Investment in Subsidiaries and Equities

Expansionary Activities

Comptroller's Corporate Manual

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Investment in Subsidiaries and Equities

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This booklet should be used together with other booklets of the *Comptroller's Corporate Manual.* Users of the "Investment in Subsidiaries and Equities" booklet should refer to the "General Policies and Procedures" booklet for discussion of general filing instructions and procedures. This booklet covers operating subsidiaries, 12 CFR 5.34; bank service companies, 12 CFR 5.35; and other equity investments, 12 CFR 5.36.

Subsidiaries

Background

Banks have developed a wide range of products and services designed to increase profitability, improve service to customers, and respond to technological innovations and competition. Banks generally are required to submit an application and obtain prior Comptroller of the Currency (OCC) approval to establish or commence new activities in an operating subsidiary or a bank service company (subsidiary). This booklet contains policies and procedures to guide banks in making a request; exceptions to these requirements also are explained.

Banks have the authority to invest in various types of subsidiaries, including statutory and operating subsidiaries. A recent addition to this authority was provided by Section 2613 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which authorized bank service companies to organize in a new form, as limited liability companies (LLC). Previous OCC regulations required banks to submit extensive filings to establish subsidiaries. Effective December 31, 1996, the OCC amended its corporate regulations to recognize three categories of procedures for subsidiary filings depending on the novelty and risk level of the activity. They are: (1) an after-the-fact notice process; (2) an expedited review process; and (3) a standard application process.

Definitions

An **affiliate** has the same meaning as provided in section 23A of the Federal Reserve Act, 12 USC 371c.

A bank service company is a corporation or an LLC organized to provide services authorized by the Bank Service Company Act, 12 USC 1861 through 1867, all of whose capital stock is owned by one or more insured banks in

the case of a corporation, or all of the members of which are one or more insured banks in the case of an LLC.

A depository institution, for purposes of the Bank Service Company Act, is defined as an insured bank, a financial institution subject to examination by the Office of Thrift Supervision (OTS) or the National Credit Union Administration (NCUA) Board, or a financial institution whose accounts or deposits are insured or guaranteed under state law and eligible to be insured by the Federal Deposit Insurance Corporation or the NCUA Board.

An **eligible bank** is a national bank that:

- Has a composite CAMELS rating of 1 or 2.
- Has an outstanding or satisfactory Community Reinvestment Act (CRA) rating. (This factor does not apply to an uninsured bank or branch or a special purpose bank covered by 12 CFR 25.11(c)(3).)
- Is well capitalized as defined in 12 CFR 6.4(b)(1).
- Is not subject to a cease and desist order, consent order, formal written agreement, or Prompt Corrective Action directive or, if subject to any such order, agreement or directive, is informed in writing by the OCC that the bank still may be treated as an "eligible bank."

Investing in a bank service company includes making any advance of funds to a bank service company, whether by the purchase of stock, the making of a loan, or otherwise, except a payment for rent earned, goods sold and delivered, or services rendered before the payment was made.

For an operating subsidiary, a **limited liability company (LLC) or a similar entity** is an unincorporated business entity organized under state law, which is not a limited partnership, providing its members with limited liability. The Bank Service Company Act provides a specific definition of an LLC that generally is the same as this definition (see 12 USC 1861(a)(7)).

A **low-quality asset** has the same meaning as provided in Section 23A of the Federal Reserve Act, 12 USC 371c.

An **operating subsidiary** is a separate corporation, LLC, or similar entity, in which a national bank maintains more than a 50 percent voting or similar type of controlling interest, or otherwise controls the subsidiary and no other party controls more than 50 percent of the voting (or similar type of controlling) interest of the subsidiary. An operating subsidiary may engage in activities that are part of, or incidental to, the business of banking under 12 USC 24(Seventh), or in other activities authorized for national banks or their subsidiaries under other statutes.

The following are not operating subsidiaries under 12 CFR 5.34:

- A subsidiary in which the bank's investment is made pursuant to specific authorization in an individual statute or other OCC regulation. Examples include:
  - Agricultural credit corporation (12 USC 24(Seventh)) (see Equities section of this booklet).
  - Community development corporation subsidiary (12 CFR 24.2(c)).
  - Bank premises subsidiary (12 USC 371d).
- A subsidiary in which the bank acquired shares, in good faith, through foreclosure on collateral, by compromise of a doubtful claim, or to avoid a loss in connection with a debt previously contracted.

A **principal investor** is the insured bank that has the largest amount invested in the equity of a bank service company. When two or more insured banks have equal amounts invested, the bank service company must designate one of them as its principal investor.

An **undercapitalized bank** is an FDIC-insured depository institution that meets the criteria established in 12 CFR 6.4(b)(3), (4), or (5), for an undercapitalized, significantly undercapitalized, or critically undercapitalized bank, respectively.

Applicability

A bank that intends to acquire or establish a subsidiary, or perform a new activity in an existing subsidiary, make a new noncontrolling investment through a subsidiary, or invest in a bank service company, generally, must submit an application to the OCC and obtain prior approval. Applicants should contact the appropriate licensing manager, if necessary, to clarify whether an expansion of an activity constitutes a new activity that necessitates a notice.

When certain qualifying criteria are met, a bank may file an after-the-fact notice or receive expedited review of its application, if it is planning to engage in one of the specific activities designated for each type of filing. The qualifying criteria and preapproved activities are discussed in detail in "Summary of Process."

A bank service company may conduct only activities that the bank could perform directly, unless the Federal Reserve Board (FRB) has authorized it

(see Exceptions section for more detail). If the bank service company has both national and state bank shareholders or members, the activities conducted must be permissible for all of the shareholders.

Exceptions

Operating Subsidiary

No new filing is required for an operating subsidiary, provided the bank is adequately or well capitalized, and all of the following criteria are met:

- Activities of a new subsidiary are limited to those the bank previously reported for the establishment or acquisition of a prior operating subsidiary.
- Establishment or acquisition of the prior operating subsidiary was deemed permissible by the OCC.
- Activities, in which the new subsidiary will engage, continue to be deemed legally permissible by the OCC.
- Activities of the new subsidiary will be conducted according to any conditions imposed by the OCC in its approval of any prior bank operating subsidiary and according to the OCC's published guidelines (see Appendixes—Operating Subsidiary Guidelines).

Bank Service Company

No filing is required for a bank service company that provides the following services only for depository institutions: check and deposit posting and sorting; computation and posting of interest and other credits and charges; preparation and mailing of checks, statements, notices, and similar items; or any other clerical, bookkeeping, accounting, statistical, or similar functions.

Additionally, the OCC does not require a filing if a bank invests in the capital stock or equity of a bank service company that provides any service, other than deposit taking, that the Federal Reserve Board (FRB) has determined by regulation to be permissible for a bank holding company under 12 USC 1843(c)(8). In such cases, however, the bank must obtain the approval of the FRB pursuant to 12 USC 1865(f).

Multiple Transactions

The OCC does not require a separate application and filing fee for subsidiary activities and investments when the subsidiary is:

- Retained in a merging or converting institution [12 CFR 5.33(e)(3) and 5.24(d)(2)(I)(G)]. A converting state bank may request permission to retain nonconforming assets or investments in subsidiaries after conversion pursuant to 12 USC 35.

- Established together with an application for a new national bank charter (see "Charters" booklet).

In those cases, the OCC will consider the subsidiary together with the primary filing and, if appropriate, may request a legal opinion on the subsidiary's activities. The review period will run concurrently with the OCC's processing and decision on the merger, conversion, or charter application. The OCC's decision on the filing and any appropriate conditions will be included in the decision letter for the merger, conversion, or charter.

Key Policies

General

The OCC reviews a bank's filing to determine whether: the proposed activities and location are legally permissible; the activities comply with OCC policy; and the activities will not endanger the safety and soundness of the parent bank.

The OCC will apply the following principles to any new activity:

- Generally, a bank may conduct in an operating subsidiary activities that are part of, or incidental to, the business of banking. To determine if an activity is part of the business of banking, the OCC considers whether: (1) the activity is functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) the activity would respond to customer needs or otherwise benefit the bank or its customers; and (3) the activity involves risks similar in nature to those already assumed by banks. Similarly, to determine if an activity is incidental to the business of banking, the OCC considers whether it is convenient or useful to the bank in conducting its banking business.

- To determine whether a new activity benefits a bank's customers, the OCC weighs the value of increased competition and the operation of free markets, both of which drive down costs, increase customer choice, and promote product service innovation.

- The OCC will conduct a rigorous and fact-based analysis of the risk of a new activity, taking into consideration the inherent characteristics of the activity, the institutions seeking to conduct the activity, and the proposed volume of the new activity.

