purchasing certain products from an affiliate. While imposing the 23B-like transaction restrictions, the FDIC is eliminating any overlapping safeguards. The FDIC requests comment on the restrictions that have been removed, including whether any of these restrictions should be reimposed for securities activities. The FDIC invites comment on the restrictions it has modeled on 23A and 23B. Specifically, the FDIC would like to know if the restrictions it has proposed address the identified risks without overburdening the industry with duplicative or ambiguous requirements. The FDIC invites suggestions for further improvements.

In contrast to the section 23B transaction restrictions, section 23A did exist and was incorporated into § 337.4 by reference. To simplify compliance for transactions between state nonmember banks and their own subsidiaries, the FDIC has restated the constraints of both sections 23A and 23B in the regulatory text language and only included the restrictions that are relevant to a particular activity. The FDIC hopes that this restatement will clarify the standards being imposed on state nonmember banks and their subsidiaries without requiring banks to undertake extensive analysis of the provisions of sections 23A and 23B that are inapplicable to the direct bank-subsidiary relationship or to particular activities. In addition, the FDIC has sought to eliminate transaction restrictions that would duplicate the restrictions on information flow or transactions imposed by the SROs and/or by the SEC.[11] The FDIC does not seek to eliminate the obligation to protect material nonpublic information nor does it seek to undercut or minimize the importance of the restrictions imposed by the SROs and SEC. Rather, the FDIC seeks to avoid imposing burdensome overlapping restrictions merely because a securities underwriting entity is owned by a bank. Further, the FDIC seeks to avoid restrictions where the risk of loss or manipulation is small or the costs of compliance are disproportionate to the purposes the restrictions serve. In addition, the FDIC defers to the expertise of the SEC which has found that greater flexibility for market activities during public offerings is appropriate due to greater securities market transparency, the surveillance capabilities of the SROs, and the continuing application of the anti-fraud and anti-manipulation provisions of the federal securities laws.[12]

The FDIC requests comment on whether the restrictions that the FDIC has restated from sections 23A and 23B provide adequate restrictions for a securities underwriting subsidiary of a bank, whether any other restrictions currently in § 337.4 should be retained, whether any additional restrictions would be appropriate, and any other issues of concern regarding the appropriate restrictions that should be applicable to a bank's securities underwriting subsidiary. In addition, the FDIC requests comment on the adequacy of the best practices requirements that would be imposed by the SROs and, indirectly, by the SEC on transactions and information flow. The FDIC also requests comment on the adequacy of the ethical walls that would prevent the flow of information from a securities underwriting subsidiary of a bank to its parent, thus eliminating the necessity of additional transaction restrictions. To the extent that these ethical walls may be insufficient barriers to the flow of nonpublic information due to management and/or employee interlocks or other issues that may not be readily apparent, the FDIC requests comment on any weaknesses that might be noted in the more limited transaction restrictions imposed under this proposal.

Consistent with the current notice procedure found in § 337.4, an insured state nonmember bank may indirectly through a majority-owned subsidiary engage in the public sale, distribution or underwriting of securities that would be impermissible for a national bank provided that the bank files notice prior to initiating the activities, the FDIC does not object prior to the expiration of the notice period and certain conditions are, and continue to be, met. The FDIC proposes that the notice period be shortened from the existing 60 days to 30 days and that required filing procedures be contained in subpart E of part 362. Previously, specific instructions and guidelines on the form

[9] *See, e.g.*, George J. Benston, The Separation of Commercial and Investment Banking: The Glass-Steagall Act Revisited and Reconsidered 41 (1990).

[10] Aug. 10, 1987, Pub. L. 100–86, Title I, s 102(a), 101 Stat. 564.

[11] *See* ''Anti-manipulation Rules Concerning Securities Offerings,'' 62 FR 520 (January 3, 1997); 15 U.S.C. 78o(f), requiring registered brokers or dealers to maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information; and ''Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Nonpublic Information,'' A Report by the Division of Market Regulation, U.S. SEC, (March 1990).

[12] *Id.* at 520.

and content of any applications or notices required under § 337.4 were found within that section. With regard to those insured state nonmember banks that have been engaging in a securities activity under a notice filed and in compliance with § 337.4, § 362.5(b) of the proposed regulation would allow those activities to continue as long as the bank and its majority-owned subsidiaries meet the core eligibility requirements, the investment and transaction limitations, and capital requirements contained in § 362.4(c), (d), and (e). We will require these securities subsidiaries to meet the additional conditions specified in § 362.4(b)(5)(ii) that require securities subsidiaries to adopt appropriate policies and procedures, register with the SEC and take steps to avoid conflicts of interest. We also require the state nonmember bank to adopt policies concerning the financing of issues underwritten or distributed by the subsidiary. The state nonmember bank and its securities subsidiary would have one year from the effective date of the regulation to meet these restrictions and would be expected to be working toward full compliance over that time period. Failure to meet the restrictions within a year after the adoption of a final rule would necessitate an application for the FDIC's consent to continue those activities to avoid supervisory concern.

To qualify for the streamlined notice procedure, a bank must be well-capitalized after deducting from its tier one capital the equity investment in the subsidiary as well as the bank's pro rata share of any retained earnings of the subsidiary. The deduction must be reflected on the bank's consolidated report of income and condition and the resulting capital will be used for assessment risk classification purposes under part 327 and for prompt corrective action purposes under part 325. However, the capital deduction will not be used to determine whether the bank is ''critically undercapitalized'' under part 325. Since the risk-based capital requirements had not been adopted when the current version of § 337.4 was adopted, no similar capital level was required of banks to establish an underwriting subsidiary, although the capital deduction has always been required. This requirement is uniform with the requirements found in the other part 362 notice procedures for insured state banks to engage in activities not permissible for national banks. We believe the well-capitalized standard and the capital deduction recognize the level of risk present in securities underwriting activities by a subsidiary of a state nonmember bank. This risk includes the potential that a bank could reallocate capital from the insured depository institution to the underwriting subsidiary. Thus, it is appropriate for the FDIC to retain the capital deduction even though the FRB eliminated the requirement that a holding company deduct its investment in a section 20 subsidiary on August 21, 1997.

Additional Requests for Comments

With regard to securities activities, the FDIC is specifically requesting comments that address the following:

(1) Whether it is inherently unsafe or unsound for insured state nonmember banks to establish or acquire subsidiaries that will engage in securities activities or for insured state nonmember banks to be affiliated with a business engaged in securities activities;

(2) Whether certain securities activities when engaged in by subsidiaries of insured state nonmember banks pose safety and soundness problems whereas others do not;

(3) Whether, and in what circumstances, securities activities of insured state nonmember banks should be considered unsafe or unsound;

(4) Whether securities activities of subsidiaries present conflicts of interest that warrant restricting the manner in which the bank may deal with its securities subsidiary (or its securities affiliate), or the manner in which common officers or employees may function, etc.;

(5) Should securities activities be limited to subsidiaries of insured state banks of a certain asset size, with a certain composite rating, etc.;

(6) Should insured state nonmember banks obtain the FDIC's prior approval before establishing or acquiring subsidiaries that will engage in securities activities in all cases, in some cases, or not at all;

(7) Should revenue limits similar to those that the FRB has established for section 20 subsidiaries be imposed on securities subsidiaries of insured state nonmember banks;

(8) Do the potential benefits, if any that would be available to insured state nonmember banks as a result of competing in the securities area through subsidiaries offset potential disadvantages to the institutions;

(9) Why haven't more banks availed themselves of the powers available under 337.4 and will the proposed regulation result in increased activity in the securities area;

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

(11) Are there any perceived public harms in insured state nonmember banks embarking on such activities; and

(12) The FDIC is also requesting comment on how to determine if a securities subsidiary is in fact a true subsidiary and not the alter ego of the parent bank.

Comments addressing these issues and any other aspects of the general subject of permitting subsidiaries and affiliates of insured state nonmember banks to engage in securities activities will be welcomed.

Notice for Change in Circumstances

The proposal requires the bank to provide written notice to the appropriate Regional Office of the FDIC within 10 business days of a change in circumstances. Under the proposal, a change in circumstances is described as a material change in subsidiary's business plan or management. The FDIC believes that it can address a bank's falling out of compliance with any of the other conditions of approval through the normal supervision and examination process. We request comment on whether specific language should be included in the regulation text that a bank must continue to meet all eligibility, capital, and investment and transaction criteria.

The FDIC is concerned about changes in circumstances which result from changes in management or changes in a subsidiary's business plan. If material changes to either condition occur, the rule requires the institution to submit a notice of such changes to the appropriate FDIC regional director (DOS) within 10 days of the material change. The standard of material change would indicate such events as a change in chief executive officer of the subsidiary or a change in investment strategy or type of business or activity engaged in by the subsidiary. The regional director also may address other changes that come to the attention of the FDIC during the normal supervisory process.

In the case of a state member bank, the FDIC will communicate our concerns with the appropriate persons in the Federal Reserve System regarding the continued conduct of an activity after a change in circumstances. The FDIC will work with the identified persons within the Federal Reserve System to develop the appropriate response to the new circumstances.

It is not the FDIC's intention to require any bank which falls out of compliance with eligibility conditions to immediately cease any activity in which the bank had been engaged subject to a notice to the FDIC. The FDIC will deal with such eventuality rather on a case-by-case basis through the supervision and examination process. In short, the FDIC intends to utilize the supervisory and regulatory tools available to it in dealing with the bank's failure to meet eligibility requirements on a continuing basis. The issue of the bank's ongoing activities will be dealt with in the context of that effort. The FDIC is of the opinion that the case-by-case approach to whether a bank will be permitted to continue an activity is preferable to forcing a bank to, in all instances, immediately cease the activity in question. Such an inflexible approach could exacerbate an already poor situation.

Core Eligibility Requirements

The proposed regulation has been organized much differently from the current regulation where separation standards between an insured state bank and its subsidiary are contained in the regulation's definition of ''bona fide'' subsidiary. The proposed regulation introduces the concept of core eligibility requirements. These requirements are used to determine those institutions that qualify to use the notice processes introduced in this regulation and to establish general criteria that the Board will be reviewing in considering applications. These requirements are defined in two parts. The first part defines the eligible depository institution criteria and the second part defines the eligible subsidiary standards.

An ''eligible depository institution'' is a depository institution that has been chartered and operating for at least three years; received an FDIC-assigned composite UFIRS rating of 1 or 2 at its most recent examination; received a rating of 1 or 2 under the ''management'' component of the UFIRS at its most recent examination; received at least a satisfactory CRA rating from its primary federal regulator at its last examination; received a compliance rating of 1 or 2 from its primary federal regulator at its last examination; and is not subject to any corrective or supervisory order or agreement. The FDIC believes that this criteria is appropriate to ensure that the notice procedures are available only to well-managed institutions that do not present any supervisory, compliance or CRA concerns.

The standards for an ''eligible depository institution'' are being standardized with similar requirements for other types of notices and applications made to the FDIC. In developing the eligibility standards, several items have been added that previously were not a stated standard for banks wishing to engage in activities not permissible for a national bank.

The requirement that the institution has been chartered and operated for three or more years reflects the experience of the FDIC that newly formed depository institutions need closer scrutiny. Therefore, a request by this type of institution to become involved in activities not permissible for a national bank should receive consideration under the application process rather than being eligible for a notice process.

The FDIC's existing standard is that only well-managed, well-capitalized banks should be eligible for engaging in activities not permissible for national banks through a notice procedure. Banks which have composite ratings of 1 or 2 have shown that they have the requisite financial and managerial resources to run a financial institution without presenting a significant risk to the deposit insurance fund. While lower-rated financial institutions may have the requisite financial and managerial resources and skills to undertake such activities, the FDIC believes that those institutions should be subject to the formal part 362 application process as opposed to the streamlined notice process described herein. Such institutions are not on their face as sound on an overall basis as those rated 1 or 2. For that reason, the FDIC feels that it is more prudent to require institutions rated 3 or below to utilize the application process.

In addition, the FDIC is adding to the proposed rule a requirement that the management component of the bank's most recent rating be a 1 or 2 also. The FDIC believes that both capital and management are extremely important to the safety and soundness of a financial institution. As noted above, a bank with a composite rating of 1 or 2 has shown that it is strong when taking into account all components of the uniform financial institutions rating system. While there are few financial institutions with 1 or 2 composite ratings with weak management, we believe that only those institutions that are well-managed should be eligible for the notice processes.

Banks which wish to become involved in activities not permissible for a national bank through the notice process should be exemplary in all areas of its operations. Therefore, the proposal requires that the institution have a satisfactory or better CRA rating, a 1 or 2 compliance rating, and not be subject to any formal or informal enforcement action.

A filing may be removed from notice processing if: (1) A CRA protest is received that warrants additional investigation or review, or the appropriate regional director of the Division of Consumer Affairs (DCA) determines that the filing presents a significant CRA or compliance concern; (2) the appropriate regional director (DOS) determines that the filing presents a significant supervisory concern, or raises a significant legal or policy issue; or (3) the appropriate regional director (DOS) determines that other good cause exists for removal. If a filing is removed from notice processing procedures, the applicant will be promptly informed in writing of the reason.

The FDIC specifically requests comment on whether the standards for eligibility are appropriate.

Eligible Subsidiary

The FDIC's support of the concepts of expansion of bank powers is based in part on establishing a corporate separateness between the insured depository institution and the entity conducting activities that are not permissible for the depository institution directly. The proposal establishes these separations as well as standards for operations through the concept of ''eligible subsidiary.'' An entity is an ''eligible subsidiary'' if it: (1) Meets applicable statutory or regulatory capital requirements and has sufficient operating capital in light of the normal obligations that are reasonably foreseeable for a business of its size and character; (2) is physically separate and distinct in its operations from the operations of the state-chartered depository institution, provided that this requirement shall not be construed to prohibit the state-chartered depository institution and its subsidiary from sharing the same facility if the area where the subsidiary conducts business with the public is clearly distinct from the area where customers of the state-chartered depository institution conduct business with the institution—the extent of the separation will vary according to the type and frequency of customer contact; (3) maintains separate accounting and other business records; (4) observes separate business formalities such as separate board of directors' meetings; (5) has a chief executive officer who is not an employee of the bank; (6) has a majority of its board of directors who are neither directors nor officers of the state-chartered depository institution; (7) conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the state-chartered depository institution and that the state-chartered depository institution is not responsible for and does not guarantee the obligations of the subsidiary; (8) has only one business purpose; (9) has a current written business plan that is appropriate to the type and scope of business conducted by the subsidiary; (10) has adequate management for the type of activity contemplated, including appropriate licenses and memberships, and complies with industry standards; and (11) establishes policies and procedures to ensure adequate computer, audit and accounting systems, internal risk management controls, and has the necessary operational and managerial infrastructure to implement the business plan.

The separations are currently outlined in the definitions of ''bona fide'' subsidiary contained in § 337.4 and part 362. The broad principles of separtion upon which the ''bona fide'' subsidiary definition and the ''eligible subsidiary'' definition are based include: (1) Adequate capitalization of the subsidiary; (2) separate corporate functions; (3) separation of facilities; (4) separation of personnel; and (5) advertising the bank and the subsidiary as separate entities.

While the ''bona fide'' subsidiary definitions currently used are substantially similar, there is one substantial difference. Each regulation has a different approach to the issue of common officers between the bank and the subsidiary. The language in the current part 362 allows the subsidiary and the parent bank to share officers so long as a majority of the subsidiary's executive officers were neither officers nor directors of the bank. Section 337.4 contains a requirement that there be no shared officers. The ''eligible subsidiary'' concept adopts a more limited standard. The eligible subsidiary requirements loosen the separations among employees and officers from those in place under the bona fide subsidiary definitions in both § 337.4 and part 362 and in Board orders authorizing most real estate activities. The eligible subsidiary only requires that the chief executive officer not be an employee of the institution. We consider officers to be employees of the institution. This limitation would allow the chief executive officer to be an employee of an affiliated entity or be on the board of directors of the institution. Are there other methods of achieving the concept of separation without requiring different public contact employees and officers for the bank and the subsidiary?

In deciding the standards to become an ''eligible subsidiary,'' the FDIC not only has reconciled the differing standards on shared officers, but also has modified some of the previous standards used in the definition of ''bona fide'' subsidiary. The changes are found in the capital requirement, the physical separation requirement, the separate employee standard, and the requirement that the subsidiary's business be conducted pursuant to independent policies and procedures.

The requirement that the subsidiary be adequately capitalized was revised to provide that the subsidiary must meet any applicable statutory or regulatory capital requirements, that the subsidiary have sufficient operating capital in light of the normal obligations that are reasonably foreseeable for a business of its size and character, and that the subsidiary's capital meet any commonly accepted industry standard for a business of its size and character. This definition clarifies that the FDIC expects the subsidiary to meet the capital requirements of its primary regulator, particularly those subsidiaries involved in securities and insurance.

The physical separation requirement was clarified by the addition of a sentence which indicates that the extent to which the bank and the subsidiary must carry on operations in physically distinct areas will vary according to the type and frequency of public contacts. It is not the intent of the FDIC to require physical separation where such a standard adds little value. For instance, a subsidiary engaged in developing commercial real estate would not require the same physical separation from the bank as a subsidiary engaged in retail securities activities. The possibility of customer confusion should be the determining factor in deciding the separation requirements for the subsidiary.

The proposal has eliminated the provision contained in the bona fide subsidiary definition that required the bank and subsidiary to have separately compensated employees who have contact with the public. This provision was imposed to reduce confusion relating to whether customers were dealing with the bank or the subsidiary. Since the adoption of the bona fide subsidiary definition, the Interagency Statement was issued. This interagency statement recognizes the concept of employees who work both for a registered broker-dealer and the bank. Because of the disclosures required in the Interagency Statement informing the customer of the nature of the product being sold and the physical separation requirements, the need for separate public contact employees is diminished. Comment is requested concerning the need for separate public contact employees. Specifically, is there a need for separate employees when an insured depository institution sells a financial instrument underwritten by a subsidiary or real estate developed by a subsidiary? Are the disclosures concerning the affiliation between the bank and the underwriter required by the Interagency Statement sufficient to protect customers from confusion about who is responsible for the product?

Language was added that the subsidiary must conduct business so as to inform customers that the bank is not responsible for and does not guarantee the obligations of the subsidiary. This language is taken from section 23B of the Federal Reserve Act which prohibits banks from entering into any agreement to guarantee the obligations of their affiliates and prohibits banks and well as their affiliates from advertising that the bank is responsible for the obligations of its affiliates. This type of disclosure is intended to reduce customer confusion concerning who is responsible for the products purchased.

After issuing its proposal last August, the FDIC received comment concerning the requirement that a majority of the board of the subsidiary be neither directors nor officers of the bank. The comment questioned if this restriction extended to directors and officers of the holding company. The FDIC is primarily concerned about risk to the deposit insurance funds and is therefore looking to establish separation between the insured bank and its subsidiary. The eligible subsidiary requirement is designed to assure that the subsidiary is in fact a separate and distinct entity from the bank. This requirement should prevent ''piercing of the corporate veil'' and insulate the bank, and the deposit insurance fund, from any liabilities of the subsidiary.

We recognize that a director or officer employed by the bank's parent holding company or sister affiliate is not as ''independent'' as a totally disinterested third party. The FDIC is, however, attempting to strike a reasonable balance between prudential safeguards and regulatory burden. The requirement that a majority of the board not be directors or officers of the bank will provide certain benefits that the FDIC thinks are very important in the context of subsidiary operation. The FDIC expects these persons to act as a safeguard against conflicts of interest and be independent voices on the board of directors. While the presence of ''independent'' directors may not, in and of itself, prevent piercing of the corporate veil, it will add incremental protection and in some circumstances may be key to preserving the separation of the bank and its subsidiary in terms of liability. In view of the other standards of separateness that have been established under the eligible subsidiary standard as well as the imposition of investment and transaction limits, we do not believe that a connection between the bank's parent or affiliate will pose undue risk to the insured bank.

The FDIC requests comment on the appropriateness of the proposed separation standards. In particular, comment is requested concerning the provision requiring that a majority of the board of the subsidiary not be directors or officers of the state chartered depository institution. What impact does this requirement have on finding qualified directors? Should the standard be the same for different types of activities?

In addition to the separation standards, the ''eligible subsidiary'' concept introduces operational standards that were not part of the ''bona fide'' subsidiary definition. These standards provide guidance concerning the organization of the subsidiary that the FDIC believes are important to the independent operation of the subsidiary.

The proposed regulation requires that a subsidiary engaged in insurance, real estate or securities have only one business purpose among those categories. Because the FDIC is limiting a bank's transactions with subsidiaries engaged in insurance, real estate, or securities activities that are not permissible for a subsidiary of a national bank, and the aggregate limitations only extend to subsidiaries engaged in the same type of business, the FDIC is limiting the scope of the subsidiary's activities. The FDIC is seeking comment on the effect of limiting the subsidiary's activities to one business purpose. Should the term ''one business purpose'' be defined more broadly? For instance, should a subsidiary engaged in real estate investment activities also be allowed to be engaged in real estate brokerage in the same subsidiary?

The proposal requires that the subsidiary have a current written business plan that is appropriate to its type and scope of business. The FDIC believes that an institution that is contemplating involvement with activities that are not permissible for a national bank or a subsidiary of a national bank should have a carefully conceived plan for how it will operate the business. We recognize that certain activities do not require elaborate business plans; however, every activity should be given board consideration to determine the scope of the activity allowed and how profitability is to be attained.

The requirement for adequate management of the subsidiary establishes the FDIC's desire that the insured depository institution consider the importance of management in the success of an operation. The requirement to obtain appropriate licenses and memberships and to comply with industry standards indicates the FDIC's support of securities and insurance industry standards in determining adequacy of subsidiary management.

An important factor in controlling the spread of liabilites from the subsidiary to the insured depository institution is that the subsidiary establishes necessary internal controls, accounting systems, and audit standards. The FDIC does not expect to supplement this requirement with specific guidance since the systems must be tailored to specific activities, some of which are otherwise regulated.

The FDIC seeks comments on the appropriateness of the restrictions contained in the ''eligible subsidiary'' standard. Are there other restrictions that should be considered? Are there standards that are unnecessary to achieve separation between the insured depository institution and the subsidiary?