- The OCC will assure that the proposed activity will be regulated and supervised appropriately to address safety and soundness risks and otherwise to serve the public interest; for example, protection of consumers and prevention of financial crime.

The OCC also will consider the applicant's efforts to identify, plan for, and manage systems risks for those subsidiaries that are heavily reliant upon technology. These risks could include software compatibility or systems integration problems, hardware system failures, and potential "Year 2000" problems. Examples include a subsidiary that performs data processing activities or electronic banking services, such as stored value, remote banking, or electronic authentication activities. Any filing that does not address systems risks issues adequately could require additional processing time, be subject to special enforceable conditions, or receive a denial decision.

Ownership

A bank may invest in an operating subsidiary, if the parent bank maintains more than 50 percent of its voting or similar type of controlling interest, and use the after-the-fact notice or expedited review procedure, if appropriate. Otherwise, it will use the standard procedure.

A bank also may own 50 percent or less of the voting interest of a subsidiary, if it controls the subsidiary or no other party controls more than 50 percent (or a percentage greater than the bank's interest) of the voting interest in the subsidiary. However, a bank must file an application for OCC approval under the standard procedures in which the bank proposes to control and own 50 percent or less of the voting (or similar) interest of the subsidiary. Thus, regardless of the type of activity that the subsidiary proposes to engage in, a bank would not qualify for the notice or expedited review.

The OCC will review the individual control mechanisms to ensure that the parent has effective working control over the subsidiary, and that the bank is not exposed to undue risks. One factor the OCC will consider is whether generally accepted accounting principles or consolidated reporting condition and income instructions would require consolidation of the bank and its subsidiary. The OCC will review carefully the risks inherent in any proposal.

For a bank service company, a bank may not invest more than 10 percent of its capital and surplus in any single bank service company. Additionally, the bank's total investment in all bank service companies may not exceed 5 percent of the bank's total assets.

Partnership or Joint Venture

A bank's operating subsidiary may be a general or limited partner in a partnership. If a bank proposes to enter a partnership business through an operating subsidiary, with the subsidiary being either a limited or a general partner, the bank must file for the subsidiary's activity, if the bank invests in the business. Because the operating subsidiary, and not the bank, will be the partner in the partnership, the bank's potential liability should be limited to its investment in the subsidiary, provided the operating subsidiary is capitalized adequately and operated appropriately to minimize the risk of the corporate veil being pierced.

Whenever an operating subsidiary joins a partnership or joint venture, it should either control the conduct of the business, possess a veto power, or be able to withdraw to assure that the partnership or joint venture will perform only activities that are part of, or incidental to, the business of banking.

Noncontrolling Interest

The OCC may determine that ownership of a noncontrolling interest in an entity (e.g., LLC) by an operating subsidiary is permissible provided the following four standards are satisfied:

- The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.
- The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard or be able to withdraw its investment.
- The investment must be convenient or useful to the bank in carrying out the bank's business and not a mere passive investment unrelated to its banking business.
- The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

Consolidated Financial Statements

Unless otherwise provided by statute or regulation, pertinent financial data of the parent bank and its operating subsidiaries will be combined to conform to applicable statutory limitations, such as for purposes of 12 USC 56, 60, 84, or 371d. For example, the combined exposure of the parent bank and all of its operating subsidiaries to a single borrower shall not exceed the bank's lending limit (12 USC 84, 12 CFR 32).

Decision Criteria

The OCC generally will grant approval for the investment in a subsidiary, provided that:

- The subsidiary's proposed activity is legally permissible.
- The activity of the bank and its subsidiary is consistent with safe and sound banking practices and does not endanger the safety or soundness of the bank.
- The bank's performance of the activity through the subsidiary is not in contravention of OCC policy.

Additional criteria for a bank service company:

- The bank's investment is less than 10 percent of capital and surplus, and its total investment in bank service companies is not greater than five percent of the bank's total assets.
- The services will be performed only at locations in a state, in which the investing bank(s) could be authorized to perform them directly.
- The bank service company and all investing banks are located in the same state, unless the FRB has granted an exception.

Special Conditions

The OCC may conditionally approve a filing, including one accorded expedited processing, after reviewing the application and considering the relevant factors. The OCC may impose appropriate special conditions for approvals of subsidiary activities to protect the safety and soundness of the parent bank, prevent conflicts of interest, provide customer protections, ensure that approval is consistent with the statutes and regulations, or provide for other supervisory or policy considerations.

Examples of conditions that may be imposed are:

Securities Brokerage, Investment Advice, Administrative Services (see Appendixes—Operating Subsidiary Guidelines)

- The bank's aggregate direct and indirect investments in and advances to the subsidiary are limited to an amount not exceeding the bank's legal lending limit.

- The bank and its subsidiaries are "affiliates" of any investment company advised by the bank, or its subsidiaries, for purposes of Sections 23A and 23B of the Federal Reserve Act, 12 USC 371c and c-1.

Noncontrolling Interest in LLC or Similar Entity

- The LLC and the operating subsidiary may engage only in activities that are part of, or incidental to, the business of banking.
- The bank, through the operating subsidiary, will have veto power over any activities and major decisions of the LLC or will withdraw from the LLC in the event it engages in activities that are not part of or incidental to the business of banking.
- The operating subsidiary and the LLC will be subject to OCC regulation, supervision, and examination.
- The bank will account for the investment in the LLC under the equity (*or if applicable, cost)* method of accounting.

Examination and Supervision

Each subsidiary is subject to OCC examination, supervision, and regulation. Additionally, each bank service company is subject to examination and supervision by the federal banking agency that supervises the bank that is the principal investor in the company. Unless otherwise provided by statute or regulation, all provisions of federal banking laws and regulations that relate to the parent bank's operations apply to those of its subsidiaries.

If, upon examination, the OCC determines that the creation or operation of the subsidiary violates a law, regulation, or written condition, or is unsafe or unsound, or threatens the safety and soundness of the bank, the OCC may direct the bank or subsidiary to take appropriate remedial action, which may include disposing of or liquidating all or part of the subsidiary or discontinuing specific activities.

Publication

Generally public notice is not required for these filings, unless the OCC determines that the application presents significant and novel policy, supervisory, or legal issues and determines that a public notice is beneficial. (See the Expanded Activities in Operating Subsidiaries section of this booklet and the "Public Involvement" booklet, Additional Notices, for more information.)

Undercapitalized Banks

The OCC will not approve an application from an undercapitalized bank to establish or invest in a subsidiary or to engage in a new line of business in a subsidiary, unless it determines that:

- The bank's capital restoration plan has been accepted by the OCC.
- The bank is implementing the plan.
- The proposal is consistent with and will further the achievement of the plan.

Summary of Process

The bank's condition and the subsidiary's activity may determine the way a bank files with the appropriate licensing manager. In addition to a standard review process, the OCC has an after-the-fact notice and an expedited review process. Only qualifying banks may file under the expedited or notice processes, and the subsidiary's activities must be among those listed in the regulation for the respective processes. For banks that do not qualify, or when activities proposed are not among those eligible for the expedited or notice process, the bank must follow the standard filing process. The OCC's Operating Subsidiary Guidelines (see Appendixes) describe the requirements or limitations to engage in the listed activities.

Where two or more banks wish to invest in the same bank service company, one filing on behalf of all of the individual investors may be made as long as the other national banks are identified. Only one filing fee is required.

After-the-Fact Notice

The after-the-fact notice category contains less complex, commonly accepted banking-related activities that the OCC has approved previously for subsidiaries. A bank meeting certain criteria may file an after-the-fact notice for specific activities listed in the "activities eligible for notice" section in the regulation. Under this process, a bank files a written notice with the OCC within 10 days after establishing or acquiring the subsidiary, or commencing the activity, and need not seek prior OCC approval.

To qualify for the notice process, the bank that owns the subsidiary must be at least "adequately capitalized" as defined at 12 CFR 6.4(b) and not be in "troubled condition" as defined at 12 CFR 5.51(c)(6). Any bank receiving approval under this section is deemed to have agreed that the subsidiary will conduct the activity in a manner consistent with OCC's guidance. No filing fee is required for an after-the-fact notice.

The activities qualifying for the notice process (12 CFR 5.34(e)(2)(ii)) are:

- Holding property, such as real estate, personal property, securities, or other assets, acquired by the bank in good faith through foreclosure or otherwise to compromise a doubtful claim, or in the ordinary course of collecting a debt previously contracted.

- Business services performed for the bank or its affiliates. Furnishing services for the internal operations of the bank or its affiliates, including: accounting, auditing, appraising, advertising and public relations, data processing and data transmission services, databases, or facilities.

- Financial advice and consulting for the bank or its affiliates.

- Selling money orders, savings bonds, or travelers checks.

- Management consulting, operational advice, and specialized services for other depository institutions.

- Courier services between financial institutions.

- Providing check guaranty and verification services.

- Data processing and warehousing products, services, and related activities, including associated equipment and technology, for the operating subsidiary, its parent bank, and their affiliates.

- Acting as investment or financial adviser (not involving the exercise of investment discretion), or providing financial counseling, including:

) Serving as the advisory company for a mortgage or real estate investment trust.

) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies.

) Providing financial advice to state or local governments or foreign governments for the issuance of securities.

) Providing tax planning and preparation.

) Providing consumer financial counseling.

- Providing financial and transactional advice to customers and assisting customers in structuring, arranging, and executing various financial transactions (provided that the bank and its affiliates do not participate as a principal), including:

- Mergers, acquisitions, divestitures, joint ventures, leveraged buy-outs, recapitalizations, capital structurings, and financial transactions (including private and public financings and loan syndications); and conducting financial feasibility studies.

- Arranging commercial real estate equity financing.

- Investment advice (not involving the exercise of investment discretion) on futures and options on futures.

- Making, purchasing, selling, servicing, or warehousing loans or other extensions of credit, or interests therein, for the subsidiary's account, or for the account of others, including consumer, credit card, commercial, residential mortgage, and commercial mortgage loans.

  The notice process is not available for this activity if the bank acquires, directly or indirectly, any low-quality asset from any affiliate in connection with the acquisition or investment.

- Leasing of personal property, including:

  - Leases in which the bank may invest pursuant to 12 USC 24 (Seventh).

  - Leases in which the bank may invest pursuant to 12 USC 24(Tenth).

  - Acting as agent, broker, or adviser in leases for others.

  The notice is not available for any leasing activity if the bank acquires, directly or indirectly, any low-quality asset from any affiliate in connection with the acquisition or investment.

- Owning, holding, and managing all or part of the parent bank's investment securities portfolio.

Expedited Review

An eligible bank receives expedited treatment when it submits its application and filing fee for a subsidiary that proposes to engage in any of the specific activities listed in the "activities eligible for expedited review" section in the regulation. Requests to engage in such activities are deemed approved 30 days after receipt by the appropriate licensing manager, unless the OCC notifies the bank prior to that date that the filing is not eligible for expedited review under the decision standards of 12 CFR 5.13(a)(2).

If removed from expedited review, the OCC may request additional information and an additional filing fee to process the filing under the

standard process. Any approved activity must be conducted in accordance with published guidelines (see Appendixes).

A sample application is provided that outlines the information to be submitted for review (see Documents, Expedited Review Application—Subsidiary or Service Company).

Activities covered by expedited review procedures (12 CFR 5.34(e)(3)(ii)) for eligible banks are:

- Providing securities brokerage, related securities credit, and related activities, including investment advice. (See Appendixes—Interagency Statement on Retail Sales of Nondeposit Investment Products.)
- Underwriting and dealing in securities permissible for a national bank under 12 USC 24(Seventh) and 12 CFR 1.
- Acting as a futures commission merchant.
- Serving as an investment advisor for investment companies under the Investment Company Act of 1940, 15 USC 80a-1 et. seq.
- Providing financial and transactional advice to customers and assisting them in structuring, arranging, and executing various financial transactions relating to swaps and other derivatives and foreign exchange, coin and bullion, and related transactions.
- Data processing and warehousing products, services, and related activities, including associated equipment and technology permissible under 12 USC 24(Seventh) and 12 CFR 7.1019. Those activities are performed externally for parties other than the subsidiary itself, its parent bank, and their affiliates.
- Real estate appraisal services for the subsidiary, parent bank, or other financial institutions.

Standard Review

A bank must submit an application and a filing fee to the OCC for the standard review process when it intends to acquire or establish a subsidiary or to perform new activities in an existing subsidiary, that does not qualify for the after-the-fact notice or expedited review process, or when it will control and own 50 percent or less of the interest of an operating subsidiary.

The OCC may require the applicant to submit a legal analysis if the proposal is novel, unusually complex, or raises substantial unresolved legal issues. In such cases, the OCC encourages applicants to arrange a prefiling meeting

with the OCC. Additionally, any bank subject to supervisory concerns should provide financial information to support the proposed transaction (e.g., strategic plan, cost projections, or pro forma financial projections).

Sample applications are provided that outline the information needed for OCC review (see Documents, Operating Subsidiary Application and Bank Service Company Application; also refer to the Standard Procedures). The standard review process does not have a definitive time frame. Any bank filing under the standard operating subsidiary process must wait for a decision prior to commencing any activity.

The OCC will consider a national bank's request to invest in a bank service company and make a final decision within 60 days of the date it receives the filing. If the OCC fails to make a decision within that time, the investment is deemed to be approved, unless the OCC notifies the bank of significant supervisory or compliance concerns or legal or policy issues.

Specific Requirements

Year 2000 Considerations

The OCC expects all national banks to have an action plan to address year 2000 systems issues. The OCC will consider those issues in deciding an operating subsidiary that relies heavily upon technology.

OCC Guidance

The OCC has issued the following advisory letters about year 2000 systems issues:

- Advisory Letter 97-6 (AL 97-6), dated May 16, 1997, which outlines comprehensive guidance for banks to effect a year 2000 compliant system.
- Advisory Letter 97-10 (AL 97-10), dated December 17, 1997, which outlines safety and soundness guidance for year 2000 business risk.
- Advisory Letter 98-1 (AL 98-1), dated January 20, 1998, which outlines OCC year 2000 expectations for year-2000-covered applications.
- Advisory Letter 98-3 (AL 98-3), dated March 27, 1998, which outlines guidance concerning certain risk factors and due diligence to consider when assessing year 2000 vulnerabilities.

Advisory Letters have established the following target time frames to accomplish critical actions for year 2000 compliance:

- September 30, 1997 — The bank should have identified affected applications and databases. Mission critical applications should be identified and an action plan set for year 2000 work.

- June 30, 1998 — The bank should have implemented a process which identifies, assesses, and controls the year 2000 risks (i.e., credit, liquidity, or counterparty trading risks) posed by their customers.

- December 31, 1998 — Code enhancements and revisions, hardware upgrades, and other associated changes should be largely completed. In addition, for mission critical applications, programming changes should be largely completed and testing should be well underway.

Between January 1, 1999, and the end of that year, the banks should be testing and implementing their year 2000 conversion programs.

Assessment of Year 2000 Compliance

An applicant filing an operating subsidiary that relies heavily upon technology must ensure that the application addresses compliance with AL 97-6, AL 97-10, AL 98-1, AL 98-3, and any other subsequent OCC year 2000 guidance. During the corporate review process, the Licensing staff will consult with the appropriate supervisory staff (i.e., portfolio manager, ADC, or BIS) to verify that the bank is on schedule with the target time frames of AL 97-6 or subsequent guidance. For the most current guidance about year 2000 issues, refer to the OCC's Internet site, http://www.occ.treas.gov. or call the OCC Information Line (fax-on-demand service).

The OCC:

- Expects any new, internally developed systems to be year 2000 ready.[1]

- Strongly encourages the bank to choose a year 2000 ready vendor, if it plans to purchase applications software or systems or to contract for data processing services.

- Expects the applicant to submit a representation about year 2000 compliance and an action plan that complies with year 2000 guidance.

Licensing staff will:

- Obtain a representation from the applicant about year 2000 compliance.

[1]When the applicant belongs to a larger domestic or foreign banking organization, existing in-house systems will be subject to the year 2000 compliance time frames of OCC AL 97-6 or subsequent guidance.

- Coordinate a review of year 2000 preparedness in consultation with supervisory staff.

Deficiencies or Concerns

In the event the operating subsidiary selects a vendor that is not yet year 2000 ready, the OCC will determine whether the bank has sufficient due diligence in place to ensure that:

- The vendor has a year 2000 compliance plan.

- The vendor has sufficient resources (e.g., hardware, people, dollars) to complete its year 2000 conversion project within the time frames of AL 97-6, AL 98-3, or subsequent OCC year 2000 guidance.

- Appropriate management monitors the vendors' year 2000 conversion efforts and develops contingency plans, including trigger dates, for mission critical applications should vendor solutions or time frames prove inadequate.

The OCC will conduct additional reviews for any operating subsidiary application that relies heavily upon technology if it is not in compliance with the OCC's year 2000 guidelines, including the target time frames of AL 97-6. At that time, the OCC may:

- Assess the applicant bank's financial and managerial ability to remedy any year 2000 deficiencies.

- Review its plans to remedy any year 2000 deficiencies.