### Investment and Transaction Limits

The proposal contains investment limits and other requirements that apply to an insured state bank and its subsidiaries that engage as principal in activities that are not permissible for a national bank *if* the requirements are imposed by order or expressly imposed by regulation. The provision is not contained in the current regulation; however, § 337.4 imposes by reference the limitations of section 23A of the Federal Reserve Act (§ 337.4 was adopted prior to the adoption of section 23B of the Federal Reserve Act), and both section 23A and section 23B restrictions have been imposed by the Board on insured state banks seeking the FDIC's consent to engage in activities not permissible for a national bank.

On August 23, 1996, the FDIC issued a proposed revision to part 362. The proposed rule would have imposed sections 23A and 23B on bank investments and transactions with subsidiaries that hold equity investments in real estate not permissible for a national bank. The FDIC received a significant number of negative comments regarding the imposition of sections 23A and 23B on real estate subsidiaries. After a thorough review, the FDIC has determined that several of the major points in this area have merit. Some of the provisions of section 23A and 23B are inapplicable while others duplicate existing legal requirements. The FDIC believes that merely incorporating sections 23A and 23B by reference raises significant interpretative issues, as pointed out by the commenters, and only promotes confusion in an already complex area.

For these reasons, in this proposal the FDIC is proposing a separate subsection which sets forth the specific investment limits and arm's length transaction requirements which the FDIC believes are necessary. In general, the provisions impose investment limits on any one subsidiary and an aggregate investment on all subsidiaries that engage in the same activity, requires that extensions of credit from a bank to its subsidiaries be fully-collateralized when made, prohibits the bank from taking a low quality asset as collateral on such loans, and requires that transactions between the bank and its subsidiaries be on an arm's length basis.

The proposal expands the definition of bank for the purposes of the investment and transaction limitations. A bank includes not only the insured entity but also any subsidiary that is engaged in activities that are not subject to these investment and transaction limits.

Sections 23A and 23B of the Federal Reserve Act combine the bank and all of its subsidiaries in imposing investment limitations on all affiliates. The FDIC is using the same concept in separating subsidiaries conducting activities that are subject to investment and transaction limits from the bank and any other subsidiary that engages in activities not subject to the investment and transaction limits.

This rule will prohibit a bank from funding a subsidiary subject to the investment and transaction limits through a subsidiary that is not subject to the limits. The FDIC invites comment on the appropriateness of this restriction on subsidiary to subsidiary transactions.

### Investment Limit

Under the proposal, a bank may be restricted in its investments in certain of its subsidiaries. Those limits are basically the same as would apply between a bank and its affiliates under section 23A. As is the case with covered transactions under section 23A, extensions of credit and other transactions that benefit the bank's subsidiary would be considered part of the bank's investment. The only exception would be for arm's length extensions of credit made by the bank to finance sales of assets by the subsidiary to third parties. These transactions would not need to comply with the collateral requirements and investment limitations of section 23A, provided that they met certain arm's length standards. The imposition of section 23A-type restrictions is intended to make sure that adequate safeguards are in place for the dealings between the bank and its subsidiary.

When the August proposal was published for comment, the FDIC invited comment on whether all provisions of sections 23A should be imposed or whether just certain restrictions are necessary. For instance, should the regulation simply provide that the bank's investment in the subsidiary is limited to 10 percent of capital and that there is an aggregate investment limit of 20 percent for all subsidiaries rather than, in effect, subjecting transactions between the bank and its subsidiary to all of the restrictions of section 23A. Eight of the seventeen commenters addressed this issue. Two commenters supported the incorporation of all the limits and restrictions in sections 23A stating that it encourages uniformity in approach for structuring transactions between the bank and its subsidiary. The remaining commenters generally considered the imposition of section 23A requirements to be unduly restrictive. One comment challenged that the wholesale incorporation of section 23A limitations is inappropriate since Congress has already determined that transactions with subsidiaries present little risk to banks. In fact, in the words of the commenter, if the subsidiary is wholly-owned, the bank is really dealing with itself.

In contrast to the bank-affiliate relationship being governed by the statutory limits of sections 23A and 23B, inherent in the idea of a subsidiary is the subsidiary's value to the bank as an asset. That value increases as the subsidiary earns profits and decreases as the subsidiary loses money. The increases are reflected in the subsidiary's retained earnings and the consolidated retained earnings of the bank as a whole. The FDIC wants to dissociate the bank's equity investment in the subsidiary from any lending to or covered transactions with the subsidiary. Thus, the FDIC proposes to treat the bank's equity investment as a deduction from capital, while treating any lending to or covered transactions with the subsidiary as transactions subject to 10% and 20% limits that are similar to those that govern the bank-affiliate relationship. Then, the question arises as to how to properly treat retained earnings at the subsidiary level. If retained earnings at the subsidiary level were treated as subject to the 10% and 20% limits, the bank could be forced to take the retained earnings out of the subsidiary to stay under the applicable limits. If retained earnings are allowed to accumulate without limit, then the bank could declare dividends to its shareholders based on the retained earnings at the subsidiary. Later, in the event that the subsidiary incurred losses, the bank's capital could become inadequate based on the subsidiary's losses. Thus, the FDIC requires that retained earnings be deducted from capital in the same way as the equity investment is deducted.

The definition of ''investment'' under this provision has four components. The first component is any extension of credit by the bank to the subsidiary. The term ''extension of credit'' is defined in part 362 to have the same meaning as that under section 22(h) of the Federal Reserve Act and would therefore apply not only to loans but also to commitments of credit. The second component is ''any debt securities of the subsidiary'' held by the bank. This component recognizes that debt securities are very similar to extensions of credit. The third component is the acceptance of securities issued by the subsidiary as collateral for extensions of credit to any person or company. The fourth and final component addresses any extensions or commitments of credit to a third party for investment in the subsidiary, investment in a project in which the subsidiary has an interest, or extensions of credit or commitments of credit which are used for the benefit of, or transferred to, the subsidiary.

Two of the components of the definition of ''investment'' are borrowed from and consistent with sections 23A and 23B. It is the FDIC's intent to include the types of investments or extensions of credit which would normally be subject to the 23A and 23B investment limits. We note in particular that the fourth component of the definition of ''investment'' includes language similar to the ''attribution rule.'' Indirect investments and extensions of credit by a bank to its subsidiaries will be included in the calculation of the 10%/20% investment limits.

In addition to the differences in coverage created by the proposed definition of investment versus the section 23A covered transactions, the percentage restrictions are calculated differently from section 23A. The proposal calulates the 10%/20% limits based on tier one capital while section 23A uses total capital. As was discussed earler, the FDIC is using tier one capital as its measure to create consistency throughout the regulation.

Also, the proposal limits the aggregate investment to all subsidiaries conducting the same activity. There is not a ''same activity'' standard in section 23A. The FDIC believes that the aggregate limitations should reflect a restriction on concentrations in a particular activity and not a general limitation on activities that are not permissible for a national bank. For the purposes of this paragraph, the FDIC intends to interpret the ''same activity'' standard to mean broad categories of activities such as real estate investment activities or securities underwriting. The FDIC specifically requests comments on this provision of the proposal. The FDIC has consistently maintained that it applies section 23A and 23B-like standards. It believes that its proposal continues to do so, but would like comment on the effect of the proposed change.

## Arm's Length Transaction Requirement

A major provision of 23B of the Federal Reserve Act is that any transaction between a bank and its affiliates must be on terms and conditions that are substantially the same as those prevailing at the time for comparable transactions with unaffiliated parties. This type of requirement, which is generally referred to as an ''arm's length transaction'' requirement, is intended to make sure that an affiliate does not take advantage of the bank. The proposal requires transactions between the bank and its real estate subsidiaries to meet this requirement. The arm's length transaction requirement found in the proposal is modeled on the statutory provisions of section 23B. The types of transactions covered by the requirement include: (1) Investments in the subsidiary, (2) the purchase from or sale to the subsidiary of any assets, including securities, (3) entering into any contract, lease or other agreement with the subsidiary, and (4) paying compensation to the subsidiary or any person who has an interest in the subsidiary. The proposal indicates, however, that the restrictions do not apply to an insured state bank giving immediate credit to a subsidiary for uncollected items received in the ordinary course of business.

The arm's length transaction requirement is meant to protect the bank from abusive practices. To the extent that the subsidiary offers the parent bank a transaction which is at or better than market terms and conditions, the bank may accept such transaction since the bank is receiving a benefit, as opposed to being harmed. It may be the case, however, that a bank will be unable to meet the regulatory standard because there are no known comparable transactions between unaffiliated parties. In these situations, the FDIC will review the transactions and expect the bank to meet the ''good faith'' standard found in section 23B.

When engaging in transactions with a subsidiary, banks and bank counsel should be aware of the FDIC's separate corporate existence concerns. Bank subsidiaries should be organized and operated as separate corporate entities. Subsidiaries should be adequately capitalized for the business they are engaged in and separate corporate formalities should be observed. Frequent transactions between the bank and its subsidiary which are not on an arm's length basis may lead to questions as to whether the subsidiary is actually a separate corporate entity or merely the alter ego of the bank. One of the primary reasons for the FDIC requiring that certain activities be conducted through an eligible subsidiary is to provide the bank, and the deposit insurance funds, with liability protection. To the extent a bank ignores the separate corporate existence of the subsidiary, this liability protection is jeopardized.

This section and the language therein is not a substantive change from the proposal. The FDIC is merely setting forth the substantive requirements of sections 23A and 23B which were proposed to be incorporated by reference. We believe setting forth the exact requirements will reduce regulatory burden and confusion as banks and bank counsel will more readily know what requirements are to be followed.

Banks will be prohibited from buying low quality assets from their subsidiaries. The FDIC has taken the definition of ''low quality asset'' from section 23A without modification.

The proposal deviates from the section 23B standards in that it contains provisions addressing insider transactions and product tying. The proposal's arm's length standard addresses transactions between an insured depository institution and its subsidiaries. The FDIC is adding a provision that an arm's length standard for transactions between the subsidiary and insiders of the insured depository institution. The proposal requires that any transactions with insiders must meet the section 23B requirements that transactions be on substantially the same terms and conditions as available generally to unaffiliated parties.

Rather than requiring an application and approval by the FDIC for transactions with insiders as we had proposed last August, the FDIC has decided to set forth the legal standard to be applied to such transactions and let banks and their legal advisors determine whether the transactions meet the arm's length requirement. Banks engaging in such transactions should retain proper documentation showing that the transactions meet the arm's length requirement. The FDIC will review transactions with insiders in the normal course of the examination process and take such actions as may be necessary and appropriate if problems arise. Questionable transactions will have to be justified under the 23B standard.

The proposal also contains a requirement that neither the insured state bank nor the majority-owned subsidiary may require a customer to either buy a product or use a service from the other as a condition of entering into a transaction. While the condition may duplicate existing standards for banks, it is not clear that all circumstances are adequately covered by the existing statutory and regulatory restrictions. The FDIC wishes to confirm that we consider tying to be unacceptable when there are no alternative financial services available. However, we recognize that a complete prohibition may be too rigid.

Banks are subject to statutory anti-tying restrictions. (12 U.S.C. 1972). In 1970 when these restrictions were enacted, Congress was concerned that the unique role banks played in the economy, particularly in providing financial services, would allow them to gain a competitive advantage in other markets. The FRB extended the anti-tying restrictions to bank holding companies and their non-banking subsidiaries by regulation in 1971. The FRB's experience since extending the anti-tying provisions has shown that non-banking companies generally operate in competitive markets. As a result, the FRB eliminated the extension of the anti-tying rules to bank holding companies and their non-bank subsidiaries this year (12 CFR 225), leaving restriction of any anti-competitive behavior to the general antitrust laws which govern the competitors of the bank holding companies and their non-bank subsidiaries. The extension of the tying restrictions to savings and loan holding companies is statutory. Consequently, the Office of Thrift Supervision is not authorized to except savings and loan holding companies and their non-bank affiliates entirely from all tying restrictions. 62 FR 15819. The Office of the Comptroller of the Currency extends anti-tying provisions to subsidiaries. See OCC Bulletin 95–20.

Based on the competitive marketplace in which nonbanking subsidiaries operate and the applicability of general antitrust laws, the FDIC is seeking comment as to whether the anti-tying language contained in the proposed regulation is appropriate. If the proposed rule is thought to be unnecessary, should we consider adopting a rule that would be applicable only in situations where there are no options for financial services?

The proposal does not contain the advertising restrictions contained in section 23B which prohibit a bank from publishing advertisements which suggest, state or infer that the bank is or shall be responsible for the obligations of an affiliate. Instead, the proposal incorporates the advertising prohibition from 23B as part of the definition of the eligible subsidiary. An eligible subsidiary is required to have policies and procedures which are designed to inform customers and potential customers that the subsidiary is a separate organization from the bank and to inform customers that the bank is not responsible for, nor guarantees, the obligations of the subsidiary.

### Collateralization Requirements

Section 23A requires that loans, extensions of credit, guarantees or letters of credit issued by the bank to or on behalf of an affiliate be fully-collateralized at the time the bank makes the loan or extension of credit. This requirement is intended to protect the bank in the event of a loan default. ''Fully collateralized'' under the proposal means extensions of credit secured by collateral with a market value at the time the extension of credit is entered into of at least 100 percent of the extension of credit amount for government securities or a segregated deposit in a bank; 110 percent of the extension of credit amount for municipal securities; 120 percent of the extension of credit amount for other debt securities; and 130 percent of the extension of credit amount for other securities, leases or other real or personal property. The FDIC intends to look to the collateralization schedule as minimum guidance, but wants to retain flexibility in making the determination if additional collateral is necessary. Therefore, this proposal differs from the section 23A requirements in that the proposal uses the collateral schedule as a minumum requirement.

The FDIC is seeking comment as to whether the proposal gives the industry enough certainty to make decisions concerning collateral adequacy? Are the collateral requirements appropriate or should some other measure of collateral adequacy be used?

### Capital Requirements

Under the proposed rule, a bank using the notice process to invest in a subsidiary engaging in certain activities not permissible for a national bank would be required to deduct its equity investment in the subsidiary as well as its pro rata share of retained earnings of the subsidiary when reporting its capital position on the bank's consolidated report of income and condition, in assessment risk classification and for prompt corrective action purposes (except for the purposes of determining if an institution is critically undercapitalized). This capital deduction may be required as a condition of an Order issued by the FDIC, is required to use the notice procedure to request consent for real estate investment activities and securities underwriting and distribution, and is required to engage in grandfathered insurance underwriting. The purpose of the restriciton is to ensure that the bank has sufficient capital devoted to its banking operations and to ensure that the bank would not be adversely impacted even if its entire investment in the subsidiary is lost.

This treatment of the bank's investment in subsidiaries engaged in activities not permissible for a national bank creates a regulatory capital standard. After issuing its proposal last August, the FDIC received comment that this capital treatment is inconsistent with generally accepted accounting principles. Although section 37 of the FDI Act generally requires that accounting principles applicable to depository institutions for regulatory reporting purposes must be consistent with, or not less stringent than, GAAP, the FDIC believes that the requirements of section 37 do not extend to the Federal banking agencies' definitions of regulatory capital. It is well established that the calculation of regulatory capital for supervisory purposes may differ from the measurement of equity capital for financial reporting purposes. For example, statutory restrictions against the recognition of goodwill for regulatory capital purposes may lead to differences between the reported amount of equity capital and the regulatory capital calculation for tier one capital. Other types of intangible assets are also subject to limitations under the agencies' regulatory capital rules. In addition, subordinated debt and the allowance for loan and lease losses are examples of items where the regulatory reporting and the regulatory capital treatments differ.

We note that the capital deduction as contained in the proposal is not a new concept for the federal banking regulators. The FDIC has required capital deduction for investments by state nonmember banks in securities underwriting subsidiaries for years. See 12 CFR 325.5(c). The FRB has required bank holding companies to deduct from capital their investment in section 20 subsidiaries, although the FRB eliminated that requirement on August 21, 1997, by adopting new operating standards. In addition, the Comptroller of the Currency recently endorsed the idea of deducting from capital a national bank's investments in certain types of operating subsidiaries. See 12 CFR 5.34(f)(3)(i), 61 FR 60342, 60377 (Nov. 27, 1996).

The calculation of the amount deducted from capital in this proposal includes the bank's equity investment in the subsidiary as well as the bank's share of retained earnings. The calculation does not require the deduction of any loans from the bank to the subsidiary or the bank's investment in the debt securities of the subsidiary. The FDIC requests comment on this method of calculating the capital deduction. Should there be a differentiation in the treatment of the bank's equity investment in the subsidiary and loans made to or debt purchased from the subsidiary?

### Notice of Grandfathered Insurance Underwriting Activities

Section 362.5 of the current regulation provides that insured state banks that are permitted to engage in insurance underwriting under the grandfather found in section 24(d)(2)(B) of section 24 of the FDI Act must file a notice with the FDIC by February 9, 1992. That notice requirement is deleted under the proposal as no longer necessary given the passage of time.

### Other Underwriting Activities

The proposed regulatory text does not directly address the underwriting of annuities. The FDIC has opined that annuities are not an insurance product and are not subject to the insurance underwriting prohibitions of section 24. The FDIC has approved one request from an insured state bank to engage in annuity underwriting activities through a majority-owned subsidiary. The proposed regulation does not provide a notice procedure to engage in such activities. Comment is requested as to whether such a notice procedure would be beneficial. What types of restrictions should the Board consider if it determines that annuities underwriting may be conducted after submission of a notice?

### Section 362.5 Approvals Previously Granted

As is discussed above, there are a number of areas in which this proposal differs in approach from the current part 362. Because of these differing approaches, the proposal contains a section dealing with approvals previously granted. The FDIC proposes that insured state banks that have previously received consent by order or notice from this agency should not be required to reapply to continue the activity, including real estate investment activities, provided the bank and subsidiary, as applicable, continue to comply with the conditions of the order of approval. It is not the intent of the FDIC to require insured state banks to request consent to engage in an activity which has already been approved previously by this agency.

Because previously granted approvals may contain conditions that are different from the standards that are established in this proposal, in certain circumstances, the bank may elect to operate under the restrictions of this proposal. Specifically, the bank may comply with the investment and transaction limitations between the bank and its subsidiaries contained in § 362.4(d), the capital requirement limitations detailed in § 362.4(e), and the subsidiary restrictions as outlined in the term ''eligible subsidiary'' and contained in § 362.4(c)(2) in lieu of similar requirements in its approval order. Any conditions that are specific to a bank's situation and do not fall within the above limitations will continue to be effective. The FDIC intends that once a bank elects to follow these proposed restrictions instead of those in the approval order, it may not elect to revert to the applicable conditions of the order.

An insured state bank that qualifies for the exception in proposed § 362.4(b)(4)(i) relating to real estate investment activities that do not exceed 2 percent of the bank's tier one capital may take advantage of the exceptions contained in that section. A bank which uses this exception must limit its real estate investment activities to one subsidiary and may engage in additional real estate investment activities without fully complying with the application or notice requirements contained in the proposal. The FDIC requests comment on the appropriateness of allowing banks which have previously received approval from the FDIC to operate under the guidelines of this proposal. Should banks which have been previously approved be allowed to use the 2% of capital exception?

The FDIC has also approved certain activities through its current regulations. Specifically, the FDIC has incorporated and modified the restrictions of § 337.4 in this proposal. The proposed rule will allow an insured state nonmember bank engaging in a securities activity in accordance with § 337.4 to continue those activities if the bank and its subsidiary meet the restrictions of § 362.4 (b)(5)(ii), (c), (d), and (e). The FDIC intends that these requirements replace the restrictions contained in § 337.4.

The FDIC recognizes that the requirements of this proposal differ from the requirements of § 337.4. Because the transition from the current § 337.4 requirements to the new regulatory requirements may have unforeseen implementation problems, the bank and its subsidiary will have one year from the effective date to comply with new restrictions and conditions without further application or notice to the FDIC. If the bank and its subsidiary are unable to comply within the one-year time period, the bank must apply in accordance with § 362.4(b)(1) and subpart E of the proposed regulation to continue with the securities underwriting activity. Comment is requested concerning the reasonableness of this transition requirement.

The proposed restrictions for engaging in grandfathered insurance underwriting through a subsidiary have also been changed. The current regulation prescribes disclosures, requires that the subsidiary be a bona fide subsidiary, and requires that the bank be adequately capitalized after deducting the bank's investment in the grandfathered insurance subsidiary. The proposal requires that disclosures are consistent with, but not the same as, those in the current regulation, that the subsidiary meet the requirements of an eligible subsidiary, and that the bank be well-capitalized after deducting its investment in the grandfathered insurance subsidiary. The FDIC recognizes that these requirements are not the same as previous standards, and the capital requirement in particular is more stringent. An insured state bank which is engaged in providing insurance as principal may continue that activity if it complies with the proposed provisions within 90 days of the effective date of the regulation.

Similarly, banks which have subsidiaries that have been operating under the bank stock and grandfathered equity securities exemption of the current regulation are subject to additional requirements in the proposal. In particular, insured state banks continuing with these exemptions must now deduct their investment in the subsidiary from capital. An insured state nonmember bank that is engaging in securities underwriting activities under notice filed pursuant to § 337.4 may continue those activities if the bank and its majority-owned subsidiary comply with the proposed restrictions within one year of the effective date of the regulation.

The FDIC also proposes that an insured state bank that converts from a savings association charter and which engages in activities through a subsidiary, even if such activity was permissible for a subsidiary of a federal savings association, shall make application or provide notice, whichever applies, to the FDIC to continue the activity unless the activity and manner and amount in which the activity is operated is one that the FDIC has determined by regulation does not pose a significant risk to the deposit insurance fund. Since the statutory and regulatory systems developed for savings associations are different from the bank systems, the FDIC believes that any institution that converts its charter should be subject to the same regulatory requirements as other institutions with a like charter.

If, prior to conversion, the savings association had received approval from the FDIC to continue through a subsidiary the activity of a type or in an amount that was not permissible for a federal savings association, the converted insured state bank need not reapply for consent provided the bank and subsidiary continue to comply with the terms of the approval order, meet all the conditions and restrictions for being an eligible subsidiary contained in § 362.4(c)(2), comply with the investment and transactions limits of § 362.4(d), and meet the capital requirement of § 362.4(e). If the converted bank or its subsidiary, as applicable, does not comply with all these requirements, the bank must obtain the FDIC's consent to continue the activity. The FDIC has imposed these conditions to fill a regulatory gap that would otherwise be present. Savings associations and their service corporations are subject to regulatory standards of separation, the savings association is limited in the amount it may invest in the service corporation, and the savings association must deduct its investment in the service corporation from its capital if the service corporation engages in activities that are not permissible for a national bank. The eligible subsidiary standard, the investment and transaction limits, and the capital requirements replace these standards once the savings association has converted its charter to a bank.

If the bank does not receive the FDIC's consent for its subsidiary to continue an activity, the bank must divest its nonconforming investment in the subsidiary within two years of the date of conversion either by divesting itself of its subsidiary or by the subsidiary divesting itself of the impermissible activity.

### *B. Subpart B—Safety and Soundness Rules Governing State Nonmember Banks*

#### Section 362.6 Purpose and Scope

This subpart, along with the notice and application provisions of subpart E of this chapter, applies to certain banking practices that may have adverse effects on the safety and soundness of insured state nonmember banks. The FDIC intends to allow insured state nonmember banks and their subsidiaries to undertake only safe and sound activities and investments that would not present a significant risk to the deposit insurance fund and that are consistent with the purposes of federal deposit insurance and other law. The safety and soundness standards of this subpart apply to activities undertaken by insured state nonmember banks when conducting real estate investment activities through a subsidiary if those activities that are permissible for a national bank subsidiary. Neither a national bank nor a state bank would not be permitted to engage in these real estate investment activities directly. The FDIC has a long history of considering the risks from real estate investment activities to be unsafe and unsound for a bank to undertake without appropriate safeguards to address that risk.

Additionally, this subpart sets forth the standards that apply when affiliated organizations of insured state nonmember banks that are not affiliated with a bank holding company conduct securities activities. The collective business enterprises of these entities are commonly described as nonbank bank holding company affiliates. The FDIC has a long history of considering the risks from the conduct of securities activities by affiliates of insured state nonmember banks to be unsafe and unsound without appropriate safeguards to address those risks. This rule incorporates many of the standards currently applicable to these entities through § 337.4 of the FDIC's regulations. The scope of this regulation is narrower than § 337.4 due to intervening regulations by other appropriate Federal banking agencies that render more comprehensive rules superfluous. In addition, the FDIC has updated the restrictions and brought them into line with modern views of appropriate securities safeguards between affiliates and insured banks.

Section 362.7 Restrictions on Activities of Insured State Nonmember Banks

Real Estate

Since national banks are generally prohibited from owning and developing real estate, insured state banks have been required to apply to the FDIC before undertaking or continuing such real estate activities. The FDIC has reviewed 95 applications under part 362 since December 1992 in which insured state banks have requested permission to undertake some type of real estate investment activity. The FDIC has concluded as a result of its experience in reviewing these applications that while real estate investments generally possess many risks that are not readily comparable to other equity investments, institutions may contain these risks by undertaking real estate investments within certain parameters. The FDIC has considered the manner under which an insured state nonmember bank may undertake real estate investment activities and determined that insured state nonmember banks and their subsidiaries should generally meet certain standards before engaging in real estate investment activities that are not permissible for national banks. As a result, the FDIC is proposing to establish standards under which insured state nonmember banks may participate in real estate investment activities. Providing notice of such standards will allow insured state nonmember banks to initiate investment activities with knowledge of what the FDIC considers when evaluating the safety and soundness of the operations of the institution and its subsidiaries. The FDIC believes its proposal simplifies and clarifies the standards under which insured state nonmember banks may conduct their investment activities while providing comprehensive and flexible regulation of the dealings between a bank and its subsidiaries.

This proposal is consistent with the views expressed by the FDIC's then Chairman Ricki Helfer in her letter of May 30, 1997, to Eugene Ludwig, Comptroller of the Currency, in regard to the NationsBank operating subsidiary notices. In that letter, the FDIC's Chairman stated her view ''that real estate development activities present risks to the deposit insurance funds and therefore should be permitted for bank subsidiaries only where there is a clear legal separation from the insured bank, stringent firewalls and limited exposure of the capital of the consolidated organization.''

Under the FDIC's proposal, if an institution and its real estate investment operations meet the standards established, the institution need only file notice with the FDIC as outlined in subpart E. However, if the institution and its operations do not meet the general standards set forth in this rule, or if the institution so chooses, it may file application with the FDIC under § 362.4(b)(1) and subpart E. We request comment on the overall goal of the proposed regulation, particularly in light of the application filed with the Office of the Comptroller of the Currency by NationsBank, National Association, Charlotte, North Carolina to engage in limited real estate development activities and the proposal of the Board of Governors of the Federal Reserve System to apply sections 23A and 23B of the Federal Reserve Act to transactions between an insured depository institution and its subsidiary.

The following discussion summarizes some of the developments that have taken place in the area of real estate investment that the FDIC considered in establishing the general standards under which an insured state nonmember bank may undertake real estate investment activities. We request comment on all facets of this proposal.

The cyclical downturn in the real estate market in the late 1980s and early 1990s, and the impact of that downturn on financial institutions, provides an illustration of the market risk presented by real estate investment activities. In addition to the high degree of variability, real estate markets are, for the most part, localized; investments are normally not securitized; financial information flow is often poor; and the market is generally not very liquid.

A financial institution—like any other investor—faces substantial risks when it takes an equity position in a real estate venture. The function of an equity investor is to bear the economic risks of the venture. Economic risk is traditionally defined as the variability of returns on an investment. If a single investor undertakes a project alone, all the risk is borne by the investor. An investor typically will have a required rate of return based on the historical track record of a particular company and/or type of investment project. Market participants face a general trade-off: the riskier the project, the higher the required rate of return. A key aspect of that trade-off is the notion that a riskier project will entail a higher probability of significant losses for the investor. Assessments of the degree of risk will depend on factors affecting future returns such as cyclical economic developments, technological advances, structural market changes, and the project's sensitivity to financial market changes.

The actual return on an investment, however, will depend on developments beyond the investor's control. If the actual return is higher than the expected rate, the investor benefits. If the project falls short of expected returns, the investor suffers. At the extreme, an investor may lose all or some of the original investment. Investments in real estate ventures follow this pattern. In fact, equity investments in commercial real estate have long been considered fairly risky because of the uncertainties in the income stream they generate.

It is possible for the investor to deflect some of the risk of the project. When a project is partially financed by debt, the risks are shared with the lender. Nonetheless, the equity investor typically still bears the bulk of the variation in the risk and rewards of an investment. As a rule, the lender is compensated at an agreed amount (or formula in the case of a variable rate loan). The lender is paid—both interest and principal—before the equity investor/borrower receives any rewards or return of investment. Thus, any downside outcome is borne first by the equity investor. In properly underwritten loan arrangements, the lender bears the economic risk of significant losses only in the case of extremely negative outcomes. Since the legal priority of the debt holder is higher in a liquidation or bankruptcy than that of the equity holder, the debt holders are hurt if the investment entity has very limited resources. Of course, the borrower/equity investor receives all of the up-side potential returns from the investment.

While a leveraged investor has less of his/her own funds at stake, the use of borrowed funds to finance an investment greatly magnifies the variability of the returns to the equity investor. That is to say, leverage increases the risks involved. For instance, a small decline in income in an unleveraged investment may only mean less positive returns; to the leveraged investor, it may mean out of pocket losses, as debt service may have already absorbed any income generated by the project. Conversely, a small increase in generated income may just moderately increase the rate of return on an all equity investment but have a major positive effect on the highly leveraged investor.

The fact that most commercial real estate investments are highly leveraged also affects overall market volatility. For instance, high interest rates will lower the expected rate of return for highly leveraged investments which will, in turn, lower effective demand. Thus, prices offered for commercial real estate during periods of high interest rates typically are lowered. For example, to the extent that there was a ''credit crunch'' for commercial real estate in the early 1990s and lenders were unwilling to extend credit, diminished effective demand for a property could have resulted in the elimination of a broad class of potential investors, rather than simply a lower price being bid.

The economic viability of any investment in real estate ultimately depends on the economic demand for the services it provides. Thus, fluctuations in the economy in general are translated into uncertainties in the underlying economics of most real estate investments. National economic trends, regional developments, and even local economic developments will affect the volatility of returns. A traditional problem for real estate investors in that regard is that when the economy as a whole reaches capacity during an economic expansion, they are one of the sectors seriously affected by the resulting run-up in interest rates.

Much of the uncertainty associated with real estate investment, however, comes from the nature of the production itself—how new supply is brought to market. Investments in the construction of real estate typically have a long gestation period; this long planning period is especially characteristic of large commercial development projects. Given the cyclical nature of the economy and financial markets, the economic prospects for an investment may change radically during that period, altering timing and terms of transactions.

Moreover, real estate investors also typically have trouble getting full information on current market conditions. Unlike highly organized markets where participants may easily obtain data on market developments such as price and supply considerations, information in the commercial real estate market is often difficult, or impossible, to obtain. Also inherent in the investment process for commercial real estate is the fact that the market is relatively illiquid—particularly for very large projects. Thus, instead of having numerous frequent transactions that incorporate the latest market information and ensure that prices reflect true economic value, markets may be thin and the timing of a sale or rental contract may affect the value of the underlying investments.

In addition to the inherent illiquidity of commercial real estate markets, transactions often are ''private deals'' in which the major parameters of the investment are not available to the public in general and, in particular, to rival developers. For instance, the costs of construction are a private transaction between the developer and his contractor. Likewise, evaluating selling prices or rental income is difficult since: (1) There are no statistical data on transaction prices available as there are for single-family structures and (2) even if there were data available, it is impossible to account for the many creative financing techniques involved in commercial sales and in rental agreements (e.g., tenant improvements and rent discounting).

Because of imperfect market information and the length of the production process, prices of existing structures are often artificially bid up in market upswings. That is, short-term shortages fuel speculative price increases. Speculative price increases (whether it be for raw land, developed construction sites, or completed buildings) typically encourage even more construction to take place, leading to additional future overbuilding relative to underlying demand.

In addition to the inherent cyclicality of real estate markets, several underlying factors create additional uncertainties in the investment process. Changes in tax laws will affect the profitability of real estate investments. For example, tax changes were a major consideration in the 1980s, but changes in depreciation allowances and in tax rates have been commonplace in the post-World War II era.

Another uncertainty is the effect of other governmental actions, especially in the area of regulations. A prime example is Federal mandates requiring clean-up of existing environmental hazards that imposed unexpected costs on investors at the time they were passed. Similar uncertainties result from state and local laws that effect real estate and how it may be developed. For instance, changes in environmental restrictions of new construction may add unexpected costs to a project or even bar its intended use. Similarly, a zoning change may positively or negatively affect investment prospects unexpectedly. All of these factors add to the uncertainty of returns and thereby increase the risk of the investment.

Two other considerations often play into increasing risks in real estate investment. First, the efficient execution of a real estate investment usually requires a ''hands on'' approach by an experienced manager. This level of involvement is especially true of a construction project where developers have to deal with a wide variety of problems ranging from governmental approvals to sub-contractors and changing commodity markets. For an investment in developed real estate, maintenance problems, replacing lost tenants, and adjusting rents to retain tenants all must be addressed in an environment of ever changing market conditions.

Many equity investors solve these problems by ''hiring'' someone else to manage the investment. The experience of the 1980s shows that there are specific risks involved in separating ownership from management. For instance, many tax-oriented investors in the early 1980s arguably knew little about the basic economics of the investments they were undertaking. In a perfect world, ''passive'' investment would work just as efficiently as direct, active investment. In reality, investment outcomes are likely to be more uncertain for equity investors when someone else is making decisions that affect the ultimate return. The experience and expertise of management is a critical factor, and there is much anecdotal evidence to suggest that the lack of adequate management creates a significant level of risk of loss.

The FDIC recognizes its ongoing responsibility to ensure the safe and sound operation of insured state nonmember banks and their subsidiaries. Thus, the Board of Directors of the FDIC has determined that there may be a need to restrict or prohibit certain real estate investment activities of subsidiaries of insured state nonmember banks. Therefore, the FDIC will not automatically follow the safety and soundness restrictions of an interpretation, order, circular or official bulletin issued by the OCC regarding real estate investment activities that are permissible for the subsidiary of a national bank when these activities are not permissible for a national bank.

Section 362.7(a) of the proposal is intended to address the FDIC's ongoing supervisory concerns regarding real estate investment activities and to impose adequate limitations to address the FDIC's concerns about the safety and soundness of these activities. Depending upon the facts, the potential risks inherent in a bank subsidiary's involvement in real estate investment activities may make these restrictions and limitations necessary to protect the bank and ultimately the deposit insurance funds from losses associated with the significant risks inherent in real estate investment activities.

To address its safety and soundness concerns about real estate investment activities not permissible for a national bank, the FDIC has adopted the same standards when insured state banks conduct those real estate investment activities regardless of whether those real estate investment activities are permissible for a national bank subsidiary. This subpart is intended to address the impact on insured state nonmember banks if the OCC were to approve recent applications submitted by national banks to conduct real estate investment activities through operating subsidiaries. The FDIC invites comment on its approach to its safety and soundness concerns about real estate investment activities.

Unless the FDIC has previously approved the real estate investment activity that is not permissible for a national bank, an insured state nonmember bank must file a notice or application with the FDIC in order to directly or indirectly undertake a real estate investment activity, even if the real estate investment activity is permissible for the subsidiary of a national bank. To qualify for the notice provision proposed under this new regulation, the insured state nonmember bank and its subsidiary must meet the standards established in § 362.4(b)(5)(i). After filing a notice as provided for in subpart E to which the FDIC does not object, the institution may then proceed with its investment activities. If the insured state nonmember bank and its subsidiary do not meet the standards established under the proposed rule, or if the institution so chooses, an application may be filed as described in § 362.4(b)(1) and subpart E.

Affiliation With Securities Companies

Section 362.7(b) reflects the FDIC Board's longstanding view that an unrestricted affiliation with a securities company may have adverse effects on the safety and soundness of insured state nonmembers banks. This section reiterates the § 337.4 prohibition against any affiliation by an insured state nonmember bank with any company that directly engages in the underwriting of stocks, bonds, debentures, notes, or other securities which is not permissible for a national bank unless certain conditions are met. As proposed, the affiliation is only allowed if:

(1) The securities business of the affiliate is physically separate and distinct in its operations from the operations of the bank, provided that this requirement shall not be construed to prohibit the bank and its affiliate from sharing the same facility if the area where the affiliate conducts retail sales activity with the public is physically distinct from the routine deposit taking area of the bank;

(2) Has a chief executive officer of the affiliate who is not an employee of the bank;

(3) A majority of the affiliate's board of directors are not directors, officers, or employees of the bank;

(4) The affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank;

(5) The bank adopts policies and procedures, including appropriate limits on exposure, to govern their participation in financing transactions underwritten by an underwriting affiliate;

(6) The bank does not express an opinion on the value or the advisability of the purchase or sale of securities underwritten or dealt in by an affiliate unless it notifies the customer that the entity underwriting, making a market, distributing or dealing in the securities is an affiliate of the bank;

(7) The bank does not purchase as principal or fiduciary during the existence of any underwriting or selling syndicate any securities underwritten by the affiliate unless the purchase is approved by the bank's board of directors before the securities are initially offered for sale to the public;

(8) The bank does not condition any extension of credit to any company on the requirement that the company contract with, or agree to contract with, the bank's affiliate to underwrite or distribute the company's securities;

(9) The bank does not condition any extension of credit or the offering of any service to any person or company on the requirement that the person or company purchase any security underwritten or distributed by the affiliate; and

(10) The bank complies with the investment and transaction limitations of § 362.4(d).

Many of the restrictions and prohibitions listed above are currently contained in § 337. 4. Additionally, the conditions that will be imposed on subsidiaries which engage in the public sale, distribution, or underwriting securities such as adopting independent policies and procedures governing participation in financing transactions underwritten by an affiliate, expressing opinions on the advisability of the purchase or sale of particular securities, and purchasing securities as principal or fiduciary only with prior board approval have been added. As indicated earlier, the prohibition against shared officers has been eased and now only refers to the chief executive officer. Comments on the appropriateness of the restrictions and prohibitions are solicited. As written, the proposal only applies these restrictions to an insured state nonmember bank affiliated with a company not treated as a bank holding company pursuant to section 4(f) of the Bank Holding Company Act (12 U.S.C. 1843(f)), that directly engages in the underwriting of stocks, bonds, debentures, notes, or other securities which are not permissible for a national bank. Other affiliates now covered by the safeguards of § 337.4 would no longer be covered under the FDIC's regulations. We believe that these other affiliates are adequately separated from the banks by the restrictions imposed by the FRB. We invite comment on whether we should include more entities in the coverage of these restrictions and whether these restrictions appropriately address the risks being undertaken by the affiliate and through the affiliate relationship.

*C. Subpart C—Activities of Insured State Savings Associations*

Section 362.8 Purpose and Scope

This subpart, together with the notice and application procedures of subpart F, implements the provisions of section 28 of the FDI Act (12 U.S.C. 1831e) that restrict and prohibit insured state savings associations and their service corporations from engaging in activities and investments of a type that are not permissible for federal savings associations and their service corporations. The phrase ''activity permissible for a federal savings association'' means any activity authorized for federal savings associations under any statute including the Home Owners Loan Act (HOLA) (12 U.S.C. 1464 *et seq.*), as well as activities recognized as permissible for a federal savings association in regulations, official thrift bulletins, orders or written interpretations issued by the Office of Thrift Supervision (OTS), or its predecessor, the Federal Home Loan

Bank Board. Regarding insured state savings associations, this subpart governs only activities conducted ''as principal'' and therefore does not govern activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee. This subpart does not restrict any interest in real estate in which the real property is (a) used or intended in good faith to be used within a reasonable time by an insured savings association or its service corporations as offices or related facilities for the conduct of its business or future expansion of its business or (b) used as public welfare investments of a type and in an amount permissible for federal savings associations. Equity investments acquired in connection with debts previously contracted that are held within the shorter of the time limits prescribed by state or federal law are not subject to the limitations of this subpart.

The FDIC intends to allow insured state savings associations and their service corporations to undertake only safe and sound activities and investments that do not present a significant risk to the deposit insurance funds and that are consistent with the purposes of federal deposit insurance and other applicable law. This subpart does not authorize any insured state savings association to make investments or conduct activities that are not authorized or that are prohibited by either federal or state law.

Section 362.9 Definitions

Section 362.9 of the proposal contains definitions used in this subpart. Rather than repeating terms defined in subpart A, the definitions contained in § 362.2 are incorporated into subpart C by reference. Included in the proposed definitions are most of the terms currently defined in § 303.13(a) of the FDIC's regulations. Editing changes are primarily intended enhance clarity without changing the meaning. However, certain deliberate changes are intended to alter the meaning of these terms and are identified in this discussion.

The terms ''Corporate debt securities not of investment grade'' and ''Qualified affiliate'' have been directly imported into subpart C from § 303.13(a) without substantive change. Substantially the same ''Control'' and ''Equity security'' definitions are incorporated by reference to subpart A. The last sentence of the current ''Equity security'' definition, which excludes equity securities acquired through foreclosure or settlement in lieu of foreclosure, would be deleted for the same reason that similar language has been deleted from several definitions in subpart A. Similar language is now included in the purpose and scope paragraph explaining that equity investments acquired through such actions are not subject to the regulation. No substantive change was intended by this modification.

Modified versions of ''Activity,'' ''Equity investment,'' ''Significant risk to the fund,'' and ''Subsidiary'' are also carried forward by reference to subpart A. The definition of activity has been broadened to encompass all activities including acquiring or retaining equity investments. Sections of this part governing activities *other than* acquiring or retaining equity investments include statements specifically excluding the activity of acquiring or retaining equity investments. This change was made to conform the ''Activity'' definition used in the regulation to that provided in the governing statutes. Both sections 24 and 28 of the FDI Act define activity to include acquiring or retaining any investment. We invite comment on whether this change enhances clarity or whether the longer definition found in the current regulation should be reinstated.

The ''Equity investment'' definition was also modified to better identify its components. The proposed definition includes any ownership interest in any company. This change was made to clarify that ownership interests in limited liability companies, business trusts, associations, joint ventures and other entities separately defined as a ''company'' are considered equity investments. The definition was likewise expanded to include any membership interest that includes a voting right in any company. Finally, a sentence was added excluding from the definition any of the identified items when taken as security for a loan. The intended effect of these changes is not to broaden the scope of the regulation, but instead to clarify the FDIC's position that such investments are all considered equity investments notwithstanding the form of business organization. We invite comment on whether these changes are helpful in defining equity investments. Comments are also requested on whether additional changes to this definition are needed.

The definition of ''Significant risk'' is effectively retitled ''Significant risk to the fund'' by the reference to subpart A. Additionally, a second sentence has been added to the definition explaining that a significant risk to the fund may be present either when an activity or an equity investment contributes or may contribute to the decline in condition of a particular state-chartered depository institution or when a type of activity or equity investment is found by the FDIC to contribute or potentially contribute to the deterioration of the overall condition of the banking system. This sentence is intended to elaborate on the FDIC Board's position that the absolute size of a projected loss in comparison to the deposit insurance funds is not determinative of the issue. Additionally, it clarifies the FDIC's position that risk to the fund may be present even if a particular activity or investment may not result in the imminent failure of a bank. Additional comments are included in the discussion of the relevant definition in subpart A. We invite comments on whether this language is appropriate or whether is should be further expanded.

With the exception of substituting the separately defined term ''company'' for the list of entities such as corporations, business trusts, associations, and joint ventures currently in the ''Subsidiary'' definition, the ''Subsidiary'' definition would be mostly unchanged. It is noted that limited liability companies are now included in the company definition and, by extension, are included in the subsidiary definition. The only other change is that the exclusion of ''Insured depository institutions'' for purposes of current § 303.13(f) has been moved to the purpose and scope section of proposed subpart D. No substantive changes are intended by these modifications. Comments are requested regarding whether the FDIC has inadvertently changed the intended meaning through these modifications.

While proposed subpart C retains substantially the same ''Service corporation'' definition, the word ''only'' has been deleted from the phrase ''available for purchase only by savings associations.'' This change is intended to make it clear that a service corporation of an insured state savings association may invest in lower-tier service corporations if allowed by this part or FDIC order, and it is consistent with the recently amended part 559 of the Office of Thrift Supervision's regulations (12 CFR 559). The change is not intended to alter the nature of the requirements governing the savings association's equity investment in the first-tier service corporation. Comments are requested regarding whether the FDIC has inadvertently altered the intended meaning through these changes.