- Remove the application from expedited review status to further review compliance issues.

- Impose appropriate conditions, enforceable under 12 USC 1818, to address year 2000 concerns if the problem represents a significant supervisory concern. Appropriate conditions could include:

  — Specific requirements and time frames for specific remedial actions.

  — Specific measures for assessment and evaluation of the bank's year 2000 status or progress.

The OCC may deny a filing if the problems represent a significant supervisory concern or if approval would be inconsistent with applicable law, regulation, or OCC policy.

Insurance

The law expressly authorizes national banks located in a "place" with a population of less than 5,000 inhabitants, as shown by the preceding decennial census, to act "as the agent for any fire, life, or other insurance company" authorized to do business in a particular state (12 USC 92). It does not specify precisely how bank insurance agents will conduct their business. The OCC provided a detailed interpretation of the scope of section 92 in Interpretive Letter 753 (November 4, 1996).

Any subsidiary application from a bank requesting to sell insurance from a "place of 5,000" under 12 USC 92 should include a representation that the bank's proposal to sell insurance will be consistent with 12 USC 92 and the OCC's interpretation in Interpretive Letter 753. Insurance sales activities also should be conducted in accordance with the operational standards and customer safeguards described in OCC issuances (see Appendixes—Guidance to National Banks on Insurance and Annuity Sales Activities).

Expanded Activities in Operating Subsidiaries

When a bank proposes to establish or operate an operating subsidiary that will engage in an activity authorized under 12 CFR 5.34(d) for the subsidiary, but different from that permissible for the parent bank, the following additional requirements apply:

Notice and Comment

- If the OCC has not previously approved the proposed activity, the OCC will provide public notice and an opportunity for comment on the filing by publishing notice in the *Federal Register.*
- The OCC also may publish notice in the same manner for subsequent applications to conduct the same activity.

Corporate Requirements

- The subsidiary must be physically separate and distinct in its operations from the bank, ensuring that the subsidiary's employees are compensated by the subsidiary. However, this requirement does not prohibit the parent bank and the subsidiary from sharing the same facility, or utilizing dual employees, provided that any area in which the subsidiary conducts business with the public is distinguishable, to the extent practicable, from the area in which bank customers conduct business with the bank.
- The subsidiary must be held out as a separate and distinct entity from the bank in its written material and direct contact with outside parties. All

written marketing material must state clearly that the subsidiary is an entity separate from the bank and its obligations are not those of the bank.

- The subsidiary's name cannot be the same as the bank's, and a subsidiary that has a name similar to its parent bank's must take appropriate steps to minimize the risk of customer confusion over the separate character of the two entities and the extent to which their respective obligations are insured or not insured by the FDIC.

- The subsidiary must be capitalized adequately according to relevant industry measures and must maintain capital sufficient to support its activities and its reasonably expected expenses and losses.

- The subsidiary must maintain separate accounting and corporate records.

- The subsidiary must conduct its operations based on independent policies and procedures that are also intended to inform customers that it is an organization separate from the bank.

- Contracts between the subsidiary and the bank for any services must be made on terms and conditions substantially comparable with those available to or from independent entities.

- The subsidiary must observe appropriate separate corporate formalities, such as separate board of directors' meetings.

- The subsidiary must maintain a board of directors, whose members (at least one-third) shall not be directors of the bank and must have relevant expertise capable of overseeing the subsidiary's activities in a safe and sound manner.

- The subsidiary and the bank must have internal controls appropriate to manage the financial and operational risks associated with the subsidiary.

Supervisory Requirements

- The bank's capital and total assets each must be reduced by an amount equal to its actual equity investment in the subsidiary (for the purposes of risk-based capital, this deduction shall be made equally from Tier 1 and Tier 2 capital), and the bank may not consolidate its assets and liabilities with those of such a subsidiary. The OCC may require the bank to calculate its capital on a consolidated basis to determine whether the bank is capitalized adequately under 12 CFR 6.

- Transactions between the bank and the subsidiary must conform to the standards contained in Sections 23A and 23B of the Federal Reserve Act (12 USC 371c and 371c-1).

- The bank must qualify as an eligible bank both prior to and immediately upon commencement of the activity, taking the capital deduction required by 12 CFR 5.34(f)(3)(I). If the bank ceases to be well capitalized for two consecutive quarters, it must submit, within a period specified by the OCC, an acceptable plan to become well capitalized.

Any new activity will be approved only after case-by-case consideration; review of the proposed compliance with the corporate and supervisory requirements; and any additional special conditions that may be appropriate for a particular activity and bank.

Fiduciary Powers for Investment Discretion

If a subsidiary proposes to exercise investment discretion, as defined in 15 USC 78c(a)(35), on behalf of its customers or to provide investment advice for a fee, the bank must have OCC approval to exercise fiduciary powers pursuant to 12 CFR 5.26, unless the subsidiary:

- Is registered under the Investment Advisers Act of 1940, 15 USC 80b-1 et. seq., or

- Is registered or has filed a notice under the applicable provisions of sections 15, 15B, or 15C of the Securities Exchange Act of 1934, 15 USC 78o, 78o-4, or 78o-5, as a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer; and the subsidiary's performance of investment advisory services as described in 15 USC 80b-2(a)(11) is solely incidental to the conduct of its business as broker or dealer, and no special compensation is made to the subsidiary for those advisory services. To determine whether the subsidiary's performance of investment advisory services is solely incidental to the conduct of its business as a broker or dealer, and no special compensation is made to the subsidiary for those advisory services, the OCC will consider the commission structure and specific facts (see OCC Interpretive Letter 769).

Locations

A bank that proposes to establish, acquire, or operate a subsidiary at a location at which it will perform branching functions (i.e., deposits received, checks paid, or money lent) may need approval for a branch office at that location, if it has not already been authorized as a branch. A separate application and filing fee under 12 CFR 5.30 is not necessary, but a request for branch authorization should accompany the subsidiary application.

Operating subsidiaries performing permissible activities, other than core branching functions, may do so at any site at which it is legally permissible.

The bank service company and all state and national banks that invest in it must be located in the same state, unless the FRB has approved an exception to this requirement. Also, the bank service company may conduct its activities only at locations in a state in which the investing banks could be authorized to perform the activities directly.

Holding Company Dissolution

A bank may elect to use a shell subsidiary to merge with a holding company for liquidation or dissolution purposes. This shell subsidiary formation is filed along with the related business combination filings to facilitate the dissolution of an existing holding company and to avoid double taxation of the consideration paid in a merger transaction.

Generally, the holding company must make a representation when filing that it has no outstanding liabilities, including present and contingent liabilities. It must divest of all assets ineligible for investment by a national bank prior to transfer to the operating subsidiary, and it must assume the merger cost prior to its dissolution, including all necessary payments to dissenting shareholders. All other regulatory approvals must be obtained; e.g., FRB approval or a waiver of the application (see "Business Combinations" booklet.)

Equity Investments

Background

National banks are permitted to make equity investments in various types of business organizations pursuant to 12 USC 24(Seventh) and other statutes. Among other things, national banks may invest in agricultural credit corporations, certain savings associations, and bank premises corporations. In 1990, the OCC published 12 CFR 5.36 to set forth the notification requirements for other equity investments by national banks. Effective December 31, 1996, the OCC removed the prior approval requirements for certain equity investments and adopted an after-the-fact notice filing.

Applicability

For equity investments in an agricultural credit corporation, a savings association eligible to be acquired under section 13 of the FDIA, 12 USC 1823, and equity investments authorized by statute after February 12, 1990, and not covered by other applicable OCC regulation, the bank must file a notice with the appropriate licensing manager within 10 days after the investment. A sample notice is provided that outlines the information to be

submitted (see Documents, After-the-Fact Notice—Equity Investment). Other types of equity investments permitted for national banks will be reviewed by the OCC on a case-by-case basis, as appropriate.

Key Policies

General

A bank may purchase for its own account stock of a corporation organized to make loans to farmers and ranchers for agricultural purposes. Such equity investments in agricultural credit corporations are authorized under 12 USC 24(Seventh) and are limited to 20 percent of the unimpaired capital and surplus of the bank, unless it owns at least 80 percent of the stock of the agricultural credit corporation.

Equity investments in eligible savings associations are authorized under section 12 of the Federal Deposit Insurance Act, as amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The OCC will consider a savings association acquired under this authority to be a "statutory subsidiary."

Banks may invest in bank premises or in a corporation holding the bank's premises. Such equity investments in bank premises corporations have been characterized as statutory subsidiaries, and not operating subsidiaries, and have no prior approval process, except if an investment exceeds the 12 USC 371d limitation (*see* "Investment in Bank Premises" booklet).