As in subpart A, the definition of ''Equity investment in real estate'' is deleted in the proposal. The descriptions of real estate investments permissible for federal savings associations that were excepted from the current definition provided by § 303.13(a)(5) were moved to the purpose and scope paragraph. As a result, readers are now informed that these excepted real estate investments are not subject to the regulation. Additionally, the FDIC believes that the remaining content of the current definition fails to provide any meaningful clarity or understanding. Therefore, the FDIC would instead rely on the ''equity investment'' definition to include relevant real estate investments. A related change was made to the ''equity investment'' definition by deleting the reference to ''equity interest in real estate'' and replacing it with language to include any interest in real estate (excluding real estate that is not within the scope of this part). No substantive changes were intended by these modifications. The FDIC invites comments on whether these changes have clarified the subject definitions. Comments are also requested concerning whether the FDIC has inadvertently changed the meaning of these definitions through these actions.

The only new definition specifically added to subpart C is the term ''Insured state savings association.'' Because this term is not explicitly defined in section 3 of the FDI Act, the proposal has added this term to ensure that readers clearly understand that an insured state savings association means any state chartered savings association insured by the FDIC. Comments are invited on whether this definition eliminates any ambiguity or whether it is actually needed. Additionally, applicable terms that were previously undefined but are added by the general incorporation of the definitions in subpart A should not result in any substantive changes to the meanings of those terms as currently used in § 303.13 of the FDIC's regulations.

### Section 362.10 Activities of Insured State Savings Associations

#### Equity Investment Prohibition

Section 362.10(a)(1) of the proposal replaces the provisions of § 303.13(d) of the FDIC's regulations and restates the statutory prohibition preventing insured state savings associations from making or retaining any equity investment of a type, or in an amount, not permissible for a federal savings association. The prohibition does not apply if the statutory exception (restated in the current regulation and carried forward in the proposal) contained in section 28 of the FDI Act applies. With the exception of deleting items no longer applicable due to the passage of time, this provision is retained as currently in effect without any substantive changes.

#### Exception for Service Corporations

The FDIC proposes to retain the exception now in § 303.13(d)(2) which allows investments in service corporations as currently in effect without any substantive change. However, the FDIC has modified the language of this section using a structure paralleling that found in proposed subpart A permitting insured state banks to invest in majority-owned subsidiaries. Similar to the treatment accorded insured state banks, an insured state savings association must meet and continue to be in compliance with the capital requirements prescribed by the appropriate federal banking agency, and the FDIC must determine that neither the amount of the investment nor the activities to be conducted by the service corporation present a significant risk to the relevant deposit insurance fund. The criteria identified in the preceding sentence is derived directly from the underlying statutory language. In order for the insured state savings association to qualify for this exception, the service corporation must be engaging in activities or acquiring and retaining investments that are described in proposed § 362.11(b) as regulatory exceptions to the general prohibition.

Language currently in § 303.13(d) concerning the filing of applications to acquire an equity investment in a service corporation would be deleted and moved to subpart F of this regulation.

#### Divesting Impermissible Equity Investments

Section 303.13(d)(1) of the FDIC's current regulations requires savings associations to file divestiture plans with the FDIC concerning any equity investments held as of August 9, 1989, that were no longer permissible. Because divestiture was required by statute to occur no later than July 1, 1994, the proposal omits this provision as it is no longer necessary due to the passage of time.

#### Other Activities

Section 362.10(b) of the proposal replaces what are now §§ 303.13(b), 303.13(c), and 303.13(e) of the FDIC's regulations. Some portions of the existing sections would be eliminated because they are no longer necessary due to the passage of time, and other portions have been edited and reformatted in a manner consistent with the corresponding sections of subpart A. Language currently in the referenced sections of § 303.13 concerning notices and applications has likewise been edited, reformatted, and moved to subpart F of this regulation.

#### Other Activities Prohibition

Section 362.10(b)(1) of the proposal restates the statutory prohibition that insured state savings associations may not directly engage as principal in any activity of a type, or in an amount, that is not permissible for a federal savings association unless the activity meets a statutory or regulatory exception. Like subpart A for insured state banks, language has been added to clarify that this prohibition does not supercede the equity investment exception of § 362.10(a)(2). We added this language because acquiring or retaining any investment is defined as an activity.

The statutory prohibition preventing state and federal savings associations from directly, or indirectly through a subsidiary (other than a subsidiary that is a qualified affiliate), acquiring or retaining any corporate debt that is not of investment grade after August 9, 1989, is also carried forward from what is now § 303.13(e) of the FDIC's regulations. However, the proposal deletes the § 303.13(e) requirement that savings institutions file divestiture plans concerning corporate debt that is not of investment grade and that is held in a capacity other than through a qualified affililate. Divestiture was required by no later than July 1, 1994, rendering that provision unnecessary due to the passage of time.

#### Exceptions to the Other Activities Prohibition

We left the statutory exception to the other activities prohibition contained in section 28 of the FDI Act to function in a manner similar to that now in the relevant provisions of § 303.13; we intend no substantive change from the current regulation through any language changes we have made. The regulation continues to permit an insured state savings association to retain any asset (including a nonresidential real estate loan) acquired prior to August 9, 1989. However, corporate debt securities that are not of investment grade may only be purchased or held by a qualified affiliate. Whether or not the security is of investment grade is measured only at the time of acquisition.

Additionally, the FDIC has provided regulatory exceptions to the other activities prohibition. The first exception retains the application process currently in § 303.13(b)(1) and provides insured state savings associations with the option of applying to the FDIC for approval to engage in an activity of a type that is not permissible for a federal savings association. The notice process from § 303.13(c)(1) has been retained for insured state savings associations that want to engage in activities of a type permissible for a federal savings association, but in an amount exceeding that permissible for federal savings associations. The proposal adds a regulatory exception enabling insured state savings associations to acquire and retain adjustable rate and money market preferred stock without submitting an application to the FDIC if the acquisition is done within the prescribed limitations. We added an exception to allow insured state savings associations to engage as principal in any activity that is not permissible for a federal savings association provided that the Federal Reserve has found the activity to be closely related to banking. This provision is similar to the exception for insured state banks and, similarly, this provision does not allow an insured state savings association to hold equity securities that a federal savings association may not hold.

Consent Obtained Through Application

Insured state savings associations are prohibited from directly engaging in activities of a type or in an amount not permissible for a federal savings association unless: (1) The association meets and continues to meet the capital standards prescribed by the appropriate federal financial institution regulator; and (2) the FDIC determines that conducting the activity in the additional amount will not present a significant risk to the relevant deposit insurance fund. Section 362.10(b)(2)(i) establishes an application option for savings associations that meet the relevant capital standards and that seek the FDIC's consent to engage in activities that are otherwise prohibited. The substance of this process is unchanged from the relevant sections of § 303.13 of the FDIC's current regulations.

Nonresidential Realty Loans Permissible for a Federal Savings Association Conducted in an Amount Not Permissible

The proposal carries forward and modifies the provision now in § 303.13(b)(1) of this chapter requiring an insured state savings association wishing to hold nonresidential real estate loans in amounts exceeding the limits described in section 5(c)(2)(B) of HOLA (12 U.S.C. 1464 (c)(2)(B)) to apply for the FDIC's consent. The proposal enables the insured state savings association to submit a notice instead of an application. This change is nonsubstantive and is made simply to expedite the process for insured state savings associations wanting to exceed the referenced limits.

Acquiring and Retaining Adjustable Rate and Money Market Preferred Stock

The proposal extends to insured state savings associations a revised version of the regulatory exception allowing an insured state bank to invest in up to 15 percent of its tier one capital in adjustable rate preferred stock and money market (auction rate) preferred stock without filing an application with the FDIC. By statute, however, insured savings associations are restricted in their ability to purchase debt that is not of investment grade. This regulatory exception does not override that statutory prohibition and any instruments purchased must comply with that statutory constraint. Additionally, this exception is only extended to savings associations meeting and continuing to meet the applicable capital standards prescribed by the appropriate federal financial institution regulator.

When this regulatory exception was adopted for insured state banks in 1992, the FDIC found that adjustable rate preferred stock and money market (auction rate) preferred stock were essentially substitutes for money market investments such as commercial paper and that their characteristics are closer to debt than to equity securities. Therefore, money market preferred stock and adjustable rate preferred stock were excluded from the definition of equity security. As a result, these investments are not subject to the equity investment prohibitions of the statute and the regulation and are considered an ''other activity'' for the purposes of this regulation.

This exception focuses on two categories of preferred stock. This first category, adjustable rate preferred stock refers to shares where dividends are established by contract through the use of a formula in based on Treasury rates or some other readily available interest rate levels. Money market preferred stock refers to those issues where dividends are established through a periodic auction process that establishes yields in relation to short term rates paid on commercial paper issued by the same or a similar company. The credit quality of the issuer determines the value of the security, and money market preferred shares are sold at auction.

The FDIC continues to believe that the activity of investing up to 15 percent of an institution's tier one capital does not represent a significant risk to the deposit insurance funds. Furthermore, the FDIC believes the same funding option should be available to insured state savings associations and proposes extending a like exception subject to the same revised limitation. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

The FDIC seeks comment on whether this treatment of money market preferred stock and adjustable rate preferred stock is appropriate and whether this exception should be extended to insured state savings associations. Is this exception useful and it is needed? Comment is requested on the proposed limit, particulary whether the limit is either too restrictive or overly generous. Comment is also requested concerning whether other, similar types of investments should be given similar treatment.

Activities That Are Closely Related to Banking Conducted by the Savings Association or a Service Corporation of an Insured Savings Association

The FDIC added an exception allowing an insured state savings association to engage in any activity ''as principal'' included on the FRB's list of activities (found at 12 CFR 225.28) or where the FRB has issued an order finding that the activity is closely related to banking. This exception is similar to that provided for insured state banks in subpart A. The FDIC believes that insured federal savings associations are permitted to do most of the activities covered by this exception and determined that the remaining activities do not present any substantially different risk when conducted by an insured savings association than when conducted by an insured state bank. The FDIC seeks comment on whether adding this express exception is helpful, redundant, or expands the powers of insured savings associations. We note that we did not propose a reference to activities found by OTS regulation or order to be reasonably related to the operation of financial institutions. Comment is invited on whether we should include this exception and, if so, how it should be incorporated into the regulation. Comment is requested concerning the appropriateness of the FRB's closely related to banking standard for savings associations. Is there another standard which would be more meaningful for state-chartered savings associations?

Guarantee Activities

The FDIC considered adding an exception for guarantee activities including credit card guarantee programs and comparable arrangements that would have been similar to that deleted from subpart A in this proposal. These programs typically involve a situation where an institution guarantees the credit obligations of its retail customers. While we continue to believe that these activities present no significant risk to the deposit insurance funds, this provision has been deleted from subpart A of this proposal because the FDIC has determined that national banks, and therefore insured state banks, may already engage in the activities. We determined that federal savings associations, and by extension insured state savings associations, may engage in these activities as well. Nonetheless, the FDIC seeks comment on whether adding this language would be helpful to make it clear that insured state savings association may engage in these activities. Commenters advocating that the FDIC retain this exception in the final rule are asked to address how the exception might be incorporated into the regulation.

Section 362.11 Service Corporations of Insured State Savings Associations

Section 362.11 of the proposal governs the activities of service corporations of insured state savings associations and generally replaces what is now § 303.13(d)(2) of the FDIC's regulations. As proposed, the section reorganizes the substance of the current regulation and consolidates all provisions concerning the activities of service corporations into the same section of the regulation. Language currently in § 303.13(d) concerning applications would be revised and moved to subpart F of this regulation. Additionally, the FDIC proposes extending several regulatory exceptions that closely resemble similar exceptions provided to subsidiaries of insured state banks in subpart A of this proposed regulation. We note that if the service corporation is a new subsidiary or is a subsidiary conducting a new activity, all of the exceptions in § 362.11 remain subject to the notice provisions contained in section 18(m) of the FDI Act which would now be implemented in subpart D of this proposal.

General Prohibition

A service corporation of an insured state savings association may not engage in any activity that is not permissible for a service corporation of a federal savings association unless the savings association submits an application and receives the FDIC's consent or the activity qualifies for a regulatory exception. This provision does not represent a substantive change from the current regulation. The regulatory language implementing this prohibition has been separated from the restrictions in § 362.10 prohibiting an insured state savings association from directly engaging in activities which are not permissible for federal savings association. By separating the savings association's activities and those of a service corporation, § 362.11 deals exclusively with activities that may be conducted by a service corporation of an insured state savings association.

Consent Obtained Through Application

The proposal continues to allow insured state savings associations to submit applications seeking the FDIC's consent to engage in activities that are otherwise prohibited. Section 362.11(b)(1) carries forward the substance of the application option in § 303.13(d)(2)(ii) of the FDIC's current regulations. Approval will be granted only if: (1) The savings association meets and continues to meet the applicable capital standards prescribed by the appropriate federal banking agency, and (2) the FDIC determines that conducting the activity in the corresponding amount will not present a significant risk to the relevant deposit insurance fund.

Service Corporations Conducting Unrestricted Activities

The FDIC has found that it is not a significant risk to the deposit insurance fund if a service corporation engages in certain activities. One of these activities is holding the stock of a company that engages in: (1) Any activity permissible for a federal savings association; (2) any activity permissible for the savings association itself under § 362.10(b)(2)(iii) or (iv); (3) activities that are not conducted ''as principal;'' or (4) activities that are not permissible for a federal savings association provided that the FRB by regulation or order has found the activity to be closely related to banking and the service corporation exercises control over the issuer of the purchased stock. We provided similar exceptions to majority-owned subsidiaries of insured state banks in subpart A. We note that we revised the language in subpart A from that currently found in part 362 to clarify the intent of this provision. The proposal differentiates between a service corporation holding stock that is a control interest and investing in the shares of a company. The FDIC intends that this provision cover a service corporation's investment in lower level subsidiaries engaged in activities that the FDIC has found to present no significant risk to the fund. To comply with this exception, the service corporation must excercise control over the lower level entity. We expect savings associations that have lower level subsidiaries engaging in other activities to conform to the application or notice procedures set forth in this regulation.

The FDIC seeks comments on whether it is appropriate to extend this exception to insured state savings associations. Comments are requested on whether the proposed exception is overly broad, should be further restricted and, if so, how it should be narrowed.

Section 28 of the FDI Act requires the FDIC's consent before a service corporation may engage in *any* activity that is not permissible for a service corporation of a federal savings association. While the language of section 28 governs only activities conducted ''as principal'' by insured state savings associations, the ''as principal'' language was not extended to service corporations in the governing statute. This means that even if the activity is not conducted ''as principal,'' subpart C applies if the activity is not permissible for a service corporation of a federal savings asociation.

Because the FDIC believes that activities conducted other than ''as principal'' present no significant risk to the relevant deposit insurance fund, we provided an exception in § 362.11(b)(2)(ii) allowing a service corporation of an insured state savings association to act other than ''as principal,'' if the savings association meets and continues to meet the applicable capital standards prescribed by its appropriate federal banking agency. Examples of such activities are serving as a real estate agent or travel agent. The FDIC seeks comment on whether it is appropriate to extend this exception to service corporations of insured state savings associations. Comments are also requested on whether this exception is necessary.

Owning Equity Securities That Do Not Represent a Control Interest

Subject to the eligibility requirements and transaction limitations discussed below, the FDIC has determined that the activity of owning equity securities by a service corporation does not present a significant risk to the relevant deposit insurance fund. Section 362.11(b)(3) enables service corporations of insured state savings associations to purchase certain equity securities by incorporating substantially the same exception as that proposed in § 362.4(b)(4) of subpart A. This exception permits service corporations of eligible insured state savings association to acquire and retain stock of insured banks, insured savings associations, bank holding companies, savings and loan holding companies. The FDIC is of the opinion that investments in such entities should not present significant risk to the relevant deposit insurance fund because these companies are subject to close regulatory and supervisory oversight. Furthermore, these entities mostly engage in activities closely related to banking.

The exception provided by this section also allows the subject service corporations to acquire and retain equity stock of companies listed on a national securities exchange. Listed securities are more liquid than nonlisted securities and companies whose stock is listed must meet capital and other requirements of the national securities exchanges. These requirements provide some assurances as to the quality of the investment. Insured state savings associations wanting to have their service corporations invest in other securities should be subject to the scrutiny of the application process.

Service corporations engaging in this activity must limit their investment to 10 percent of the voting stock of any company. This limitation reflects the FDIC's intent that this exception be used only as a vehicle to invest in equity securities. The 10 percent limitation was chosen because it reflects an investment level that is generally recognized as not involving control of the business. Additionally, the service corporation is not permitted to control any issuer of investment stock. These requirements reflect the FDIC's intent that the depository institution is not operating a business through investments in equity securities. Comment is requested concerning the appropriateness of the 10 percent limitation.

To be eligible for this exception, the insured state savings association must be well-capitalized exclusive of its investment in the service corporation. Additionally, the insured state savings association may not extend credit to the service corporation, purchase any debt instruments from the service corporation, or originate any other transaction that is used to benefit the corporation which invests in stock under this subpart. Finally, the savings association may have only one service corporation engaged in this activity. These requirements reflect the FDIC's desire that the scope of the exception should be limited. Institutions that wish to have multiple service corporations engaged in purchasing and retaining equity securities and that wish to extend credit to finance the transactions should use the applications procedures to request consent.

In addition to requesting comment on the particular exception as proposed, the FDIC requests comment on whether it is appropriate for the regulation to extend this exception to insured state savings associations in the same manner extended to insured state banks in subpart A. The FDIC also requests comment on the adequacy of the restrictions and constraints that it has proposed for the savings associations and service corporations that would hold these investments. What additional constraints, if any, should we consider adding for the savings associations and service corporations that would hold these investments?

Securities Underwriting

Section 362.11(b)(4) of the proposal allows an insured state savings association to acquire or retain an investment in a service corporation that underwrites or distributes securities that would not be permissible for a federal savings association to underwrite or distribute if notice is filed with the FDIC, the FDIC does not object to the notice before the end of the notice period, and a number of conditions are and continue to be met.

The proposed exception enabling service corporations to underwrite or distribute securities is patterned on the exception found in subpart A (see proposed § 362.4(b)(5)(ii)). In both cases, the state-chartered depository institution must conduct the securities activity in compliance with the core eligibility requirements, the same additional requirements listed for this activity in subpart A, and the investment and transaction limits. The savings association also must meet the capital requirements and the service corporation must meet the ''eligible subsidiary'' requirements as an ''eligible service corporation.'' Since the requirements are the same as those imposed in subpart A and the risks of the activity also are identical, the discussion in subpart A will not be repeated here.

Notice of Change in Circumstance

Like subpart A, the proposal requires the insured state savings association to provide written notice to the appropriate Regional Office of the FDIC within 10 business days of a change in circumstances. Under the proposal, a change in circumstances is described as a material change in the service corporation's business plan or management. Together with the insured state savings association's primiary federal financial institution regulator, the FDIC believes that it may address a savings association's falling out of compliance with any of the other conditions of approval through the normal supervision and examination process.

The FDIC is concerned about changes in circumstances which result from changes in management or changes in an service corporation's business plan. If material changes to either condition occur, the rule requires the association to submit a notice of such changes to the appropriate FDIC regional director (DOS) within 10 days of the material change. The standard of material change would indicate such events as a change in chief executive officer of the service corporation or a change in investment strategy or type of business or activity engaged in by the service corporation.

The FDIC will communicate its concerns regarding the continued conduct of an activity after a change in circumstances with the appropriate persons from the insured state savings association's primary federal banking agency. The FDIC will work with the identified persons from the primary federal banking agency to develop the appropriate response to the new circumstances.

It is not the FDIC's intention to require any savings association which falls out of compliance with eligibility conditions to immediately cease any activity in which the savings association had been engaged subject to a notice to the FDIC. The FDIC will instead deal with such eventuality on a case-by-case basis through the supervision and examination process. In short, the FDIC intends to utilize the supervisory and regulatory tools available to it in dealing with the savings association's failure to meet eligibility requirements on a continuing basis. The issue of the savings association's ongoing activities will be dealt with in the context of that effort. The FDIC is of the opinion that the case-by-case approach to whether a savings association will be permitted to continue an activity is preferable to forcing a savings association to, in all instances, immediately cease the activity in question. Such an inflexible approach could exacerbate an already unfortunate situation that probably is receiving supervisory attention.

Core Eligibility Requirements

The proposed regulation imports by reference the core eligibility requirements listed in subpart A. Refer to the discussion on this topic provided under subpart A for additional information. When reading the referenced discussion, ''Subsidiary'' and ''Majority-owned subsidiary'' should be replaced with ''Service corporation.'' Additionally, ''eligible subsidiary'' should be replaced with ''Eligible service corporation.'' Finally, ''Insured state savings association'' shall be read to replace ''Bank'' or ''Insured state bank.'' Comments are requested concerning whether these standards are appropriate for insured state savings associations and their service corporations. Should other restrictions be considered? Have standards been imposed that are unnecessary to achieve separation between an insured state savings association and its service corporation?

Investment and Transaction Limits

The proposal contains investment limits and other requirements that apply to an insured state savings association and its service corporations engaging in activities that are not permissible for a federal savings association if the requirements are imposed by FDIC order or expressly imposed by regulation. In general, the provisions impose limits on a savings association's investment in any one service corporation, impose an aggregate limit on a savings association's investment in all service corporations that engage in the same activity, require extensions of credit from a savings association to its service corporations to be fully-collateralized when made, prohibit low quality assets from being taken as collateral on such loans, and require that transactions between the savings association and its service corporations be on an arm's length basis.

The proposal expands the definition of insured state savings association for the purposes of the investment and transaction limitations. A savings association includes not only the insured entity, but also any service corporation or subsidiary that is engaged in activities that are not subject to these investment and transaction limits.

Sections 23A and 23B of the Federal Reserve Act combine the bank and all of its subsidiaries in imposing investment limitations on all affiliates. The FDIC is using the same concept in separating subsidiaries and service corporations conducting activities that are subject to investment and transaction limits from the insured state savings association and any other service corporations and subsidiaries engaging in activities not subject to the investment and transaction limits.

Investment Limits

Under the proposal, a savings association's investment in certain service corporations may be restricted. Those limits are basically the same as would apply between a bank and its affiliates under section 23A: 10 percent of tier one capital for each service corporation and 20 percent for each activity. As is the case with covered transactions under section 23A, extensions of credit and other transactions with third parties that benefit the savings association's service corporation would be considered as being part of the savings association's investment. The only exception would be for arm's length extensions of credit made by the savings association to finance sales of assets by the service to third parties. These transactions would not need to comply with the collateral requirements and investment limitations, provided that they met certain arm's-length standards. The imposition of section 23A-type restrictions is intended to make sure that adequate safeguards are in place for the dealings between the insured state savings association and its service corporations.