National banks also may make certain types of equity investments in entities, such as an LLC, when the investment is part of or incidental to the business of banking and is convenient or useful to the bank in carrying out its banking business. Investments of this type are permitted under a national bank's incidental powers under 12 USC 24(Seventh). The OCC reviews those types of investments, because of their potential variety, on a case-by-case basis.

Examination and Supervision

If any equity investment is found to be in violation of law or is unsafe or unsound, the OCC will direct the bank to take appropriate remedial action, which may include divestiture of all or part of the equity investment.

Summary of Process

A national bank that wishes to invest in an agricultural credit corporation, an eligible savings association, or any other entity authorized by statute after February 12, 1990, must inform the appropriate licensing manager by providing a written notice.

A bank may file an after-the-fact notice for specific investments. For those qualifying investments, a bank files a written notice with the OCC within 10 days after making such an investment. The investments that qualify for this notice process (12 CFR 5.36(c)(l)) are:

- An agricultural credit corporation.
- A savings association eligible to be acquired under section 13 of the Federal Deposit Insurance Act (12 USC 1823).
- Any other equity investment that may be authorized by statute after February 12, 1990, if not covered separately by another applicable OCC regulation (e.g., 12 CFR 24).

A sample notice is provided that outlines the information needed for OCC review (see Documents, After-the-Fact Notice—Equity Investment).

After-the-Fact Notice—Subsidiary or Service Company

Date

Licensing Manager, District
Comptroller of the Currency
Address
City, State, ZIP Code

Re: Notice of Subsidiary Activity, Bank Charter Number

Dear Licensing Manager:

This letter provides notice that on (insert date) we (established or acquired a subsidiary or commenced performing) new activities through an investment in an operating subsidiary (or bank service company).

We are eligible for the after-the-fact notice process for the investment we have made for the activity listed at 12 CFR 5.34(e)(2)(ii)(___)(insert the appropriate activity cite: A-N). The name and address of the subsidiary are: (insert).

The activity being conducted is: (insert complete description of the activity).

The activity will be performed at the: (insert main office, branch office, or other location).

The investment is: Amount $_____
Percent of Bank Capital _____

[If the operating subsidiary is heavily reliant upon technology, provide:

- A representation of year 2000 compliance similar to the following:

  The (name of the operating subsidiary) represents that its internal systems will be year 2000 compliant in accordance with OCC guidance. In addition, the (name of the operating subsidiary) will perform due diligence to ensure that any third-party data processing servicers or purchased applications or systems from software vendors also will be year 2000 compliant. In the event that the (name of the operating subsidiary) selects a servicer or vendor that is not year 2000 compliant, it will ensure that the servicer or vendor has a year 2000 compliance plan and both the financial and personnel capacity to complete its year 2000 conversion project within the time frames outlined in year 2000 guidance from the OCC.

- A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.]

The bank represents and undertakes that the proposed activity is being conducted and will continue to be conducted according to the OCC policies contained in guidance issued for this activity.

I certify that the information contained in this filing has been examined carefully by me and is true, correct, and complete, and is current as of the date of this submission. I acknowledge that any misrepresentation or omission of a material fact constitutes fraud in the inducement and may subject me to legal sanctions provided by 18 USC 1001.

If you have any questions, please contact (name, address, city, state, ZIP Code) at (telephone number).

Sincerely,

)Signature)

Name and Title

After-the-Fact Notice—Equity Investment

Date

Licensing Manager, District
Comptroller of the Currency
Address
City, State, ZIP Code

Re: Notice of Equity Investment, Bank Charter Number

Dear Licensing Manager:

We are providing notice that on (insert date) we invested (dollar amount) in (describe the investment or business including the statutory authority).

I certify that the information contained in this filing has been examined carefully by me and is true, correct, and complete, and is current as of the date of this submission. I acknowledge that any misrepresentation or omission of a material fact constitutes fraud in the inducement and may subject me to legal sanctions provided by 18 USC 1001.

If you have any questions, please contact (name, address, city, state, ZIP Code) at (telephone number).

Sincerely,

)Signature)

Name and Title

Expedited Review Application—Subsidiary or Service Company

Date

Licensing Manager, District
Comptroller of the Currency
Address
City, State, ZIP Code

Re: Subsidiary Activity Application, Bank Charter Number

Dear Licensing Manager:

The bank intends to (establish or acquire a subsidiary or conduct) new activities through an investment in an operating subsidiary or bank service company. The name and address of the subsidiary are: (insert). The activity will be conducted at the: (insert main office, branch officer, or other location).

We are eligible for the expedited review process for the investment activity listed at 12 CFR 5.34(e)(3)(ii)(___)(insert the appropriate activity cite: A-G). The activity to be conducted is: (insert complete description).

In addition, the bank owns more than 50 percent of the voting or similar type of controlling interest of the subsidiary (or describe how the bank will control the subsidiary).

The investment is: Amount $_____
Percent of Bank Capital _____

[If the operating subsidiary is heavily reliant upon technology, provide:

- A representation of year 2000 compliance similar to the following:

  The (name of the operating subsidiary) represents that its internal systems will be year 2000 compliant in accordance with OCC guidance. In addition, the (name of the operating subsidiary) will perform due diligence to ensure that any third-party data processing servicers or purchased applications or systems from software vendors also will be year 2000 compliant. In the event that the (name of the operating subsidiary) selects a servicer or vendor that is not year 2000 compliant, it will ensure that the servicer or vendor has a year 2000 compliance plan and both the financial and personnel capacity to complete its year 2000 conversion project within the time frames outlined in year 2000 guidance from the OCC.

- A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.]

The bank represents and undertakes that it will conduct the proposed activity according to the policies contained in OCC's guidance issued for this activity.

I certify that the information contained in this filing has been examined carefully by me and is true, correct, and complete, and is current as of the date of this submission. Additionally, I agree to notify the OCC if the facts described in the filing change materially prior to a decision. I acknowledge that any misrepresentation or omission of a material fact constitutes fraud in the inducement and may subject me to legal sanctions provided by 18 USC 1001.

The filing fee of $_____ is enclosed.

If you have any questions, please contact (name, address, city, state, ZIP Code) at (telephone number).

Sincerely,

)Signature)

Name and Title

Enclosure

Operating Subsidiary Application

Date

Licensing Manager, District
Comptroller of the Currency
Address
City, State, ZIP Code

Re: Operating Subsidiary, Bank Charter Number

Dear Licensing Manager:

The bank intends to (establish or acquire a subsidiary or conduct) new activities through an investment in an operating subsidiary or bank service company. The name and address of the subsidiary are: (insert). The activity will be performed at the: (Insert main office, branch office, or other location).

We request approval for an operating subsidiary (activity) as described as follows.

The bank owns more than 50 percent of the voting or similar type of controlling interest of the subsidiary. (Or describe how the bank controls or will control the subsidiary.)

The following information is provided to describe completely the activity to be performed, and the organizational structure, management, and relationships between the bank and the subsidiary, and any significant effect that the subsidiary will have on the bank's condition and earnings: (Insert complete description so the OCC may determine legality.)

The investment is:	Amount	$_____
	Percent of Bank Capital	_____

[If the activity is novel, unusually complex, or within the business of banking or incidental thereto, but different from that permissible for a bank to conduct directly, provide an opinion of counsel or a legal analysis and describe how the bank will follow the additional corporate and supervisory requirements, if applicable, as outlined at 12 CFR 5.34(f).]

[If the operating subsidiary is heavily reliant upon technology, provide:

- A representation of year 2000 compliance similar to the following:

  The (name of the operating subsidiary) represents that its internal systems will be year 2000 compliant in accordance with OCC guidance. In addition, the (name of the operating subsidiary) will perform due diligence to ensure that any third-party data processing servicers or purchased applications or systems from software vendors also will be year 2000 compliant. In the event that the (name of the operating subsidiary) selects a servicer or vendor that is not year 2000 compliant, it will ensure that the servicer or vendor has a year 2000 compliance plan and both the financial and personnel capacity to complete its

year 2000 conversion project within the time frames outlined in year 2000 guidance from the OCC.

- A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.]

The filing fee of $ ___ is enclosed. We desire action on this application no later than (date).

I certify that the information contained in this filing has been examined carefully by me and is true, correct, and complete, and is current as of the date of this submission. Additionally, I agree to notify the OCC if the facts described in the filing change materially prior to receiving a decision. I acknowledge that any misrepresentation or omission of a material fact constitutes fraud in the inducement and may subject me to legal sanctions provided by 18 USC 1001.

If you have questions, please contact (name, address, city, state, ZIP Code) at (telephone number).