The ''investment'' definition resembles that used in the relevant section of proposed subpart A, but it differs somewhat due to underlying statutory differences. The definition of investment for insured state savings associations includes only: (1) Extensions of credit to any person or company for which an insured state savings association accepts securities issued by the service corporation as collateral; and (2) any extensions or commitments of credit to a third party for investment in the subsidiary, investment in a project in which the subsidiary has an interest, or extensions of credit or commitments of credit which are used for the benefit of, or transferred to, the subsidiary.

The investment definition differs from that used in subpart A in that it excludes extensions of credit provided to the service corporation and any debt securities owned by the savings association that were issued by the service corporation. While these items are included in the investment definition in subpart A, insured state banks are not required to deduct the corresponding amounts from regulatory capital. The investment definition coverage in subpart C has been limited because an insured state savings association is required by the Home Owners' Loan Act to deduct from its regulatory capital any extensions of credit provided to a service corporation and any debt securities owned by the savings association that were issued by a service corporation engaging in activities that are not permissible for a national bank. Since the regulatory exceptions provided in subpart C that invoke the investment limits are not permissible for a national bank, insured state savings associations are required by the referenced statute to deduct these items from regulatory capital. The FDIC finds no reason to impose investment limits on amounts completely deducted from capital and therefore imposes the investment limitation only on items that are not deducted from regulatory capital.

The FDIC seeks comment on whether this definition of investment is appropriate. Commenters are asked to address whether this treatment is equitable given the underlying statutory differences and the FDIC welcomes suggested alternatives.

Like subpart A, the proposal calulates the 10 percent and 20 percent limits based on tier one capital while section 23A uses total capital. As was discussed earlier, the FDIC is using tier one capital as its measure to create consistency throughout the regulation. The proposal also limits the aggregate investment to all service corporations conducting the same activity. There is not a ''same activity'' standard in section 23A. The FDIC believes that the aggregate limitations should restrict concentrations in a particular activity and not impose a general limitation on activities that are not permissible for a service corporation of a federal savings association. For the purposes of this paragraph, the FDIC intends to interpret the ''same activity'' standard to mean broad categories of activities such as securities underwriting.

Transaction Requirements

The arm's length transaction requirement, prohibition on purchasing low quality assets, anti-tying restriction, and insider transaction restriction are applicable between an insured state savings association and a service corporation to the same extent and in the same manner as that described in subpart A between an insured state bank and certain majority-owned subsidiaries. Refer to the discussion of this topic in subpart A for comments.

Collateralization Requirement

The collateralization requirement in proposed § 362.4(d)(4) is also applicable between an insured state savings association and a service corporation to the same extent and in the same manner as that described in subpart A. Refer to the discussion of this topic in subpart A for comments.

Capital Requirements

Under the proposed rule, an insured state savings association using the notice process to invest in a service corporation engaging in certain activities not permissible for a federal savings association must be ''well-capitalized'' after deducting from its regulatory capital any amount required by section 5(t) of the Home Owners Loan Act. The bank's risk classification assessment under part 327 is also determined after making the same deduction. This standard reflects the FDIC's belief that only well-capitalized institutions should be allowed, either without notice or by using the notice process, to engage through service corporations in activities that are not permissible for service corporations of federal savings associations. All savings associations failing to meet this standard and wanting to engage in such activities should be subject to the scrutiny of the application process. The FDIC seeks comments on whether this requirement is too restrictive.

Approvals Previously Granted

The FDIC proposes that insured state savings associations that have previously received consent by order or notice from this agency should not be required to reapply to continue the activity, provided the savings association and service corporation, as applicable, continue to comply with the conditions of the order of approval. It is not the intent of the FDIC to require insured state savings associations to request consent to engage in an activity which has already been approved previously by this agency.

Because previously granted approvals may contain conditions that are different from the standards that are established in this proposal, in certain circumstances, the insured state savings association may elect to operate under the restrictions of this proposal. Specifically, the insured state savings association bank may comply with the investment and transaction limitations between the savings association and its service corporations contained in § 362.11(c), the capital requirement limitations detailed in § 362.4(d), and the service corporation restrictions as outlined in the term ''eligible service corporation'' (by substitution) and contained in § 362.4(c)(2) in lieu of similar requirements in its approval order. Any conditions that are specific to a savings association's situation and do not fall within the above limitations will continue to be effective. The FDIC intends that once a savings association elects to follow these proposed restrictions instead of those in the approval order, it may not elect to revert to the applicable conditions of the order. The FDIC requests comment on this approach to approvals previously granted by this agency.

Other Matters on Which the FDIC Requests Comments

Comments describing the contents of subpart A include an extensive discussion of the FDIC's concerns with real estate investment activities. It is also noted that subpart A of the proposed regulation contains significant provisions regarding the real estate investment activities of majority-owned subsidiaries of insured state banks. Additionally, proposed subpart B in part addresses real estate activities of majority-owned subsidiaries that may become permissible for national bank subsidiaries.

The FDIC believes real estate investment activities present similar risks when conducted by a service corporation of an insured state savings association. However, subpart C of this proposal does not incorporate any of the requirements imposed in subparts A and B on real estate activities conducted by bank subsidiaries. While the FDIC has attempted to conform the treatment of insured state banks and their subsidiaries and that of insured state savings associations and their service corporation, differences in the governing statutes result in some variances.

Service corporations of federal savings associations may engage in numerous real estate investment activities and, therefore, the activities are permissible for service corporations of insured state savings associations. However, because real estate investment activities are not permissible for a national bank, insured state savings associations are required by the Home Owners' Loan Act to deduct from their regulatory capital any investment in a service corporation engaging in these activities. This deduction includes both the savings association's investments in (debt and equity) and extensions of credit to the service corporation. There are also statutory limitations on the amount of a savings association's investments in and credit extensions to service corporations.

Given the fact that: (1) Real estate investment activities are permissible for service corporations of federal savings associations; (2) there are statutory requirements regarding the capital deduction; and (3) there are statutory limitations on investments and credit extensions, this proposal does not contain any provisions concerning the real estate investment activities of service corporations of insured savings associations. As a result, the arm's length transaction requirements, prohibition on purchasing low quality assets, anti-tying restriction, insider transaction restriction, and the collateralization requirements are not applicable between an insured savings association and a service corporation engaging in real estate investment activities. Additionally, neither the insured savings association nor the service corporation are required to meet the eligibility standards; nor is a notice required to be submitted to the FDIC (unless a notice is needed pursuant to proposed subpart D).

Comment is invited on whether provisions should be added to part 362 subjecting service corporations of insured savings associations to the eligibility requirements and various restrictions that the FDIC has found necessary to implement in the proposed subparts A and B. Comments are requested regarding how the FDIC should implement any such provisions. If provisions are added, they would implement section 18(m) of the FDI Act which provides the FDIC with authority to adopt regulations prohibiting any specific activity that poses a serious threat to the Savings Association Insurance Fund.

Notice That a Federal Savings Association is Conducting Activities Grandfathered Under Section 5(I)(4) of HOLA

Section 303.13(g) of the FDIC's current regulations requires any federal savings association that is authorized by section 5(I)(4) of HOLA to conduct activities that are not normally permitted for federal savings associations to file a notice of that fact with the FDIC. Section 5(I)(4) of HOLA provides that any federal savings bank chartered as such prior to October 15, 1982, may continue to make investments and continue to conduct activities it was permitted to conduct prior October 15, 1982. It also provides that any federal savings bank organized prior to October 15, 1982, that was formerly a state mutual savings bank may continue to make investments and engage in activities that were authorized to it under state law. Finally, the provision confers this grandfather on any federal savings association that acquires by merger or consolidation any federal savings bank that enjoys the grandfather.

The notice requirement contained in § 303.13(g) is deleted under the proposal. The notice is not required by law and is currently imposed by the FDIC as an information gathering tool. The FDIC has determined that eliminating the notice will reduce burden and will not materially affect the FDIC's supervisory responsibilities.

*D. Subpart D of Part 362 Acquiring, Establishing, or Conducting New Activities Through a Subsidiary by an Insured Savings Association*

Section 362.13 Purpose and Scope

Subpart D implements the statutory requirement of section 18(m) of the FDI Act. Section 18(m) requires that prior notice be given to the FDIC when an insured savings association, both federal and state, establishes or acquires a subsidiary or engages in any new activity in a subsidiary. This requirement is based on the FDIC's role of ensuring that activities and investments of insured savings associations do not represent a significant risk to the affected deposit insurance fund. In fulfilling that role, the FDIC needs to be aware of the activities contemplated by subsidiaries of insured savings associations. It is noted that for purposes of this subpart, a service corporation is a subsidiary, but the term subsidiary does not include any insured depository institution as that term is defined in the FDI Act. Because this requirement applies to both federal and state savings associations, the proposal would segregate the implementing requirements of the FDIC's regulations into a separate subpart D. In that manner, the requirement is highlighted for both federal and state savings associations.

Notice of the Acquisition or Establishment of a Subsidiary, or Notice That an Existing Subsidiary Will Conduct New Activities

Section 303.13(f) of the FDIC's current regulations (1) requires savings associations to file a notice with the FDIC by January 29, 1990, listing subsidiaries held by the association at that time (essentially a ''catch up'' notice), (2) establishes an abbreviated notice procedure concerning subsidiaries created to hold real estate acquired pursuant to DPC (after the first notice, additional real estate subsidiaries created to hold real estate acquired through DPC could be established after providing the FDIC with 14 days prior notice), and (3) lists the content of the notice. The proposed section would delete the first item because it no longer necessary due to the passage of time. The second item is also deleted because the FDIC seeks to conform all notice periods used in this regulation. While proposed § 362.14 continues to require a prior notice, the required content of the notice would be revised in a manner consistent with that required for other notices under this regulation and moved to subpart F of this regulation. The FDIC wants to make it clear that any notice or application submitted to the FDIC pursuant to a provision of subpart C of this regulation will satisfy the notice requirement of this subpart D.

The FDIC seeks comment on whether deleting the abreviated notice period currently in § 303.13(f) imposes a substantial burden, or if the benefits gained by applying the concept of uniform notice periods exceed any potential burden. Comment is also requested on whether explicit references are needed in the regulation to clarify that the notice required under this subpart also applies to newly acquired or established service corporations and service corporations conducting new activitities.

*E. Subpart E—Applications and Notices; Activities and Investments of Insured State Banks*

Overview

This proposed rule includes a separate subpart E containing application procedures and delegations of authority for the substantive matters covered by the proposal for insured state banks.[13] As discussed above, the FDIC is currently preparing a complete revision of part 303 of the FDIC's rules and regulations containing the FDIC's applications procedures and delegations of authority. As part of these revisions to part 303, subpart G of part 303 will address application requirements relating to the activities of insured state nonmember banks. It is the FDIC's intent that at such time as part 362 and part 303 are both final, the application procedures proposed in subpart E of this proposal will be relocated to subpart G of part 303 to centralize all banking application and notice procedures in one convenient place.

Section 362.15 Scope

This subpart contains the procedural and other information for any application or notice that must be submitted under the requirements specified for activities and investments of insured state banks and their subsidiaries under subparts A and B, including the format, information requirements, FDIC processing deadlines, and other pertinent guidelines or instructions. The proposal also contains delegations of authority from the Board of Directors to the director and deputy director of the Division of Supervision.

Section 362.16 Definitions

This subpart contains practical, procedural definitions of the following terms: ''Appropriate regional director,'' ''Appropriate deputy regional director,'' ''Appropriate regional office,'' ''Associate director,'' ''Deputy Director,'' ''Deputy regional director,'' ''DOS,'' ''Director,'' and ''Regional director.'' These definitions should be self-explanatory. When this subpart is moved to part 303 as subpart G, most, if not all, of these definitions should be contained in the general definitions to that part and will no longer be necessary in the subpart. Comments are requested on the clarity of these definitions.

Section 362.17 Filing Procedures

This section explains to insured state banks where they should file, how they should file and the contents of any filing, including any copies of any application or notice filed with another agency. This section also explains that the appropriate regional director may request additional information. Comments are requested on the clarity of these explanations.

Section 362.18 Processing

This section explains the procedures for the expedited processing of notices and the regular processing of applications and notices that have been removed from expedited processing. This section also explains how a notice is removed from expedited processing. The expedited processing period for notices will normally be 30 days, subject to extension for an additional 15 days upon written notice to the bank. The FDIC will normally review and act on applications within 60 days after receipt of a completed application, subject to extension for an additional 30 days upon written notice to the bank. Comments are requested on the clarity of these explanations of the processing procedures.

Section 362.19 Delegations of Authority

The authority to review and act upon applications and notices is delegated in this section. The only substantive change to the existing delegation is the addition of the deputy director of the Division of Supervision.

[13] Under the FDIC's current rules, these application requirements are located in various sections of three different regulations: 12 CFR 303, 12 CFR 337.4 and 12 CFR 362.

*F. Subpart F—Applications and Notices; Activities and Investments of Insured Savings Associations*

Overview

This proposed rule includes a separate subpart F containing application procedures and delegations of authority for the substantive matters covered by the proposal for savings associations. As discussed above, the FDIC is currently preparing a complete revision of part 303 of the FDIC's rules and regulations containing the FDIC's applications procedures and delegations of authority. As part of these revisions to part 303, subpart H of part 303 will address application requirements relating to the activities of savings associations. It is the FDIC's intent that at such time as part 362 and part 303 are both final, the application procedures proposed in subpart F of this proposal will be relocated to subpart H of part 303 to centralize application and notice procedures governing all savings associations in one convenient place.

Section 362.20 Scope

This subpart contains the procedural and other information for any application or notice that must be submitted under the requirements specified for activities and investments of insured savings associations and their subsidiaries under subparts C and D, including the format, information requirements, FDIC processing deadlines, and other pertinent guidelines or instructions. The proposal also contains delegations of authority from the Board of Directors to the director and deputy director of the Division of Supervision.

Section 362.21 Definitions

This subpart contains practical, procedural definitions of the following terms: ''Appropriate regional director,'' ''Appropriate deputy regional director,'' ''Appropriate regional office,'' ''Associate director,'' ''Deputy Director,'' ''Deputy regional director,'' ''DOS,'' ''Director,'' and ''Regional director.'' These definitions should be self-explanatory. When this subpart is moved to part 303 as subpart H, most, if not all, of these definitions should be contained in the general definitions to that part and will no longer be necessary in the subpart. Comments are requested on the clarity of these definitions.

Section 362.22 Filing Procedures

This section explains to insured savings associations where they should file, how they should file and the contents of any filing, including any copies of any application or notice filed with another agency. This section also explains that the appropriate regional director may request additional information. Comments are requested on the clarity of these explanations.

Section 362.23 Processing

This section explains the procedures for the expedited processing of notices and the regular processing of applications and notices that have been removed from expedited processing. This section also explains how a notice is removed from expedited processing. The expedited processing period for notices will normally be 30 days, subject to extension for an additional 15 days upon written notice to the bank. The FDIC will normally review and act on applications within 60 days after receipt of a completed application, subject to extension for an additional 30 days upon written notice to the bank. Comments are requested on the clarity of these explanations of the processing procedures.

Section 362.24 Delegations of Authority

The authority to review and act upon applications and notices is delegated in this section. The only substantive change to the existing delegation is the addition of the deputy director of the Division of Supervision.

The FDIC requests public comments about all aspects of the proposal. In addition, the FDIC is raising specific questions for public comment throughout the preamble discussion.

## IV. Paperwork Reduction Act

The collection of information contained in this proposed rule and identified below have been submitted to the Office Of Management and Budget (OMB) for review and approval in accordance with the requirements of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et. seq.*). Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the FDIC's functions, including whether the information has practical utility; (b) the accuracy of the estimates of the burden of the information collection; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

Comments should be addressed to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer Alexander Hunt, New Executive Office Building, Room 3208, Washington, D.C. 20503, with copies of such comments to Steven F. Hanft, Assistant Executive Secretary (Regulatory Analysis), Federal Deposit Insurance Corporation, room F–400, 550 17th Street, NW, Washington, D.C. 20429. All comments should refer to ''Part 362.'' OMB is required to make a decision concerning the collections of information contained in the proposed regulations between 30 and 60 days after the publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of this publication. This does not affect the deadline for the public to comment to the FDIC on the proposed regulation.

*Title of the collection of information:* Activities and Investments of Insured State Banks, OMB Control number 3064–0111.

*Summary of the collection:* A description of the activity in which an insured state bank or its subsidiary proposes to engage that would be impermissible absent the FDIC's consent or nonobjection, and information about the relationship of the proposed activity to the bank's and/or subsidiary's operation and compliance with applicable laws and regulations, as detailed at § 362.17.

*Need and use of the information:* The FDIC uses the information to determine whether to grant consent or provide a nonobjection for the insured state bank or its subsidiary to engage in the proposed activity that otherwise would be impermissible pursuant to § 24 of the FDI Act and proposed Part 362.

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

*Estimated annual burden:*

Frequency of response: Occasional
Number of responses: 18
Average number of hours to prepare an application or notice: 7 hours
Total annual burden: 126 hours

*Title of the collection of information:* Activities and Investments of Insured Savings Associations, OMB Control number 3064–0104.

*Summary of the collection:* A description of the activity in which an insured state savings association or its service corporation proposes to engage that would be impermissible absent notification to the FDIC or absent the FDIC's consent or nonobjection and information about the relationship of the proposed activity to the savings association's and/or service corporation's operation and compliance with applicable laws and regulations, as detailed at § 362.22 and § 362.23(c). Also, a notice of the new activities to be conducted by a subsidiary or the activities to be conducted by a newly formed or acquired subsidiary of insured state and federal savings associations in accordance with § 362.23(c).

*Need and use of the information:* The FDIC uses the information to determine whether to grant consent or provide a nonobjection for the insured state savings association or its service corporation to engage in the proposed activity that otherwise would be impermissible for the savings association or service corporation under § 28 of the FDI Act and proposed Part 362. The FDIC also collects information under § 18(m) of the FDI Act regarding activities of existing or acquired subsidiaries to monitor the types of activities being conducted by subsidiaries of savings associations.

*Respondents:* Insured state savings associations or their subsidiaries desiring to engage in activities that would be impermissible absent notification or the FDIC's consent or nonobjection. All insured savings associations must give notice prior to acquiring or establishing a new subsidiary or initiating a new activity through a subsidiary.

*Estimated annual burden:*

Frequency of response: Occasional
Number of responses: 24
Average number of hours to prepare an application or notice: 5 hours
Total annual burden: 120 hours

### V. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the FDIC certifies that this proposed rule will not have a significant impact on a substantial number of small entities. The proposed rule streamlines requirements for all insured state banks and insured state savings associations. The requirements for insured federal savings associations are statutory and remain unchanged by this rule. It simplifies the requirements that apply when insured state banks and insured state savings associations create, invest in, or conduct new activities through majority-owned corporate subsidiaries and service corporations, respectively, by eliminating requirements for any filing or reducing the burden from filing an application to filing a notice in other instances. The rule also simplifies the information required for both notices and applications. Whenever possible, the rule clarifies the expectations of the FDIC when it requires notices or applications to consent to activities by insured state banks and insured state savings associations. The proposed rule will make it easier for small insured state banks and insured state savings associations to locate the rules that apply to their investments.

### List of Subjects

*12 CFR Part 303*

Administrative practice and procedure, Authority delegations (Government agencies), Bank deposit insurance, Banks, banking, Reporting and recordkeeping requirements, Savings associations.

*12 CFR Part 337*

Banks, banking, reporting and recordkeeping requirements, securities.

*12 CFR Part 362*

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

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

## PART 303—APPLICATIONS, REQUESTS, SUBMITTALS, DELEGATIONS OF AUTHORITY, AND NOTICES REQUIRED TO BE FILED BY STATUTE OR REGULATION

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

**Authority:** 12 U.S.C. 378, 1813, 1815, 1816, 1817(j), 1818, 1819 (Seventh and Tenth), 1828, 1831e, 1831o, 1831p-1; 15 U.S.C. 1607.

### § 303.13 [Removed]

2. § 303.13 is removed.

## PART 337—UNSAFE AND UNSOUND BANKING PRACTICES

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

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

### § 337.4 [Removed and Reserved]

4. § 337.4 is removed and reserved.

5. Part 362 is revised to read as follows:

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

### Subpart A—Activities of Insured State Banks



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



### Subpart C—Activities of Insured State Savings Associations



### Subpart D—Acquiring, Establishing, or Conducting New Activities through a Subsidiary by an Insured Savings Association



### Subpart E—Applications and Notices; Activities of Insured State Banks



### Subpart F—Applications and Notices; Activities of Insured Savings Associations



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

## Subpart A—Activities of Insured State Banks

### § 362.1 Purpose and scope.

(a) This subpart, along with the notice and application procedures in subpart E, implements the provisions of section 24 of the Federal Deposit Insurance Act (12 U.S.C. 1831a) that restrict and prohibit insured state banks and their subsidiaries from engaging in activities and investments that are not permissible for national banks and their subsidiaries. The phrase "activity permissible for a national bank" means any activity authorized for national banks under any statute including the National Bank Act (12 U.S.C. 21 *et seq.*), as well as activities recognized as permissible for a national bank in regulations, official circulars, bulletins, orders or written interpretations issued by the Office of the Comptroller of the Currency (OCC).

(b) This subpart does not cover the following activities:

(1) Activities conducted other than ''as principal.'' Therefore, this subpart does not restrict activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee;

(2) Interests in real estate in which the real property is used or intended in good faith to be used within a reasonable time by an insured state bank or its subsidiaries as offices or related facilities for the conduct of its business or future expansion of its business or used as public welfare investments of a type permissible for national banks; and

(3) Equity investments acquired in connection with debts previously contracted that are held within the shorter of the time limits prescribed by state or federal law.

(c) A majority-owned subsidiary of an insured state bank may not engage in real estate investment activities that are not permissible for a subsidiary of a national bank unless the bank does so through a majority-owned subsidiary, is in compliance with applicable capital standards, and the FDIC has determined that the activity poses no significant risk to the appropriate deposit insurance fund. Subpart A provides standards for insured state banks engaging in real estate investment activities that are not permissible for a subsidiary of a national bank. Because of safety and soundness concerns relating to real estate investment activities, subpart B reflects special rules for subsidiaries of insured state nonmember banks that engage in real estate investment activities of a type that are not permissible for a national bank, but may be otherwise permissible for a subsidiary of a national bank.

(d) The FDIC intends to allow insured state banks and their subsidiaries to undertake only safe and sound activities and investments that do not present significant risks to the deposit insurance funds and that are consistent with the purposes of federal deposit insurance and other applicable law. This subpart does not authorize any insured state bank to make investments or to conduct activities that are not authorized or that are prohibited by either state or federal law.

**§ 362.2 Definitions.**

(a) For the purposes of this subpart, the terms ''bank,'' ''state bank,'' ''savings association,'' ''state savings association,'' ''depository institution,'' ''insured depository institution,'' ''insured state bank,'' ''federal savings association,'' and ''insured state nonmember bank'' shall each have the same respective meaning contained in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), and the following definitions shall apply:

(b) *Activity* means the conduct of business by a state-chartered depository institution, including acquiring or retaining an equity investment or other investment.

(c) *As principal* means any activity conducted other than as agent for a customer, is conducted other than in a brokerage, custodial, advisory, or administrative capacity, or is conducted other than as trustee.

(d) *Change in control* means (1) any transaction for which a notice is required to be filed with the FDIC, or the Board of Governors of the Federal Reserve System (FRB), pursuant to section 7(j) of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)) except a transaction that is presumed to be an acquisition of control under the FDIC's or FRB's regulations implementing section 7(j), or (2) any transaction as a result of which a depository institution eligible for the exception described in § 362.3(b)(2)(B) is acquired by or merged into a depository institution that is not eligible for the exception.

(e) *Company* means any corporation, partnership, limited liability company, business trust, association, joint venture, pool, syndicate or other similar business organization.

(f) *Control* means the power to vote, directly or indirectly, 25 per cent or more of any class of the voting securities of a company, the ability to control in any manner the election of a majority of a company's directors or trustees, or the ability to exercise a controlling influence over the management and policies of a company.

(g) *Convert its charter* means an insured state bank undergoes any transaction that causes the bank to operate under a different form of charter than it had as of December 19, 1991, except a change from mutual to stock form shall not be considered a charter conversion.

(h) *Equity investment* means an ownership interest in any company; any membership interest that includes a voting right in any company; any interest in real estate; any transaction which in substance falls into any of these categories even though it may be structured as some other form of business transaction; and includes an equity security. The term ''equity investment'' does not include any of the foregoing if the interest is taken as security for a loan.

(i) *Equity security* means any stock (other than adjustable rate preferred stock and money market (auction rate) preferred stock) certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, or voting-trust certificate; any security immediately convertible at the option of the holder without payment of substantial additional consideration into such a security; any security carrying any warrant or right to subscribe to or purchase any such security; and any certificate of interest or participation in, temporary or interim certificate for, or receipt for any of the foregoing.

(j) *Extension of credit, executive officer, director, principal shareholder,* and *related interest* each has the same respective meaning as is applicable for the purposes of section 22(h) of the Federal Reserve Act (12 U.S.C. 375) and § 337.3 of this chapter.

(k) *Institution* shall have the same meaning as ''state-chartered depository institution.''

(l) *Majority-owned subsidiary* means any corporation in which the parent insured state bank owns a majority of the outstanding voting stock.

(m) *National securities exchange* means a securities exchange that is registered as a national securities exchange by the Securities and Exchange Commission pursuant to section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) and the National Market System, i.e., the top tier of the National Association of Securities Dealers Automated Quotation System.

(n) *Real estate investment activity* means any interest in real estate (other than as security for a loan) held directly or indirectly that is not permissible for a national bank and is not real estate leasing.

(o) *Residents of the state* includes individuals living in the state, individuals employed in the state, any person to whom the company provided insurance as principal without interruption since such person resided in or was employed in the state, and companies or partnerships incorporated in, organized under the laws of, licensed to do business in, or having an office in the state.

(p) *Security* has the same meaning as it has in part 344 of this chapter.

(q) *Significant risk to the deposit insurance fund* shall be understood to be present whenever the FDIC determines there is a high probability that any insurance fund administered by the FDIC may suffer a loss. Such risk may be present either when an activity contributes or may contribute to the decline in condition of a particular state-chartered depository institution or when a type of activity is found by the FDIC to contribute or potentially contribute to the deterioration of the overall condition of the banking system.

(r) *State-chartered depository institution* means any state bank or state savings association insured by the FDIC.

(s) *Subsidiary* means any company controlled by an insured depository institution.

(t) *Tier one capital* has the same meaning as set forth in part 325 of this chapter for an insured state nonmember bank. For other state-chartered depository institutions, the term ''tier one capital'' has the same meaning as set forth in the capital regulations adopted by the appropriate Federal banking agency.

(u) *Well-capitalized* has the same meaning set forth in part 325 of this chapter for an insured state nonmember bank. For other state-chartered depository institutions, the term ''well-capitalized'' has the same meaning as set forth in the capital regulations adopted by the appropriate Federal banking agency.

**§ 362.3 Activities of insured state banks.**

(a) *Equity investments.* (1) Prohibited equity investments. No insured state bank may directly or indirectly acquire or retain as principal any equity investment of a type that is not permissible for a national bank unless one of the exceptions in § 362.3(a)(2) applies.

(2) *Exceptions.* (i) *Equity investment in majority-owned subsidiaries.* An insured state bank may acquire or retain an equity investment in a majority-owned subsidiary, provided that the majority-owned subsidiary is engaging in activities that are allowed pursuant to the provisions of or application under § 362.4(b).

(ii) *Investments in qualified housing projects.* An insured state bank may invest as a limited partner in a partnership the sole purpose of which is to invest in the acquisition, rehabilitation, or new construction of a qualified housing project, provided that the bank's aggregate investment (including legally binding commitments) does not exceed, when made, 2 percent of total assets as of the date of the bank's most recent consolidated report of condition prior to making the investment. For the purposes of this paragraph, *Aggregate investment* means the total book value of the bank's investment in the real estate calculated in accordance with the instructions for the preparation of the consolidated report of condition. *Qualified housing project* means residential real estate intended to primarily benefit lower income persons throughout the period of the bank's investment including any project that has received an award of low income housing tax credits under section 42 of the Internal Revenue Code (26 U.S.C. 42) (such as a reservation or allocation of credits) from a state or local housing credit agency. A residential real estate project that does not qualify for the tax credit under section 42 of the Internal Revenue Code will qualify under this exception if 50 percent or more of the housing units are to be occupied by lower income persons. A project will be considered residential despite the fact that some portion of the total square footage of the project is utilized for commercial purposes, provided that such commercial use is not the primary purpose of the project. *Lower income* has the same meaning as ''low income'' and ''moderate income'' as defined for the purposes of § 345.12(n) (1) and (2) of this chapter.

(iii) *Grandfathered investments in common or preferred stock; shares of investment companies.* (A) *General.* An insured state bank that is located in a state which as of September 30, 1991, authorized investment in:

(*1*)(*i*) Common or preferred stock listed on a national securities exchange (listed stock); or

(*ii*) Shares of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) (registered shares); and

(*2*) Which during the period beginning on September 30, 1990, and ending on November 26, 1991, made or maintained an investment in listed stock or registered shares, may retain whatever lawfully acquired listed stock or registered shares it held and may continue to acquire listed stock and/or registered shares, provided that the bank files a notice in accordance with section 24(f)(6) of the Federal Deposit Insurance Act and the FDIC does not object. The content of the notice and procedures to process the notice shall conform to the requirements of § 362.18(a). Approval will not be granted unless the FDIC determines that acquiring or retaining the stock or shares does not pose a significant risk to the fund. Approval may be subject to whatever conditions or restrictions the FDIC determines are necessary or appropriate.

(B) *Loss of grandfather exception.* The exception for grandfathered investments under paragraph (a)(2)(iii)(A) of this section shall no longer apply if the bank converts its charter or the bank or its parent holding company undergoes a change in control. If any of these events occur, the bank may retain its existing investments unless directed by the FDIC or other applicable authority to divest the listed stock or registered shares.

(C) *Maximum permissible investment.* A bank's aggregate investment in listed stock and registered shares under paragraph (a)(2)(iii)(A) of this section shall in no event exceed, when made, 100 percent of the bank's tier one capital as measured on the bank's most recent consolidated report of condition prior to making any such investment. Book value of the investment shall be used to determine compliance. The total book value of the bank's investment in the listed stock and registered shares is calculated in accordance with the instructions for the preparation of the consolidated report of condition. The FDIC may determine when acting upon a notice filed in accordance with § 362.18(a) that the permissible limit for any particular insured state bank is something less than 100 percent of tier one capital.

(iv) *Stock investment in insured depository institutions owned exclusively by other banks and savings associations.* An insured state bank may acquire or retain the stock of an insured depository institution if the insured depository institution engages only in activities permissible for national banks; the insured depository institution is subject to examination and regulation by a state bank supervisor; the voting stock is owned by 20 or more insured depository institutions, but no one institution owns more than 15 percent of the voting stock; and the insured depository institution's stock (other than directors' qualifying shares or shares held under or acquired through a plan established for the benefit of the officers and employees) is owned only by insured depository institutions.

(v) *Stock investment in insurance companies.* (A) *Stock of director and officer liability insurance company.* An insured state bank may acquire and retain up to 10 percent of the outstanding stock of a corporation that solely provides or reinsures directors'', trustees'', and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions.

(B) *Stock of savings bank life insurance company.* An insured state bank located in Massachusetts, New York, or Connecticut may own stock in a savings bank life insurance company, provided that the savings bank life insurance company provides written disclosures to purchasers or potential purchasers of life insurance policies, other insurance products, and annuities that are consistent with the disclosures described in the Interagency Statement on the Retail Sale of Nondeposit Investment Products (FIL–9–94,[1] February 17, 1994) or any successor statement which indicate that the policies, products, and annuities are not FDIC insured deposits, are not guaranteed by the bank and may involve risk of loss.

(b) *Activities other than equity investments*—(1) *Prohibited activities.* An insured state bank may not directly or indirectly engage as principal in any activity that is not an equity investment and is of a type not permissible for a national bank unless one of the exceptions in paragraph (b)(2) of this section applies.

(2) *Exceptions.* (i) Consent obtained through application. An insured state bank that meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency may conduct activities prohibited by § 362.3(b)(1) if the bank obtains the FDIC's prior consent. Consent will be given only if the FDIC determines that the activity poses no significant risk to the affected deposit insurance fund. Applications for consent should be filed in accordance with § 362.18(b). Approvals granted under § 362.18(b) may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from risk, to prevent unsafe or unsound banking practices, and/or to ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law.

(ii) *Insurance underwriting*—(A) *Savings bank life insurance.* An insured state bank that is located in Massachusetts, New York or Connecticut may provide as principal savings bank life insurance through a department of the bank, provided that the department meets the core standards of paragraph (c) of this section.

(B) *Federal crop insurance.* Any insured state bank that was providing insurance as principal on or before September 30, 1991, which was reinsured in whole or in part by the Federal Crop Insurance Corporation, may continue to do so.

(C) *Grandfathered insurance underwriting.* A well-capitalized insured state bank that on November 21, 1991, was lawfully providing insurance as principal through a department of the bank may continue to provide insurance as principal to the residents of the state or states in which the bank did so on such date provided that the bank's department meets the core standards of paragraph (c) of this section.

(iii) *Acquiring and retaining adjustable rate and money market preferred stock.* An insured state bank's investment of up to 15 percent of the bank's tier one capital in adjustable rate preferred stock or money market (auction rate) preferred stock does not represent a significant risk to the deposit insurance funds. An insured state bank may conduct this activity without first obtaining the FDIC's consent, provided that the bank meets and continues to meet the applicable capital standards as prescribed by the appropriate Federal banking agency. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

(iv) *Activities that are closely related to banking.* An insured state bank may engage as principal in any activity that is not permissible for a national bank provided that the Federal Reserve Board by regulation or order has found the activity to be closely related to banking for the purposes of section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) provided that this exception:

(A) Shall not be construed to permit an insured state bank to directly hold equity securities of a type that a national bank may not hold;

(B) Does not authorize an insured state bank engaged in real estate leasing to hold the leased property for more than two years at the end of the lease unless the property is re-leased; and

(C) Does not authorize an insured state bank to directly hold equity debt investments in corporations or projects designed primarily to promote community welfare if such investments are of a type that a national bank may not hold.

(c) *Core standards.* For any insured state bank to be eligible to conduct insurance activities listed in paragraph (b)(2)(ii)(A) or (C) of this section, the bank must conduct the activities in a department that meets the following ''core operating standards'' and ''core separation standards'.

(1) The ''core operating standards'' for a department are:

(i) The department provides purchasers or potential purchasers of life insurance policies, other insurance products and annuities written disclosures that are consistent with the disclosures described in the Interagency Statement on the Retail Sale of Nondeposit Investment Products (FIL–9–94, February 17, 1994) and any successor statement which indicate that the policies, products and annuities are not FDIC insured deposits, are not guaranteed by the bank, and may involve risk of loss; and

(ii) The department informs its customers that only the assets of the department may be used to satisfy the obligations of the department.

(2) The ''core separation standards'' for a department are:

(i) The department is physically distinct from the remainder of the bank;

(ii) The department maintains separate accounting and other records;

(iii) The department has assets, liabilities, obligations and expenses that are separate and distinct from those of the remainder of the bank; and

(iv) The department is subject to state statute that requires its obligations, liabilities and expenses be satisfied only with the assets of the department.

### § 362.4 Subsidiaries of insured state banks.

(a) *Prohibition.* A subsidiary of an insured state bank may not engage as principal in any activity that is not of a type permissible for a subsidiary of a national bank, unless it meets one of the exceptions in paragraph (b) of this section.

(b) *Exceptions*—(1) *Consent obtained through application.* A subsidiary of an insured state bank may conduct otherwise prohibited activities if the bank obtains the FDIC's prior written consent and the insured state bank meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency. Consent will be given only if the FDIC determines that the activity poses no significant risk to the affected deposit insurance fund. Applications for consent should be filed in accordance with § 362.18(b). Approvals granted under § 362.18(b) may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from risk, to prevent unsafe or unsound banking practices, and/or to ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law.

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

(2) *Grandfathered insurance underwriting subsidiaries.* A subsidiary of an insured state bank may:

(i) Engage in grandfathered insurance underwriting if the insured state bank or its subsidiary on November 21, 1991, was lawfully providing insurance as principal. The subsidiary may continue to provide the same types of insurance as principal to the residents of the state or states in which the bank or subsidiary did so on such date provided that:

(A) The bank meets the capital requirements of paragraph (e) of this section;

(B) The subsidiary is an ''eligible subsidiary'' as described in paragraph (c)(2) of this section; and

(C) The subsidiary provides purchasers or potential purchasers of life insurance policies, other insurance products and annuities written disclosures that are consistent with the disclosures described in the Interagency Statement on the Retail Sale of Nondeposit Investment Products (FIL–9–94, February 17, 1994) or any successor statement which indicate that the policies, products and annuities are not FDIC insured deposits, are not guaranteed by the bank, and may involve risk of loss.

(ii) Continue to provide as principal title insurance, provided the bank was required before June 1, 1991, to provide title insurance as a condition of the bank's initial chartering under state law and neither the bank or its parent holding company undergoes a change in control.

(iii) May continue to provide as principal insurance which is reinsured in whole or in part by the Federal Crop Insurance Corporation if the subsidiary was engaged in the activity on or before September 30, 1991.

(3) Majority-owned subsidiaries which own a control interest in companies engaged in permissible activities. The FDIC has determined that the following investment activities do not represent a significant risk to the deposit insurance funds. The following listed activities may be conducted by a majority-owned subsidiary of an insured state bank without first obtaining the FDIC's consent, provided that the bank meets and continues to meet the applicable capital standards as prescribed by the appropriate Federal banking agency, and the majority-owned subsidiary controls the issuer of the stock purchased by the subsidiary. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

(i) *Stock of a company that engages in authorized activities.* A majority-owned subsidiary may own the stock of a company that engages in any activity permissible for an insured state bank under § 362.3(b)(2)(iii).

(ii) *Stock of a company that engages in activities closely related to banking.* A majority-owned subsidiary may own the stock of a company that engages as principal in any activity that is not permissible for a national bank provided that the Federal Reserve Board by regulation or order has found the activity to be closely related to banking for the purposes of section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) provided that this exception:

(A) Does not authorize a subsidiary engaged in real estate leasing to hold the leased property for more than two years at the end of the lease unless the property is re-leased; and

(B) Does not authorize a subsidiary to acquire or hold the stock of a savings association other than as allowed by paragraph (b)(4) of this section.

(4) *Majority-owned subsidiaries ownership of equity securities that do not represent a control interest.* The FDIC has determined that a majority-owned subsidiary's investment in the equity securities of any company, including an insured depository institution, a bank holding company (as that term is defined for purposes of the Bank Holding Company Act, 12 U.S.C. 1841 et seq.), or a savings and loan holding company (as that term is defined in 12 U.S.C. 1467a), does not represent a significant risk to the deposit insurance funds and may be conducted by a majority-owned subsidiary of an insured state bank without first obtaining the FDIC's consent, provided that the insured state bank and its majority-owned subsidiary meet the eligibility requirements of paragraph (b)(4)(i) of this section and transaction limitation of paragraph (b)(4)(ii) of this section; and the insured state bank meets the capital requirements of paragraph (e) of this section. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

(i) *Eligibility requirements.* (A) The state-chartered depository institution may have only one majority-owned subsidiary engaging in this activity;

(B) The majority-owned subsidiary's investment in equity securities (except stock of an insured depository institution, a bank holding company or a savings and loan holding company) must be limited to equity securities listed on a national securities exchange.

(C) The state-chartered depository institution and/or the majority-owned subsidiary do not control any issuer of equity securities purchased by the subsidiary.

(D) The majority-owned subsidiary may not purchase equity securities representing more than 10% of the outstanding voting stock of any one issuer.

(ii) *Transaction limitation.* A state-chartered depository institution and any of its subsidiaries may not extend credit to the majority-owned subsidiary, purchase any debt instruments issued by the majority-owned subsidiary, or originate any other transaction that is used to benefit the majority-owned subsidiary which invests in stock under paragraph (b)(4) of this section.

(iii) *Portfolio management.* For the purposes of this section, investment in the equity securities of any company does not include pursuing active short-term trading strategies.

(5) *Majority-owned subsidiaries conducting real estate investment activities and securities underwriting.* The FDIC has determined that the following activities do not represent a significant risk to the deposit insurance funds, provided that the activities are conducted by a majority-owned subsidiary in compliance with the core eligibility requirements listed in paragraph (c) of this section; any additional requirements listed in paragraph (b)(5) (i) or (ii) of this section; the bank complies with the investment and transaction limitations of paragraph (d) of this section; and the bank meets the capital requirements of paragraph (e) of this section. Subject to the stated requirements and limitations, the FDIC consents that these listed activities may be conducted by a majority-owned subsidiary of an insured state bank if the bank files a notice in compliance with § 362.18(a) and the FDIC does not object to the notice. The FDIC is not precluded from taking any appropriate action or imposing additional requirements with respect to the activities if the facts and circumstances warrant such action. If changes to the management or business plan of the majority-owned subsidiary at any time result in material changes to the nature of the majority-owned subsidiary's business or the manner in which its business is conducted, the insured state bank shall advise the appropriate regional director (Supervision) in writing within 10 business days after such change. Such a majority-owned subsidiary may:

(i) Engage in real estate investment activities. However, the requirements of paragraph (c)(2) (ii), (v), (vi), and (xi) of this section need not be met if the bank's investment in the equity securities of the subsidiary does not exceed 2 percent of the bank's tier one capital; the bank has only one subsidiary engaging in real estate investment activities; and the bank's total investment in the subsidiary does not include any extensions of credit from the bank to the subsidiary, any debt instruments issued by the subsidiary, or any other transaction originated by the bank that is used to benefit the subsidiary.

(ii) Engage in the public sale, distribution or underwriting of securities that are not permissible for a national bank under section 16 of the Banking Act of 1933 (12 U.S.C. 24 Seventh), provided that the following additional conditions are, and continue to be, met:

(A) The state-chartered depository institution adopts policies and procedures, including appropriate limits on exposure, to govern the institution's participation in financing transactions underwritten or arranged by an underwriting majority-owned subsidiary;

(B) The state-chartered depository institution may not express an opinion on the value or the advisability of the purchase or sale of securities underwritten or dealt in by a majority-owned subsidiary unless the state-chartered depository institution notifies the customer that the majority-owned subsidiary is underwriting or distributing the security;

(C) The majority-owned subsidiary is registered with the Securities and Exchange Commission, is a member in good standing with the appropriate self-regulatory organization, and promply informs the appropriate regional director (Supervision) in writing of any material actions taken against the majority-owned subsidiary or any of its employees by the state, the appropriate self-regulatory organizations or the Securities and Exchange Commission; and

(D) The state-chartered depository institution does not knowingly purchase as principal or fiduciary during the existence of any underwriting or selling syndicate any securities underwritten by the majority-owned subsidiary unless the purchase is approved by the state-chartered depository institution's board of directors before the securities are initially offered for sale to the public.

(6) *Subsidiaries may engage in authorized activities.* A subsidiary of an insured state bank may engage in any activity permissible for an insured state bank under § 362.3(b)(2)(iii) or § 362.3(b)(2)(iv), provided that this exception does not authorize a subsidiary to acquire or hold the stock of a savings association other than as allowed by paragraph (b)(4) of this section.

(c) *Core eligibility requirements.* If specifically required by this part or by FDIC order, any state-chartered depository institution that wishes to be eligible and continue to be eligible to conduct as principal activities through a subsidiary that are not permissible for a subsidiary of a national bank must be an ''eligible depository institution'' and the subsidiary must be an ''eligible subsidiary''.

(1) A state-chartered depository institution is an ''eligible depository institution'' if it:

(i) Has been chartered and operating for 3 or more years;

(ii) Has a composite rating of 1 or 2 assigned under the Uniform Financial Institutions Rating System (UFIRS) or such other comparable rating system as may be adopted in the future by the institution's appropriate Federal banking agency;

(iii) Received a rating of 1 or 2 under the ''management'' component of the UFIRS as assigned by the institution's appropriate Federal banking agency;

(iv) Has a satisfactory or better Community Reinvestment Act rating at its most recent examination conducted by the institution's appropriate Federal banking agency;

(v) Has a compliance rating of 1 or 2 at its most recent examination conducted by the institution's appropriate Federal banking agency; and

(vi) Is not subject to a cease and desist order, consent order, prompt corrective action directive, formal or informal written agreement, or other administrative agreement with its appropriate Federal banking agency or chartering authority.