Sincerely,

)Signature)

Name and Title

Enclosure

Bank Service Company Application

Date

Licensing Manager, District
Comptroller of the Currency
Address
City, State, ZIP Code

Dear Licensing Manager:

Re: Bank Service Company, Bank Charter Number

We request approval to invest in the capital stock of a bank service company.

The name and address of the service company are: (insert).

The services will be performed only at locations in a state in which the investing national bank(s) could be authorized to perform them. (If not, state whether the Federal Reserve Board has approved an exception to this requirement.)

The bank service company and investing banks are all located in the same state. (If not, state whether the Federal Reserve Board has approved an exception to this requirement.)

The activity to be performed subject to this application will be: (completely describe the activity to be conducted, the expected effect on the bank's earnings and condition, and the legal basis supporting the permissibility of the activity.)

The amount of the investment is limited to 10 percent of the bank's capital and surplus and 5 percent of total assets. Specifically, the investment is:

Amount	$_____
Percent of Capital and Surplus	_____
Percent of Total Assets	_____

(Add if appropriate) The principal investor is: (insert).

(Add if appropriate) The following supplementary information is provided to describe adequately the activity to be performed; the percentage of control by each investing bank; and the organizational structure, management, and relationships between the bank and the subsidiary: (insert).

[If the company is heavily reliant upon technology, provide:

- A representation of year 2000 compliance similar to the following:

  The (name of the company) represents that its internal systems will be year 2000 compliant in accordance with OCC guidance. In addition, the (name of the company) will perform due diligence to ensure that any third-party data processing servicers or purchased applications or systems from software

vendors also will be year 2000 compliant. In the event that the (name of the company) selects a servicer or vendor that is not year 2000 compliant, it will ensure that the servicer or vendor has a year 2000 compliance plan and both the financial and personnel capacity to complete its year 2000 conversion project within the time frames outlined in year 2000 guidance from the OCC.

- A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.]

The filing fee of $ ___ is enclosed. We desire action on this application no later than (date).

I certify that the information contained in this filing has been examined carefully by me and is true, correct, and complete, and is current as of the date of this submission. Additionally, I agree to notify the OCC if the facts described in the filing change materially prior to receiving a decision. I acknowledge that any misrepresentation or omission of a material fact constitutes fraud in the inducement and may subject me to legal sanctions provided by 18 USC 1001.

If you have questions, please contact (name, address, city, state, ZIP Code) at (telephone number).

Sincerely,

)Signature)

Name and Title

Enclosures

After-the-Fact Notice

Licensing Staff

1. Refers a bank that requests instructions to the "General Polices and Procedures" booklet and this booklet of the *Comptroller's Corporate Manual.*

Filing the Notice

Bank

2. Submits a complete notice to the appropriate licensing manager.

   The subsidiary notice contains:

   - A complete description of the investment in the subsidiary.
   - A complete description of the activity.
   - The date the activity commenced or the investment was made.
   - A representation and undertaking that the activity is conducted and will continue to be conducted according to the policies contained in guidance issued by the OCC for those activities.
   - (If heavily reliant upon technology:
     - — A representation of year 2000 compliance.
     - — A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.)

   The equity investment notice contains:

   - A description of the investment or business, and the statutory authority, permitting the investment.
   - The dollar amount of the investment.

Review

Licensing Staff

3. Initiates and enters appropriate information into the Corporate Activities Information System (CAIS).

4. Establishes the official file to maintain all original documents.

5. Reviews the notice and verifies that:

   - The bank is at least ”adequately” capitalized and is not in ”troubled condition.”

   - The description of the activity meets the regulatory criteria under 12 CFR 5.34(e)(2)(ii), the Operating Subsidiary Guidelines, and all required information has been provided.

   - It contains the required notice criteria in step 2.

6. If the notice is sufficient, sends an acknowledgment letter and skips to step 9.

7. If the notice is insufficient or filed incorrectly, contacts the bank for clarification and missing information.

8. Reviews any additional information, makes appropriate CAIS entries, and notifies the appropriate portfolio manager and Assistant Deputy Comptroller of the filing.

Close Out

9. Forwards the file to Central Records.

Prefiling

Licensing Staff

1. Refers a bank that requests instructions about operating subsidiaries or bank service companies (subsidiaries) to the "General Polices and Procedures" booklet and this booklet of the *Comptroller's Corporate Manual*.

2. Arranges a prefiling meeting with the applicant, if appropriate. Invites the appropriate OCC staff (e.g., legal, supervision, compliance, community development, economics). During the prefiling discussions (or if no prefiling discussions, within seven days of receipt of the filing), the licensing staff should inform the applicant of the importance of year 2000 preparedness by:

   - Providing copies of the OCC's current year 2000 guidelines, including: AL 97-6, AL 97-10, AL 98-1, AL 98-3, and any subsequent issuances.

   - Advising the applicant that it must prepare a year 2000 action plan that complies with OCC guidance, which will be evaluated by the OCC during its review of the application.

3. If any prefiling discussions or meetings reveal policy, legal, supervisory, or other novel issues, contacts Bank Organization and Structure (BOS) to decide:

   - Whether the application should be filed with the Washington office if broad issues are involved.

   - If specific issues should be carved out for Washington action, while the application continues to be processed by the appropriate Licensing staff.

   - When the filing should be forwarded to Washington.

4. Prepares a summary memorandum of policy issues raised and retains all pertinent information in the pending file.

Filing the Application

Bank

5. Submits a complete application (filing) and a filing fee to the appropriate licensing manager. The expedited filing must contain:

    - A complete description of:

        — The bank's investment in the subsidiary.

        — The proposed activity of the subsidiary.

    - A representation and undertaking that the bank will conduct the proposed activity according to the policies contained in guidance issued by the OCC for that activity.

    - (If heavily reliant upon technology:

        — A representation of year 2000 compliance.

        — A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.)

    - The prescribed filing fee (see OCC Bulletin) Notice of the Comptroller of the Currency Fees).

Review

Licensing Staff

6. Initiates and enters appropriate information into the Corporate Activities Information System (CAIS).

7. Establishes the official file to maintain all original documents.

8. Forwards the correct filing fee and the deposit memorandum (Form 6043-01) to the Comptroller of the Currency, P. O. Box 73150, Chicago, Illinois 60673-7150. Retains a copy of the memorandum. Requests filing fee, if not received.

9. Determines if the bank meets:

    - The eligible bank criteria for expedited review.

    - If not an eligible bank, goes to step 13.

10. If eligible, reviews the entire filing for completeness and verifies that the description of the activity meets the regulatory criteria under 12 CFR 5.34(e)(3)(ii), the description in the Operating Subsidiary Guidelines for the activity, and qualifies for expedited review.

11. If both the bank is eligible and the activity qualifies for expedited review processing, acknowledges filing within five business days of receipt.

12. Within five business days of receipt, notifies the appropriate portfolio manager and Assistant Deputy Comptroller (ADC) of the filing and solicits comments from other OCC divisions, as appropriate, with a preliminary response required within 15 days. If, at any time, policy, legal, or supervisory issues are identified, repeats step 3.

13. If not an eligible bank or if otherwise subject to standard processing, sends a letter within five business days of receipt, notifying the bank that its filing will be processed under the standard review process and that the activity cannot begin until the OCC provides written approval for the operating subsidiary (or within 60 days of receipt for a bank service company).

Decision

Licensing Staff

14. (If appropriate) Takes one of the following actions concerning year 2000 issues:

    - Continues to process the application if year 2000 issues do not constitute a significant supervisory concern.

    - Consults with BOS for guidance if year 2000 issues constitute a significant supervisory concern.

15. Prepares the confidential memorandum and decision letter, recommending a decision to the delegated official.

16. Decides application under delegated authority or forwards the official file to BOS for decision. If referred to BOS, makes CAIS entry and goes to step 22.

17. Notifies the bank by telephone of the decision and sends the bank a decision letter and Satisfaction Survey (if appropriate).

18. If the application is conditionally approved or denied, forwards a copy of the confidential memorandum, decision document, and transmittal letter to the Quality Assurance Coordinator.

19. Makes appropriate CAIS entries.

20. Notifies the appropriate portfolio manager and Assistant Deputy Comptroller (ADC) of the decision by forwarding updated CAIS comments and, if warranted, advises of any written conditions or supervisory concerns in the decision.

21. Goes to step 31.

BOS

22. Makes appropriate CAIS entries.

23. Reviews file and:

    - Solicits comments from other OCC divisions, as appropriate.

    - If precedent setting, involves a policy strip out issue, or presents unresolved legal issues, requests legal analysis or Supervision's guidance.

24. Prepares and sends the confidential memorandum and decision letter, recommending a decision to the delegated official.