(2) A subsidiary of a state-chartered depository institution is an ''eligible subsidiary'' if it:

(i) Meets applicable statutory or regulatory capital requirements and has sufficient operating capital in light of the normal obligations that are reasonably foreseeable for a business of its size and character within the industry;

(ii) Is physically separate and distinct in its operations from the operations of the state-chartered depository institution, provided that this requirement shall not be construed to prohibit the state-chartered depository institution and its subsidiary from sharing the same facility if the area where the subsidiary conducts business with the public is clearly distinct from the area where customers of the state-chartered depository institution conduct business with the institution. The extent of the separation will vary according to the type and frequency of customer contact;

(iii) Maintains separate accounting and other business records;

(iv) Observes separate business entity formalities such as separate board of directors' meetings;

(v) Has a chief executive officer of the subsidiary who is not an employee of the institution;

(vi) Has a majority of its board of directors who are neither directors nor officers of the state-chartered depository institution;

(vii) Conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the state-chartered depository institution and that the state-chartered depository institution is not responsible for and does not guarantee the obligations of the subsidiary;

(viii) Has only one business purpose within the types described in paragraphs (b)(2) and (b)(5) of this section;

(ix) Has a current written business plan that is appropriate to the type and scope of business conducted by the subsidiary;

(x) Has qualified management and employees for the type of activity contemplated, including all required licenses and memberships, and complies with industry standards; and

(xi) Establishes policies and procedures to ensure adequate computer, audit and accounting systems, internal risk management controls, and has necessary operational and managerial infrastructure to implement the business plan.

(d) *Investment and transaction limits.*—(1) *General.* If specifically required by this part or FDIC order, the following conditions and restrictions apply to an insured state bank and its majority-owned subsidiaries that engage in and wish to continue to engage in activities which are not permissible for a national bank subsidiary.

(2) *Investment limits*—(i) *Investment in one subsidiary.* An insured state bank may not invest more than 10 percent of the insured state bank's tier one capital in any majority-owned subsidiary subject to this paragraph (d).

(ii) *Aggregate investment in subsidiaries.* An insured state bank's investments in majority-owned subsidiaries conducting the same activity subject to this paragraph (d) shall not exceed, in the aggregate, 20 percent of the insured state bank's tier one capital.

(iii) *Definition of investment.* (A) For purposes of this subsection, the term *investment* means:

(*1*) Any extension of credit to the majority-owned subsidiary by the insured state bank;

(*2*) Any debt securities, as such term is defined in part 344 of this chapter, issued by the majority-owned subsidiary held by the insured state bank;

(*3*) The acceptance by the insured state bank of securities issued by the majority-owned subsidiary as collateral for an extension of credit to any person or company; and

(*4*) Any extensions of credit by the insured state bank to any third party for the purpose of making a direct investment in the majority-owned subsidiary, making any investment in which the majority-owned subsidiary has an interest, or which is used for the benefit of, or transferred to, the majority-owned subsidiary.

(B) For the purposes of paragraph (d)(2) of this section, the term ''investment'' does not include:

(*1*) Extensions of credit by the insured state bank to finance sales of assets by the majority-owned subsidiary which do not involve more than the normal degree of risk of repayment and are extended on terms that are substantially similar to those prevailing at the time for comparable transactions with or involving unaffiliated persons or companies;

(*2*) An extension of credit by the insured state bank to a majority-owned subsidiary that is fully collateralized by government securities, as such term is defined in § 344.3 of this chapter; or

(*3*) An extension of credit by the insured state bank to a majority-owned subsidiary that is fully collateralized by a segregated deposit in the insured state bank.

(3) *Transaction requirements*—(i) *Arm's length transaction requirement.* An insured state bank may not:

(A) Make an investment in a majority-owned subsidiary;

(B) Purchase from or sell to a majority-owned subsidiary any assets (including securities);

(C) Enter into a contract, lease, or other type of agreement with a majority-owned subsidiary; or

(D) Pay compensation to a majority-owned subsidiary or any person or company who has an interest in the majority-owned subsidiary unless the transaction is on terms and conditions that are substantially the same as those prevailing at the time for comparable transactions with unaffiliated parties, provided that an insured state bank may give immediate credit to a majority-owned subsidiary for uncollected items received in the ordinary course of business. This requirement also shall apply in the case of any transaction the proceeds of which are used for the benefit of, or that are transferred to, the majority-owned subsidiary.

(ii) *Prohibition on purchase of low quality assets.* An insured state bank is prohibited from purchasing a low quality asset from a majority-owned subsidiary. For purposes of this subsection, low quality asset means:

(A) An asset classified as ''substandard'', ''doubtful'', or ''loss'' or treated as ''other loans especially mentioned'' in the most recent report of examination of the bank;

(B) An asset in a nonaccrual status;

(C) An asset on which principal or interest payments are more than 30 days past due; or

(D) An asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

(iii) *Anti-tying restriction.* Neither the insured state bank nor the majority-owned subsidiary may require a customer to either buy any product or use any service from the other as a condition of entering into a transaction.

(iv) *Insider transaction restriction.* Neither the insured state bank nor the majority-owned subsidiary may enter into any transaction (exclusive of those covered by § 337.3 of this chapter) with the bank's executive officers, directors, principal shareholders or related interests of such persons which relate to the majority-owned subsidiary's activities unless the transactions are on terms and conditions that are substantially the same as those prevailing at the time for comparable transaction with persons not affiliated with the insured state bank.

(4) *Collateralization requirements.* (i) An insured state bank is prohibited from making an extension of credit to or on behalf of a majority-owned subsidiary unless such transaction is fully-collateralized at the time the transaction is entered into. No insured state bank may accept a low quality asset as collateral. An extension of credit is fully collateralized if it is secured at the time of the transaction by collateral having a market value equal to at least:

(A) 100 percent of the amount of the transaction if the collateral is composed of:

(*1*) Obligations of the United States or its agencies;

(*2*) Obligations fully guaranteed by the United States or its agencies as to principal and interest;

(*3*) Notes, drafts, bills of exchange or bankers acceptances that are eligible for rediscount or purchase by the Federal Reserve Bank; or

(*4*) A segregated, earmarked deposit account with the member bank;

(B) 110 percent of the amount of the transaction if the collateral is composed of obligations of any State or political subdivision of any State;

(C) 120 percent of the amount of the transaction if the collateral is composed of other debt instruments, including receivables; or

(D) 130 percent of the amount of the transaction if the collateral is composed of stock, leases, or other real or personal property.

(ii) An insured state bank may not release collateral prior to proportional payment of the extension of credit; however, collateral may be substituted if there is no dimunition of collateral coverage.

(5) *Investment and transaction limits extended to insured state bank subsidiaries.* For purposes of applying paragraphs (d)(2) through (d)(4) of this section, any reference to ''insured state bank'' means the insured state bank and any subsidiaries of the insured state bank which are not themselves subject under this part or FDIC order to the restrictions of this paragraph (d).

(e) *Capital requirements.* If specifically required by this part or by FDIC order, any insured state bank that wishes to conduct or continue to conduct as principal activities through a subsidiary that are not permissible for a subsidiary of a national bank must:

(1) Be well-capitalized after deducting from its tier one capital the investment in equity securities of the subsidiary as well as the bank's pro rata share of any retained earnings of the subsidiary;

(2) Reflect this deduction on the appropriate schedule of the bank's consolidated report of income and condition; and

(3) Use such regulatory capital amount for the purposes of the bank's assessment risk classification under part 327 and its categorization as a ''well-capitalized'', an ''adequately capitalized'', an ''undercapitalized'', or a ''significantly undercapitalized'' institution as defined in § 325.103(b) of this chapter, provided that the capital deduction shall not be used for purposes of determining whether the bank is ''critically undercapitalized'' under part 325.

**§ 362.5 Approvals previously granted.**

(a) *FDIC consent by order or notice.* An insured state bank that previously filed an application or notice and obtained the FDIC's consent to engage in an activity or to acquire or retain a majority-owned subsidiary engaging as principal in an activity or acquiring and retaining any investment that is prohibited under this subpart may continue that activity or retain that investment without seeking the FDIC's consent, provided that the insured state bank and its subsidiary, if applicable, continue to meet the conditions and restrictions of the approval. An insured state bank which was granted approval based on conditions which differ from the requirements of § 362.4(c)(2), (d) and (e) will be considered to meet the conditions and restrictions of the approval relating to being an eligible subsidiary, meeting investment and transactions limits, and meeting capital requirements if the insured state bank and subsidiary meet the requirements of § 362.4(c)(2), (d) and (e).

(b) *Approvals by regulation—(1) Securities underwriting.* An insured state nonmember bank engaging in securities activities under a notice filed under and in compliance with the restrictions of former § 337.4 of this chapter may continue those activities if the bank and its majority-owned subsidiaries comply with the restrictions set forth in §§ 362.4(b)(5)(ii) and 362.4 (c), (d), and (e) by [*insert date one year after the effective date of the final rule*]. During the one-year period of transition between the effective date of this regulation and [*insert date one year after the effective date of the final rule*], the bank and its majority-owned subsidiary must meet the restrictions set forth in the former § 337.4 of this chapter until §§ 362.4(b)(5)(ii) and 362.4 (c), (d) and (e) are met. If the banks fails to meet these restrictions, the bank must apply for the FDIC's consent to continue those activities under §§ 362.4(b)(1) and 362.18(b).

(2) *Grandfathered insurance underwriting.* An insured state bank which is directly providing insurance as principal pursuant to former § 362.4(c)(2)(i) may continue that activity if it complies with the provisions of § 362.3(b)(2)(ii)(C) by [*insert date ninety days after the effective date of the final rule*]. An insured state bank indirectly providing insurance as principal through a subsidiary pursuant to former § 362.3(b)(7) may continue that activity if it complies with the provisions of § 362.4(b)(2)(i). During the ninety-day period of transition between [*insert the effective date of the final rule*] and [*insert date ninety days after the effective date of the final rule*], the bank and its majority-owned subsidiary must meet the restrictions set forth in former § 362.4(c)(2)(i) or § 362.3(b)(7), as applicable, of this chapter until the requirements of §§ 362.3(b)(2)(ii)(C) or 362.4(b)(2)(i) are met. If the insured state bank or its subsidiary fails to comply with the restrictions, as applicable, the insured state bank must apply for the FDIC's consent under §§ 362.4(b)(1) and 362.18(b).

(3) *Equity securities.* An insured state bank, indirectly through a subsidiary, owning equity securities pursuant to former § 362.4(c)(3)(iv) (A) and (B) may continue that activity if it complies with the provisions of § 362.4(b)(4) by [*insert date one year after the effective date of the final rule*]. During the one-year period of transition between the effective date of this regulation and [*insert date one year after the effective date of the final rule*], the bank and its majority-owned subsidiary must meet the restrictions set forth in former § 362.4(c)(3)(iv)(A) and (B) of this chapter until § 362.4(b)(4) is met. If the insured state bank or its subsidiary fails to meet these restrictions, the insured state bank must apply for the FDIC's consent under §§ 362.4(b)(1) and 362.18(b).

(c) *Charter conversions.* (1) An insured state bank that has converted its charter from an insured state savings association may continue activities through a majority-owned subsidiary that were permissible prior to the time it converted its charter only if the insured state bank receives the FDIC's consent. Except as provided in paragraph (c)(2) of this section, the insured state bank should apply under § 362.4(b)(1), submit a notice required under § 362.4(b)(5), or comply with the provisions of § 362.4(b) (3), (4), or (6), if applicable, to continue the activity.

(2) *Exception for prior consent.* If the FDIC had granted consent to the savings association under section 28 of the Federal Deposit Insurance Act (12 U.S.C. 1831(e)) prior to the time it converted its charter, the insured state bank may continue the activities without providing notice or making application to the FDIC, provided that the bank is in compliance with:

(i) The terms of the FDIC approval order and

(ii) The provisions of § 362.4(c)(2), (d), and (e) regarding operating as an ‘‘eligible subsidiary'', ‘‘investment and transaction limits'', and ‘‘capital requirements''.

(3) *Divestiture.* An insured state bank that does not receive FDIC consent shall divest of the nonconforming investment as soon as practical but in any event no later than two years from the date of charter conversion.

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

### § 362.6 Purpose and scope.

This subpart, along with the notice and application procedures in subpart E apply to certain banking practices that may have adverse effects on the safety and soundness of insured state nonmember banks. The FDIC intends to allow insured state nonmember banks and their subsidiaries to undertake only safe and sound activities and investments that would not present a significant risk to the deposit insurance fund and that are consistent with the purposes of federal deposit insurance and other law. The following standards shall apply for insured state nonmember banks to conduct real estate investment activities through a subsidiary if those activities are permissible for a national bank subsidiary but are different from activities permissible for the national bank parent itself. Additionally, the following standards shall apply for insured state nonmember banks that are not affiliated with a bank holding company to conduct securities activities in an affiliated organization.

### § 362.7 Restrictions on activities of insured state nonmember banks.

(a) *Real estate investment made by subsidiaries of insured state nonmember banks.* The FDIC Board of Directors has found that real estate investment activity may have adverse effects on the safety and soundness of insured state nonmember banks. Notwithstanding any interpretations, orders, circulars or official bulletins issued by the Office of the Comptroller of the Currency regarding activities permissible for operating subsidiaries of a national bank but different from activities permissible for the parent national bank itself under 12 CFR 5.34(f), insured state nonmember banks may not establish or acquire a subsidiary that engages in real estate investment activities not permissible for a national bank itself unless the insured state nonmember bank:

(1) Has an approval previously granted by the FDIC; or

(2) Meets the requirements for engaging in real estate investment activities that are not permissible for national banks as set forth in § 362.4(b)(5), and submits a corresponding notice under § 362.18(a) without objection, or files an application under §§ 362.4(b)(1) and 362.18(b) and receives approval to engage in the activity.

(b) *Affiliation with securities companies.* The Board of Directors of the FDIC has found that an unrestricted affiliation between an insured state nonmember bank and a securities company may have adverse effects on the safety and soundness of insured state nonmember banks. An insured state nonmember bank which is affiliated with a company that is not treated as a bank holding company pursuant to section 4(f) of the Bank Holding Company Act (12 U.S.C. 1843(f)) is prohibited from becoming or remaining affiliated with any company that directly engages in the public sale, distribution or underwriting of stocks, bonds, debentures, notes, or other securities which is not permissible for a national bank unless:

(1) The securities business of the affiliate is physically separate and distinct in its operations from the operations of the bank, provided that this requirement shall not be construed to prohibit the bank and its affiliate from sharing the same facility if the area where the affiliate conducts retail sales activity with the public is physically distinct from the routine deposit taking area of the bank;

(2) Has a chief executive officer of the affiliate who is not an employee of the bank:

(3) A majority of the affiliate's board of directors are not directors, officers, or employees of the bank;

(4) The affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank;

(5) The bank adopts policies and procedures, including appropriate limits on exposure, to govern their participation in financing transactions underwritten by an underwriting affiliate;

(6) The bank does not express an opinion on the value or the advisability of the purchase or sale of securities underwritten or dealt in by an affiliate unless it notifies the customer that the entity underwriting, making a market, distributing or dealing in the securities is an affiliate of the bank;

(7) The bank does not purchase as principal or fiduciary during the existence of any underwriting or selling syndicate any securities underwritten by the affiliate unless the purchase is approved by the bank's board of directors before the securities are initially offered for sale to the public;

(8) The bank does not condition any extension of credit to any company on the requirement that the company contract with, or agree to contract with, the bank's affiliate to underwrite or distribute the company's securities;

(9) The bank does not condition any extension of credit or the offering of any service to any person or company on the requirement that the person or company purchase any security underwritten or distributed by the affiliate; and

(10) The bank complies with the investment and transaction limitations of § 362.4(d). For the purposes of applying these restrictions, the term ''affiliate'' shall be substituted wherever the terms ''subsidiary'' or ''majority-owned subsidiary'' are used in § 362.4(d)(2), (3), and (4). For the purposes of applying these limitations, the term ''investment'' as defined in § 362.4(d)(2)(iii) shall also include any equity securities of the affiliate held by the insured state bank.

(c) *Definitions.* For the purposes of this section, the following definitions apply:

(1) *Affiliate* shall mean any company that directly or indirectly, through one or more intermediaries, controls or is under common control with an insured state nonmember bank.

(2) *Company, Control, Equity Security, Insured state nonmember bank, Security, and Subsidiary* have the same meaning as provided in subpart A.

## Subpart C—Activities of Insured State Savings Associations

### § 362.8 Purpose and scope.

(a) This subpart, along with the notice and application procedures in subpart F, implements the provisions of section 28 of the Federal Deposit Insurance Act (12 U.S.C. 1831e) that restrict and prohibit insured state savings associations and their service corporations from engaging in activities and investments of a type that are not permissible for federal savings associations and their service corporations. The phrase ''activity permissible for a federal savings association'' means any activity authorized for federal savings associations under any statute including the Home Owners' Loan Act (HOLA, 12 U.S.C. 1464 *et seq.*), as well as activities recognized as permissible for a federal savings association in regulations, official thrift bulletins, orders or written interpretations issued by the Office of Thrift Supervision (OTS), or its predecessor, the Federal Home Loan Bank Board.

(b) This subpart does not cover the following activities:

(1) Activities conducted by the insured state savings association other than ''as principal''. Therefore, regarding insured state savings associations, this subpart does not restrict activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee.

(2) Interests in real estate in which the real property is used or intended in good faith to be used within a reasonable time by an insured savings association or its service corporations as offices or related facilities for the conduct of its business or future expansion of its business or used as public welfare investments of a type and in an amount permissible for federal savings associations.

(3) Equity investments acquired in connection with debts previously contracted that are held within the shorter of the time limits prescribed by state or federal law.

(c) The FDIC intends to allow insured state savings associations and their service corporations to undertake only safe and sound activities and investments that do not present a significant risk to the deposit insurance funds and that are consistent with the purposes of federal deposit insurance and other applicable law. This subpart does not authorize any insured state savings association to make investments or conduct activities that are not authorized or that are prohibited by either federal or state law.

### § 362.9 Definitions.

For the purposes of this subpart, the definitions provided in § 362.2 apply. Additionally, the following definitions apply to this subpart:

(a) *Affiliate* shall mean any company that directly or indirectly, through one or more intermediaries, controls or is under common control with an insured state savings association.

(b) *Corporate debt securities not of investment grade* means any corporate debt security that when acquired was not rated among the four highest rating categories by at least one nationally recognized statistical rating organization. The term shall not include any obligation issued or guaranteed by a corporation that may be held by a federal savings association without limitation as to percentage of assets under subparagraphs (D), (E), or (F) of section 5(c)(1) of HOLA (12 U.S.C. 1464 (c)(1)(D), (E), (F)).

(c) *Insured state savings association* means any state-chartered savings association insured by the Federal Deposit Insurance Corporation.

(d) *Qualified affiliate* means, in the case of a stock insured state savings association, an affiliate other than a subsidiary or an insured depository institution. In the case of a mutual savings association, ''qualified affiliate'' means a subsidiary other than an insured depository institution provided that all of the savings association's investments in, and extensions of credit to, the subsidiary are deducted from the savings association's capital.

(e) *Service corporation* means any corporation the capital stock of which is available for purchase by savings associations.

**§ 362.10 Activities of insured state savings associations.**

(a) *Equity investments.*—(1) *Prohibited investments.* No insured state savings association may directly acquire or retain as principal any equity investment of a type, or in an amount, that is not permissible for a federal savings association unless the exception in paragraph (a)(2) of this section applies.

(2) *Exception: Equity investment in service corporations.* An insured state savings association that is and continues to be in compliance with the applicable capital standards as prescribed by the appropriate Federal banking agency may acquire or retain an equity investment in a service corporation:

(i) Not permissible for a federal savings association to the extent the service corporation is engaging in activities that are allowed pursuant to the provisions of or an application under § 362.11(b); or

(ii) Of a type permissible for a federal savings association, but in an amount exceeding the investment limits applicable to federal savings associations, if the insured state savings association obtains the FDIC's prior consent. Consent will be given only if the FDIC determines that the amount of the investment in a service corporation engaged in such activities does not present a significant risk to the affected deposit insurance fund. Applications should be filed in accordance with § 362.23(b). Approvals granted under § 362.23(b) may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from significant risk, to prevent unsafe or unsound practices, and/or to ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law.

(b) *Activities other than equity investments.*—(1) *Prohibited activities.* An insured state savings association may not directly engage as principal in any activity, that is not an equity investment, of a type not permissible for a federal savings association, and an insured state savings association shall not make nonresidential real property loans in an amount exceeding that described in section 5(c)(2)(B) of HOLA (12 U.S.C. 1464 (c)(2)(B)), unless one of the exceptions in paragraph (b)(2) of this section applies. This section shall not be read to require the divestiture of any asset (including a nonresidential real estate loan), if the asset was acquired prior to August 9, 1989; however, any activity conducted with such asset must be in accordance with this subpart. After August 9, 1989, an insured state savings association directly or through a subsidiary (other than, in the case of a mutual savings association, a subsidiary that is a qualified affiliate), may not acquire or retain any corporate debt securities not of investment grade.

(2) *Exceptions.*—(i) *Consent obtained through application.* An insured state savings association that meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency may directly conduct activities prohibited by paragraph (b)(1) of this section if the savings association obtains the FDIC's prior consent. Consent will be given only if the FDIC determines that conducting the activity designated poses no significant risk to the affected deposit insurance fund. Applications should be filed in accordance with § 362.22. Approvals granted under § 362.23(b) may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from significant risk, to prevent unsafe or unsound practices, and/or to ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law.

(ii) *Nonresidential realty loans permissible for a federal savings association conducted in an amount not permissible.* An insured state savings association that meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency may make nonresidential real property loans in an amount exceeding that described in section 5(c)(2)(B) of HOLA (12 U.S.C. 1464 (c)(2)(B)), if the savings association files a notice in compliance with § 362.23(a) and the FDIC does not object to the notice. Consent will be given only if the FDIC determines that engaging in such lending in the amount designated poses no significant risk to the affected deposit insurance fund.

(iii) *Acquiring and retaining adjustable rate and money market preferred stock.* An insured state savings association's investment of up to 15 percent of the association's tier one capital in adjustable rate preferred stock or money market (auction rate) preferred stock does not represent a significant risk to the relevant deposit insurance fund. An insured state savings association may conduct this activity without first obtaining the FDIC's consent, provided that the association meets and continues to meet the applicable capital standards as prescribed by the appropriate Federal banking agency. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

(iv) *Activities that are closely related to banking.* An insured state savings association may engage as principal in any activity that is not permissible for a federal savings association provided that the Federal Reserve Board by regulation or order has found the activity to be closely related to banking for the purposes of section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), except that the insured state savings association shall make no equity investment directly which is not permissible for a federal savings association.

(3) *Activities permissible for a federal savings association conducted in an amount not permissible.* Except as provided in paragraph (b)(2)(ii) of this section, an insured state savings association may engage as principal in any activity, which is not an equity investment, of a type permissible for a federal savings association in an amount in excess of that permissible for a federal savings association, if the savings association meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency, the institution has advised the appropriate regional director (Supervision) under the procedure in § 362.23(c) within thirty days before engaging in the activity, and the FDIC has not advised the insured state savings association that conducting the activity in the amount indicated poses a significant risk to the affected deposit insurance fund. This section shall not be read to require the divestiture of any asset if the asset was acquired prior to August 9, 1989; however, any activity conducted with such asset must be conducted in accordance with this subpart.

**§ 362.11 Service corporations of insured state savings associations.**

(a) *Prohibition.* A service corporation of an insured state savings association may not engage in any activity that is not permissible for a service corporation of a federal savings association, unless it meets one of the exceptions in paragraph (b) of this section.

(b) *Exceptions.*—(1) *Consent obtained through application.* A service corporation of an insured state savings association may conduct activities prohibited by paragraph (a) of this section if the savings association obtains the FDIC's prior written consent and the insured state savings association meets and continues to meet the applicable capital standards set by the appropriate Federal banking agency. Consent will be given only if the FDIC determines that the activity poses no significant risk to the relevant deposit insurance fund. Applications for consent should be filed in accordance with § 362.23(b). Approvals granted under § 362.23(b) may be made subject to any conditions or restrictions found by the FDIC to be necessary to protect the deposit insurance funds from risk, to prevent unsafe or unsound banking practices, and/or to ensure that the activity is consistent with the purposes of federal deposit insurance and other applicable law.

(2) *Service corporations conducting unrestricted activities.* The FDIC has determined that the following activities do not represent a significant risk to the deposit insurance funds. The FDIC consents that the following activities may be conducted by a service corporation of an insured state savings association without first obtaining the FDIC's consent, provided that the savings association meets and continues to meet the applicable capital standards as prescribed by the appropriate Federal banking agency. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action.

(i) *Service corporations which own a control interest in companies engaged in permissible activities.* Provided the service corporation controls the issuer of owned stock, a service corporation may directly acquire and retain ownership interests in:

(A) *Stock of a company that engages in permissible activities.* A service corporation may own the stock of a company that engages in any activity permissible for a federal savings association or any activity permissible for an insured state savings association under § 362.10(b)(2)(iii) or (iv).

(B) *Stock of a company engaged in activities conducted not as principal.* A service corporation may own the stock of a company that engages solely in activities which are not conducted as principal.

(ii) *Activities that are not conducted "as principal".* A service corporation may engage in activities which are not conducted "as principal" such as acting as an agent for a customer, acting in a brokerage, custodial, advisory, or administrative capacity, or acting as trustee.

(iii) *Service corporations may engage in authorized activities.* A service corporation may engage in any activity permissible for an insured state savings association under § 362.10(b)(2)(iii) or § 362.10(b)(2)(iv), provided that this exception does not authorize a service corporation to acquire or hold the stock of a savings association other than as allowed by paragraph (b)(3) of this section.

(3) *Service corporation ownership of equity securities that do not represent a control interest.* The FDIC has determined that a service corporation's investment in the equity securities of any company, including an insured depository institution, a bank holding company (as that term is defined for purposes of the Bank Holding Company Act, 12 U.S.C. 1841, et seq.), or a savings and loan holding company (as that term is defined in 12 U.S.C. 1467a), does not represent a significant risk to the deposit insurance funds and may be conducted by a service corporation without first obtaining the FDIC's consent provided that the insured state savings association or its service corporation meets the eligibility requirements of § 362.4(b)(4)(i) and the transaction limitation contained in § 362.4(b)(4)(ii); and the savings association meets the capital requirements of paragraph 362.11(d) of this section. The fact that prior consent is not required by this subpart does not preclude the FDIC from taking any appropriate action with respect to the activities if the facts and circumstances warrant such action. For purposes of applying § 362.4(b)(4) (i) and (ii), the term "majority-owned subsidiary" shall be replaced with "service corporation".

(4) *Service corporations conducting securities underwriting.* The FDIC has determined that it does not represent a significant risk to the relevant deposit insurance fund for a service corporation of an insured state savings association to engage in the public sale, distribution or underwriting of securities provided that the activity is conducted by the service corporation in compliance with the core eligibility requirements listed in § 362.4(c); any additional requirements listed in § 362.4(b)(5)(ii); the savings association complies with the investment and transaction limitations of paragraph (c) of this section; and the savings association meets the capital requirements of paragraph (d) of this section. Subject to the stated requirements and limitations, the FDIC consents that these listed activities may be conducted by a service corporation of an insured state savings association if the savings association files a notice in compliance with § 362.23(a) and the FDIC does not object to the notice. The FDIC is not precluded from taking any appropriate action or imposing additional requirements with respect to the activities if the facts and circumstances warrant such action. If changes to the management or business plan of the service corporation at any time result in material changes to the nature of the service corporation's business or the manner in which its business is conducted, the insured state savings association shall advise the appropriate regional director (Supervision) in writing within 10 business days after such change. For purposes of applying § 362.4 (b)(5)(ii) and (c) to this paragraph, the terms "subsidiary" and "majority-owned subsidiary" shall be replaced with "service corporation". For the purposes of applying § 362.4(c), "eligible subsidiary" shall be replaced with "eligible service corporation".

(c) *Investment and transaction limits.* The restrictions detailed in § 362.4(d) apply to transactions between an insured state savings association and any service corporation engaging in activities which are not permissible for a service corporation of a federal savings association if specifically required by this part or FDIC order. For purposes of applying the investment limits detailed by § 362.4(d)(2), the term "investment" includes only those items described in § 362.4(d)(2)(iii)(A) (3) and (4). For purposes of applying § 362.4(d) (2), (3), and (4) to this paragraph, the terms "insured state bank" and "majority-owned subsidiary" shall be replaced, respectively, with "insured state savings association" and "service corporation". For purposes of applying § 362.4(d)(5), the term "insured state bank" shall be replaced by "insured state savings association", and "subsidiary" shall be replaced by "service corporations or subsidiaries".

(d) *Capital requirements.* If specifically required by this part or by FDIC order, an insured state savings association that wishes to conduct as principal activities through a service corporation which are not permissible for a service corporation of a federal savings association must:

(1) Be well-capitalized after deducting from its capital any amount required by section 5(t) of HOLA.

(2) Use such regulatory capital amount for the purposes of the insured state savings association's assessment risk classification under part 327 of this chapter.

### § 362.12 Approvals previously granted.

*FDIC consent by order or notice.* An insured state savings association that previously filed an application and obtained the FDIC's consent to engage in an activity or to acquire or retain an investment in a service corporation engaging as principal in an activity or acquiring and retaining any investment that is prohibited under this subpart may contine that activity or retain that investment without seeking the FDIC's consent, provided the insured state savings association and the service corporation, if applicable, continue to meet the conditions and restrictions of approval. An insured state savings association which was granted approval based on conditions which differ from the requirements of §§ 362.4(c)(2) and 362.11 (c) and (d) will be considered to meet the conditions and restrictions of the approval if the insured state savings association and any applicable service corporation meet the requirements of §§ 362.4(c)(2) and 362.11 (c) and (d). For the purposes of applying § 362.4(c)(2), ''eligible subsidiary'' and ''subsidiary'' shall be replaced with ''eligible service corporation'' and ''service corporation'', respectively.

## Subpart D—Acquiring, Establishing, or Conducting New Activities Through a Subsidiary by an Insured Savings Association

### § 362.13 Purpose and scope.

This subpart implements section 18(m) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)) which requires that prior notice be given the FDIC when an insured savings association establishes or acquires a subsidiary or engages in any new activity in a subsidiary. For the purposes of the subpart, the term ''subsidiary'' does not include any insured depository institution as that term is defined in the Federal Deposit Insurance Act. Unless otherwise indictated, the definitions provided in § 362.2 apply to this subpart.

### § 362.14 Acquiring or establishing a subsidiary; conducting new activities through a subsidiary.

No state or federal insured savings association may establish or acquire a subsidiary, or conduct any new activity through a subsidiary, unless it files a notice in compliance with § 362.23(c) and the FDIC does not object to the notice. This requirement does not apply to any federal savings bank that was chartered prior to October 15, 1982, as a savings bank under state law or any savings association that acquired its principal assets from such an institution.

## Subpart E—Applications and Notices; Activities of Insured State Banks

### § 362.15 Scope.

This subpart sets out the procedures for complying with the notice and application requirements for activities and investments of insured state banks and their subsidiaries under subparts A and B.

### § 362.16 Definitions.

For the purposes of this subpart, the following definitions shall apply:

(a) *Appropriate regional director, appropriate deputy regional director, and appropriate regional office* mean the regional director of DOS, deputy regional director of DOS, and FDIC regional office which the FDIC designates as follows:

(1) When an institution that is the subject of a notice or application is not part of a group of related institutions, the appropriate region for the institution and any individual associated with the institution is the FDIC region in which the institution or proposed institution is or will be located; or

(2) When an institution that is the subject of a notice or application is part of a group of related institutions, the appropriate region for the institution and any individual associated with the institution is the FDIC region in which the group's major policy and decision makers are located, or any other region the FDIC designates on a case-by-case basis.

(b) *Associate director* means any associate director of DOS, or in the event such title becomes obsolete, any official of equivalent authority within the division.

(c) *Deputy Director* means the Deputy Director of DOS, or in the event such title becomes obsolete, any official of equivalent or higher authority within the division.

(d) *Deputy regional director* means any deputy regional director of DOS, or in the event such title becomes obsolete, any official of equivalent authority within the same FDIC region of DOS.

(e) *DOS* means the Division of Supervision, or in the event the Division of Supervision is reorganized, any successor division.

(f) *Director* means the Director of DOS, or in the event such title becomes obsolete, any official of equivalent or higher authority within the division.

(g) *Regional director* means any regional director in DOS, or in the event such title becomes obsolete, any official of equivalent authority within the division.

### § 362.17 Filing procedures.

(a) *Where to file.* All applications and notices required by subpart A or subpart B of this part are to be in writing and filed with the appropriate regional director .

(b) *Contents of filing*—(1) *Filings generally.* All applications or notices required by subpart A or subpart B may be in letter form and shall contain the following information:

(i) A brief description of the activity and the manner in which it will be conducted;

(ii) The amount of the bank's existing or proposed direct or indirect investment in the activity as well as calculations sufficient to indicate compliance with any specific capital ratio or investment percentage limitation detailed in subpart A;

(iii) A copy of the bank's business plan regarding the conduct of the activity;

(iv) A citation to the state statutory or regulatory authority for the conduct of the activity;

(v) A copy of the order or other document from the appropriate regulatory authority granting approval for the bank to conduct the activity if such approval is necessary and has already been granted;

(vi) A brief description of the bank's policy and practice with regard to any anticipated involvement in the activity by a director, executive office or principal shareholder of the bank or any related interest of such a person; and

(vii) A description of the bank's expertise in the activity.

(2) *Copy of application or notice filed with another agency.* If an insured state bank has filed an application or notice with another federal or state regulatory authority which contains all of the information required by paragraph (b)(1) or (b)(2) of this section, the insured state bank may submit a copy to the FDIC in lieu of a separate filing.

(3) *Additional information.* The appropriate regional director may request additional information.

### § 362.18 Processing.

(a) *Expedited processing*—(1) *Notices.* Where subparts A and B permit an insured state bank or its subsidiary to commence or continue an activity after notice to the FDIC, and the appropriate regional director does not require any additional information with respect to the notice, the appropriate regional director will provide written acknowledgment that the FDIC has received the notice. The acknowledgment will indicate the date after which the bank or its subsidiary may commence the activity or continue the activity as proposed if the FDIC has not withdrawn the notice from expedited processing in the interim in accordance with paragraph (a)(2). This period will normally be 30 days, subject to extension for an additional 15 days upon written notice to the bank. If the appropriate regional director requests additional information, the written acknowledgment will be provided to the bank once complete information has been received.

(2) *Removal from expedited processing.* Upon prompt written notice to the insured state bank, the appropriate regional director may remove the notice from expedited processing because:

(i) The notice presents a significant supervisory concern, policy issue, or legal issue; or

(ii) Other good cause exists for removal.

(b) *Standard processing for applications and notices that have been removed from expedited processing.* Where subparts A and B permit an insured state bank or its subsidiary to commence or continue an activity after application to the FDIC, or for notices which are not processed pursuant to the expedited processing procedures, the FDIC will provide the insured state bank with written notification of the final action taken. The FDIC will normally review and act on such applications within 60 days after receipt of a completed application, subject to extension for an additional 30 days upon written notice to the bank. Failure of the FDIC to act on an application prior to the expiration of these periods does not constitute approval of the application.

#### § 362.19 Delegations of authority.

The authority to review and act upon applications and notices filed pursuant to this subpart E and to take any other action authorized by this subpart E or subparts A and B is delegated to the Director, the Deputy Director, and, where confirmed in writing by the Director, to an associate director, and to the appropriate regional director and deputy regional director.

### Subpart F—Applications and Notices; Activities of Insured Savings Associations

#### § 362.20 Scope.

This subpart sets out the procedures for complying with the notice and application requirements for activities and investments of insured state savings associations and their service corporations under subpart C. This subpart also sets out the procedures for complying with the notice requirements for establishing or engaging in new activities through a subsidiary of an insured savings association under subpart D.

#### § 362.21 Definitions.

For the purposes of this subpart, the following definitions shall apply:

(a) *Appropriate regional director, appropriate deputy regional director, and appropriate regional office,* respectively, mean the regional director of DOS, deputy regional director of DOS, and FDIC regional office which the FDIC designates as follows:

(1) When an institution that is the subject of a notice or application is not part of a group of related institutions, the appropriate region for the institution and any individual associated with the institution is the FDIC region in which the institution or proposed institution is or will be located; or

(2) When an institution that is the subject of a notice or application is part of a group of related institutions, the appropriate region for the institution and any individual associated with the institution is the FDIC region in which the group's major policy and decision makers are located, or any other region the FDIC designates on a case-by-case basis.

(b) *Associate director* means any associate director of DOS, or in the event such title becomes obsolete, any official of equivalent authority within the division.

(c) *Deputy Director* means the Deputy Director of DOS, or in the event such title becomes obsolete, any official of equivalent or higher authority within the division.

(d) *Deputy regional director* means any deputy regional director of DOS, or in the event such title becomes obsolete, any official of equivalent authority within the same FDIC region of DOS.

(e) *DOS* means the Division of Supervision, or in the event the Division of Supervision is reorganized, such successor division.

(f) *Director* means the Director of DOS, or in the event such title becomes obsolete, any official of equivalent or higher authority within the division.

(g) *Regional director* means any regional director in DOS, or in the event such title becomes obsolete, any official of equivalent authority within the division.

#### § 362.22 Filing procedures.

(a) *Where to file.* All applications and notices required by subpart C or subpart D of this part are to be in writing and filed with the appropriate regional director .

(b) *Contents of filing*—(1) *Filings generally.* All applications or notices required by subpart C or subpart D of this part may be in letter form and shall contain the following information:

(i) A brief description of the activity, the manner in which it will be conducted, and the expected volume or level of the activity;

(ii) The amount of the savings association's existing or proposed direct or indirect investment in the activity as well as calculations sufficient to indicate compliance with any specific capital ratio or investment percentage limitation detailed in subparts C or D;

(iii) A copy of the savings association's business plan regarding the conduct of the activity;

(iv) A citation to the state statutory or regulatory authority for the conduct of the activity;

(v) A copy of the order or other document from the appropriate regulatory authority granting approval for the bank to conduct the activity if such approval is necessary and has already been granted;

(vi) A brief description of the savings association's policy and practice with regard to any anticipated involvement in the activity by a director, executive office or principal shareholder of the savings association or any related interest of such a person; and

(vii) A description of the savings association's expertise in the activity.

(2) *Copy of application or notice filed with another agency.* If an insured savings association has filed an application or notice with another federal or state regulatory authority which contains all of the information required by paragraph (b)(1) or (b)(2) of this section, the insured savings association may submit a copy to the FDIC in lieu of a separate filing.

(3) *Additional information.* The appropriate regional director may request additional information.

#### § 362.23 Processing.

(a) *Expedited processing.*—(1) *Notices.* Where subparts C and D permit an insured savings association, service corporation, or subsidiary to commence or continue an activity after notice to the FDIC, and the appropriate regional director does not require any additional information with respect to the notice, the appropriate regional director will provide written acknowledgment that the FDIC has received the notice. The acknowledgment will indicate the date after which the savings association, service corporation, or subsidiary may commence the activity or continue the activity as proposed if the FDIC has not withdrawn the notice from expedited processing in the interim in accordance with paragraph (d)(2). This period will normally be 30 days, subject to extension for an additional 15 days upon written notice to the bank. If the appropriate regional director requests additional information, the written acknowledgment will be provided to the savings association once complete information has been received.

(2) *Removal from expedited processing.* Upon prompt written notice to the insured savings association, the appropriate regional director may remove the notice from expedited processing because:

(i) The notice presents a significant supervisory concern, policy issue, or legal issue; or

(ii) Other good cause exists for removal.

(b) *Standard processing for applications, and notices removed from expedited processing.* Where subpart C and D permit an insured savings association, service corporation, or subsidiary to commence or continue an activity after application to the FDIC, or for notices which are not processed pursuant to the expedited processing procedures, the FDIC will provide the insured savings association with written notification of the final action taken. The FDIC will normally review and act on such applications within 60 days after receipt of a completed application, subject to extension for an additional 30 days upon written notice to the bank. Failure of the FDIC to act on an application prior to the expiration of these periods does not constitute approval of the application.

(c) *Notices of activities in excess of an amount permissible for a federal savings association; subsidiary notices.* For notices required by § 362.10(b)(3) or § 362.14, the appropriate regional director will provide written acknowledgement that the FDIC has received the notice. The notice will be reviewed at the appropriate regional office, which will take such action as it deems necessary and appropriate.

**§ 362.24 Delegations of authority.**

The authority to review and act upon applications and notices filed pursuant to this subpart F and to take any other action authorized by this subpart F or subparts C and D is delegated to the Director, the Deputy Director, and, where confirmed in writing by the Director, to an associate director, and to the appropriate regional director and deputy regional director.

Dated at Washington, D.C. this 26th day of August, 1997.

By order of the Board of Directors.

Federal Deposit Insurance Corporation

**Valerie J. Best,**

*Assistant Executive Secretary.*

[FR Doc. 97–23881 Filed 9–11–97; 8:45 am]

BILLING CODE 6714–01–p

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## FEDERAL DEPOSIT INSURANCE CORPORATION

## 12 CFR Part 362

**RIN 3064–AB75**

## Activities and Investments of Insured State Banks

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Proposed rule; withdrawal.

**SUMMARY:** As part of the FDIC's systematic review of its regulations and written policies under section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI), the FDIC is withdrawing its proposed rule published August 23, 1996, in the **Federal Register** at 61 FR 43486 to amend its regulations governing the activities and investments of insured state banks. The FDIC has decided to withdraw this proposal to amend the regulation and to propose a comprehensive restructuring of the regulation. The new proposal is published elsewhere in today's **Federal Register**.

**DATES:** Proposed amendment to part 362 is withdrawn on September 12, 1997.

**FOR FURTHER INFORMATION CONTACT:** Curtis Vaughn, Examination Specialist, (202) 898–6759 or John Jilovec, Examination Specialist (202) 898–8958, Division of Supervision, FDIC 550 17th Street, N.W., Washington, D.C. 20429; Linda L. Stamp, Counsel, (202) 898–7310, or Jamey Basham, Counsel, (202) 898–7265, Legal Division, FDIC, 550 17th Street, N.W., Washington, D.C. 20429.

**SUPPLEMENTARY INFORMATION:**

### Background

On August 23, 1996, the FDIC published for comment a proposal (61 FR 43486) to amend part 362 (12 CFR part 362) of its regulations governing the activities and investments of insured banks. In general, subject to certain exceptions, insured state banks are prohibited from making equity investments of a type that are not permissible for national banks or engaging as principal in activities of a type not permissible for national banks. The proposed amendment substituted a notice for an application in the case of particular real estate, life insurance and annuity investment activities if banks met specified requirements. If the FDIC did not object during the notice period, the bank would have been allowed to proceed with the planned investment activities.

### Proposed Rule Part 362

The FDIC is conducting a systematic review of its regulations and written policies. Section 303(a) of the CDRI (12 U.S.C. 4803(a)) requires the FDIC to streamline and modify its regulations and written policies in order to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. Section 303(a) also requires the FDIC to remove inconsistencies and outmoded and duplicative requirements from its regulations and written policies.

As part of this review, and concurrent with the FDIC's withdrawal of its proposed rule amending its regulations governing the activities and investments of insured state banks, the FDIC is proposing a new rule that completely revises part 362, combining the regulations now found in §§ 303.13 and 337.4 of the FDIC's regulations (12 CFR 303.13 and 337.4 ) into part 362 and moving the application and notice procedures to part 303. The issues dealt with in the August, 1996 proposed amendment are addressed in the proposed overall revision to part 362.

### Withdrawal of the Proposed Rule

In light of the FDIC's complete revision of the regulatory text of part 362, the FDIC withdraws its proposal published in the **Federal Register** on August 23, 1996 at 61 FR 43486.

Dated at Washington, D.C., this 26th day of August, 1997.

By Order of the Board of Directors.

Federal Deposit Insurance Corporation.

**Valerie J. Best,**

*Assistant Executive Secretary.*

[FR Doc. 97–23880 Filed 9–11–97; 8:45 am]

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## DEPARTMENT OF TRANSPORTATION

## Federal Aviation Administration

## 14 CFR Part 71

**[Airspace Docket No. 97–ASO–13]**

## Proposed Establishment of Class E Airspace; Guntersville, AL

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This notice proposes to establish Class E airspace at