25. After decision, notifies the district and the bank by telephone of the decision and sends the bank a decision letter.

26. If the filing is conditionally approved or denied, forwards a copy of the confidential memorandum, decision document, and transmittal letter to the Quality Assurance Coordinator.

27. Makes appropriate CAIS entries.

28. Notifies the appropriate portfolio manager and Assistant Deputy Comptroller (ADC) of the decision by forwarding updated CAIS comments and, if warranted, advises of any written conditions or supervisory concerns in the decision.

29. For approved and conditionally approved filings, returns the official file to the district for additional processing.

30. If denied, goes to step 31.

Close Out

Licensing Staff/BOS

31. Reviews the file for completeness and forwards it to Central Records.
32. Makes appropriate CAIS entries.

Prefiling

Licensing Staff

1. Refers a bank that requests instructions about operating subsidiaries or bank service companies (subsidiaries) to the "General Polices and Procedures" booklet and this booklet of the *Comptroller's Corporate Manual*.

2. Arranges a prefiling meeting with the applicant, if appropriate. Invites the appropriate OCC staff (e.g., legal, supervision, compliance, community development, economics). During the prefiling discussions (or if no prefiling discussions, within seven days of receipt of the filing), the licensing staff should inform the applicant of the importance of year 2000 preparedness by:

   - Providing copies of the OCC's current year 2000 guidelines, including: AL 97-6, AL 97-10, AL 98-1, AL 98-3, and any subsequent issuances.

   - Advising the applicant that it must prepare a year 2000 action plan that complies with OCC guidance, which will be evaluated by the OCC during its review of the application.

3. If any prefiling discussions or meetings reveal policy, legal, supervisory, or other novel issues, contacts Bank Organization and Structure (BOS) to decide:

   - Whether the application should be filed with the Washington office, if broad issues are involved.

   - If specific issues should be carved out for Washington action, while the application continues to be processed by the appropriate Licensing staff.

   - When the filing should be forwarded to Washington.

4. Prepares a summary memorandum of policy or legal issues raised and retains all pertinent information in the pending file.

Filing the Application

Bank

5. Submits a complete application (filing) and a filing fee to the appropriate licensing manager.

   Operating Subsidiary

   The standard operating subsidiary filing must contain:

   - A complete description of:
     - — The bank's investment in the subsidiary.
     - — The proposed activities of the subsidiary.
     - — The organizational structure and management of the subsidiary.
     - — The relationship between the bank and the subsidiary.
     - — Any other information necessary to describe the proposal adequately.
   - The location(s) of the proposed activity, stating if any activity will be conducted at a location other than the main office or a previously approved branch of the bank.
   - An opinion of counsel or a legal analysis, if novel, unusually complex, or substantial unresolved legal issues are raised.
   - (If heavily reliant upon technology:
     - — A representation of year 2000 compliance.
     - — A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.)
   - If the activity involves investment discretion:
     - Request approval to exercise fiduciary powers and include the additional information required by 12 CFR 5.26.
     - State that the bank has approval to exercise fiduciary powers.

- State that the subsidiary is registered as an investment adviser under the Investment Advisers Act of 1940 or as a broker/dealer under the Securities Exchange Act of 1934.

- State that the subsidiary will register with the Securities and Exchange Commission under the Investment Advisers Act of 1940 or as a broker/dealer under the Securities Exchange Act of 1934.

- The prescribed filing fee (see OCC Bulletin) Notice of the Comptroller of the Currency Fees).

Bank Service Company

The standard bank service company filing must include:

- The name and location of the bank service company.

- A complete description of the activities that the bank service company will conduct.

- Information demonstrating that the bank will comply with the regulatory investment limitations.

- Information demonstrating that the bank service company and all banks investing in it are located in the same state, unless the FRB has approved an exception to this requirement under the authority of 12 USC 1864(b).

- Information demonstrating that the bank service company will conduct those activities only at locations in a state in which the investing bank could be authorized to perform them directly, unless the FRB has approved an exception to this requirement under the authority of 12 USC 1865(b).

- (If heavily reliant upon technology:

  — A representation of year 2000 compliance.

  — A year 2000 action plan that is in compliance with the OCC's year 2000 guidelines.)

Review

Licensing Staff

6. Determines the filing process and initiates and enters appropriate information into the Corporate Activities Information System (CAIS).

7. Establishes the official file to maintain all original documents.

8. Forwards the correct filing fee and the deposit memorandum (Form 6043-01) to the Comptroller of the Currency, P.O. Box 73150, Chicago, Illinois 60673-7150. Retains a copy of the memorandum. Requests a filing fee if not received.

9. Sends a letter within five business days of receipt, notifying the bank that its filing will be processed under the standard review process and that the activity cannot begin until the OCC provides written approval for the operating subsidiary (or within 60 days of receipt for a bank service company).

10. Reviews the filing and any other relevant information about the bank.

    - If the filing presents policy, legal or novel issues, repeats step 3.

    - Determines if the OCC should publish a public notice for comment in the *Federal Register*.

11. Within five business days of receipt, notifies appropriate portfolio manager and Assistant Deputy Comptroller (ADC)/Examiner-in-Charge (EIC) of the filing and solicits comments, as appropriate, from district counsel, supervision, and other OCC divisions with a preliminary response required by the 15th day after the filing date. Consults with Bank Information Systems (BIS) cadre to determine if the applicant's year 2000 compliance action plan properly identifies critical applications and systems that must be year 2000 compliant. For undercapitalized banks, contacts supervisory staff for capital plan status.

12. If the activity of the proposed subsidiary is unclear, the legality is in doubt, or if additional information is necessary to make a decision about the permissibility of the proposed investment, requires the bank to submit additional information or legal analysis, including a specific due date for reply.

13. If the activity is covered by 12 CFR 5.34(f), ensures that the supervisory staff indicates that it has established the supervisory strategies and procedures to review this activity.

Decision

Licensing Staff

14. (If appropriate) Takes one of the following actions concerning year 2000 issues:

    - Continues to process the application if year 2000 issues do not constitute a significant supervisory concern.

    - Consults with BOS for guidance if year 2000 issues constitute a significant supervisory concern.

15. Prepares the confidential memorandum and decision letter, recommending a decision to the delegated official.

16. Decides application under delegated authority or forwards the official file to BOS for decision. If referred to BOS, makes CAIS entry and goes to step 22.

17. Notifies bank by telephone of the decision and sends the decision letter.

18. If the application is conditionally approved or denied, forwards a copy of the confidential memorandum, decision document, and transmittal letter to the Quality Assurance Coordinator.

19. Makes appropriate CAIS entries.

20. Notifies the appropriate portfolio manager and Assistant Deputy Comptroller (ADC) of the decision by forwarding updated CAIS comments and, if warranted, advises of any written conditions or supervisory concerns in the decision.

21. Goes to step 31.

BOS

22. Makes appropriate CAIS entries.

23. Reviews file and solicits comments from other OCC divisions, as appropriate.

    - If an expanded activity is precedent setting, involves a carved out policy issue, or presents unresolved legal issues, requests legal analysis or supervisory guidance as soon as identified.

- Determines if the OCC should publish a public notice for comment in the *Federal Register*.

24. Prepares and sends the confidential memorandum and decision letter recommending a decision to the delegated official.

25. After decision, notifies the licensing manager and the bank by telephone of the decision and sends the bank a decision letter.

26. If the filing is conditionally approved or denied, forwards a copy of the confidential memorandum, decision document, and transmittal letter to the Quality Assurance Coordinator.

27. Makes appropriate CAIS entries.

28. Notifies the appropriate portfolio manager and Assistant Deputy Comptroller (ADC) of the decision by forwarding updated CAIS comments and, if warranted, advises of any written conditions or supervisory concerns in the decision.

29. For approved and conditionally approved filings, returns the official file to the district for additional processing.

30. If denied, goes to step 31.

Close Out

Licensing Staff/BOS

31. Reviews the file for completeness and forwards it to Central Records.

32. Makes appropriate CAIS entries.

Agricultural Credit Corporations	
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Annuities	
Law	12 USC 24(Seventh)
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Consideration for Loan	
Regulation	12 CFR 7.1006
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Law	12 USC 24(Seventh)
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Decisions

Regulation	12 CFR 5.13

Eligible Activities—Notice Procedures

Regulation	12 CFR 5.34(e)(2)(ii)

Eligible Activities—Expedited Procedures

Regulation	12 CFR 5.34(e)(3)(ii)

Federal Deposit Insurance Act

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Filing Fees

Regulation	12 CFR 5.5
Bulletin	OCC 97-47

Finder

Regulation	12 CFR 7.1002

Insurance

Laws	12 USC 24(Seventh) and 92
Advisory Letter	AL 96-8

Investment in Bank Premises

Law	12 USC 371d
Regulations	12 CFR 5.37 and 7.1000

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Limited Liability Company

Law	12 USC 24(Seventh)
Regulation	12 CFR 5.34

Operating Subsidiaries

Regulation	12 CFR 5.34

Other Equity Investments

Regulation	12 CFR 5.36

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Regulations	12 CFR 31 and 215

Stored Value Card

Bulletin	OCC 96-48

Year 2000 Issues

Advisory Letters	AL 97-6, 97-10, 98-1, 98-3
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Operating Subsidiary Guidelines

These guidelines describe those activities of national banks the OCC has determined may be performed in an operating subsidiary under the after-the-fact notice procedure or the expedited approval procedure available in the OCC's operating subsidiary regulation.[1] An operating subsidiary includes corporations and limited liability companies and may include other entities with similar corporate characteristics.[2] Operating subsidiaries established by these procedures, like all operating subsidiaries, must operate according to the standards and requirements found in the operating subsidiary regulation.[3] In addition, banks using the after-the-fact notice or expedited procedures must provide a representation and undertaking that the activity will be conducted in accordance with OCC policies contained in guidance issued by the OCC for the activity. Any bank receiving approval under these procedures is deemed to have agreed that the subsidiary will conduct the activity in a manner consistent with published OCC guidance, which includes these guidelines.[4]

These guidelines are divided into three sections: (1) a discussion of activities eligible for notice procedures; (2) a discussion of activities eligible for expedited procedures; and (3) a miscellaneous section. The following table of contents lists the sections in the guidelines that cover each activity eligible for notice or expedited approval treatment.

[1] 12 CFR 5.34(e)(2) and (3).

[2] 12 CFR 5.34(d)(2).

[3] 12 CFR 5.34(d).

[4] 12 CFR 5.34(e)(2)(I) and (3)(I).

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A. Holding property, such as real estate, personal property, securities, or other assets, acquired by the bank through foreclosure or otherwise in good faith to compromise a doubtful claim or in the ordinary course of collecting a debt previously contracted. 12 CFR 5.34(e)(2)(ii)(A).

National banks and their operating subsidiaries may acquire, manage, and liquidate assets acquired in satisfaction of debts previously contracted by the parent bank or the operating subsidiary (DPC). These assets must be disposed of in a timely fashion and cannot be used for speculation. Transfer of the DPC assets to the operating subsidiary does not alter the limitations on the bank's holding period for that asset. The property need not have been collateral for the loan in question.

Title 12 USC 29 governs the treatment of real property taken DPC. Banks should consult 12 CFR 34, Subpart E, "Other Real Estate Owned," for specific information on the treatment of DPC real estate. In addition, banks are authorized to take other property DPC under 12 USC 24 (Seventh), for sale to reduce the bank's losses on the underlying debts. A bank may take appropriate steps to preserve the property's value for sale. For example, if a national bank takes corporate stock DPC, it has the implied power to operate the corporation's business, particularly when the resale value depends on its uninterrupted operation, provided that the purpose of operating the corporation's business is not to speculate on its future value.

Generally, real property must be disposed of within five years. The Comptroller may extend that period up to five additional years, if the bank has made a good faith attempt to dispose of the real estate within the five-year period or its disposal within that period would be detrimental to the bank. A national bank also may hold securities in satisfaction of DPC for five years. This holding period also may be extended up to an additional five years upon a clearly convincing demonstration of why an additional holding period is needed.[5] An operating subsidiary that acquires stock of the parent bank must dispose of it within six months.[6]

[5]Twelve CFR 1.7 clarifies how a bank must treat securities held in satisfaction of DPC and provides for the five-year holding period with limited extensions. It also requires banks to account for those holdings in accordance with GAAP and states that they may not be taken for speculative purposes.

[6]12 USC 83.

Operating subsidiaries established by the notice procedure to engage in DPC activity also may enter into arrangements as a general or limited partner with depository or nondepository co-lenders to engage in the orderly acquisition, management, and disposition of DPC assets stemming from the parent bank's loans.[7] DPC partnership activity must be conducted as follows: (1) The partnership must be limited to the acquisition, management, and disposition of the DPC assets; (2) partners will be limited to co-lenders and their agents; (3) the DPC assets must be disposed of promptly within the previously described guidelines; and (4) the bank must maintain at its headquarters office and make available to OCC examiners current information on all DPC assets activities of its operating subsidiary, including the name and location of each operating subsidiary, each partnership and relevant agreement, and each DPC asset being held pending disposition.

National banks establishing operating subsidiaries that will engage in debt-equity swap transactions[8] must follow the standard processing procedures in section 5.34.

B. Business services for the bank or its affiliates. Furnishing services for the internal operations of the bank or its affiliates, including: accounting, auditing, appraising, advertising and public relations, data processing and data transmission services, databases, or facilities. 12 CFR 5.34(e)(2)(ii)(B).

National banks and their operating subsidiaries may provide internal operation services for the parent bank, its holding company, and their subsidiaries.[9] These services generally relate to the day-to-day operations of those entities.[10] Data processing activities are described more specifically in a separate section that follows. Appraisal services under this section exclude real estate appraisal services subject to the expedited procedures at 12 CFR 5.34(e)(3)(ii)(G).

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[7]Interpretive Letter No. 397 (September 15, 1987) *reprinted in* [Transfer Binder 1988-89] Fed. Banking L. Rep. (CCH) ¶ 85,621.

[8]No Objection Letter No. 87-10 (November 27, 1987) *reprinted in* [Transfer Binder 1988-89] Fed. Banking L. Rep. (CCH) ¶ 84,039; No Objection Letter No. 88-7 (May 20, 1988) *reprinted in* [Transfer Binder 1988-89] Fed. Banking L. Rep. (CCH) ¶ 84, 047.

[9]Interpretive Letter No. 513 (June 18, 1990) *reprinted in* [1990-91 Transfer Binder] Federal Banking L. Rep. (CCH) ¶ 83,215.

[10]Letter from Robert Bloom, Deputy Comptroller for Policy (August 26, 1975).

C. Financial advice and consulting for the bank or its affiliates. 12 CFR 5.34(e)(2)(ii)(C).

National banks and their operating subsidiaries may provide advice, opinions, research, analyses, reports and other information and opinion on any financial matter to any affiliate of the operating subsidiary. Banks traditionally have provided financial advice and consulting to customers on a stand-alone basis and have provided deposit taking, lending, investment, and trust services. Banks typically develop financial information and analysis internally. Such information and analysis may be sold as a permissible by-product of a banking-related function.[11]

D. Selling money orders, savings bonds, or travelers checks. 12 CFR 5.34(e)(2)(ii)(D).

National banks and their operating subsidiaries generally may sell these instruments without regard to where the bank's branch offices are or could be located. In addition, the OCC's interpretive ruling, "Sale of money orders at nonbanking outlets," 12 CFR 7.1014, allows bonded agents to sell money orders on behalf of the bank or its operating subsidiary at nonbanking locations.

E. Management consulting, operational advice, and specialized services for other depository institutions. 12 CFR 5.34(e)(2)(ii)(E).

National banks and their operating subsidiaries may gather information and provide advice to any unaffiliated depository institution, in the form of information or opinion about its management and operation, and provide other services tailored to the management and operational needs of a depository institution customer. Banks traditionally have performed those activities in their correspondent relationships, under which they act on behalf of other banks in conducting the banking business. Operating subsidiaries may provide a broad range of services to other depository institutions under this authority.[12]

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[11]Letter from J. Michael Shepherd, Senior Deputy Comptroller (March 8, 1988); Letter from J. T. Watson, Deputy Comptroller (July 22, 1974).

[12]Letter from Emory Rushton, Deputy Comptroller (February 16, 1988) Interpretive Letter No. 137 (December 27, 1979) *reprinted in* [1981-82 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218 Letter from John Shockey, Deputy Chief Counsel (April 12, 1976) Letter from H. Joe Selby, Deputy Comptroller (October 2, 1975); Letter from Thomas G. DeShazo, Deputy Comptroller (August 22, 1975).

Services offered pursuant to this authority must be those that reflect and incorporate the unique nature of the banking business.[13]

Any actions taken or decisions made by a depository institution customer, based on services provided by the operating subsidiary, must be a function of the management or board of directors of the customer, with the operating subsidiary refraining from engaging in a management role or exercising any form of operating control over the customer.[14]

F. Courier services between financial institutions. 12 CFR 5.34(e)(2)(ii)(F).

National banks and their operating subsidiaries may transport items pertaining to banking operations between the offices of the bank, the bank and its affiliated financial institutions, and the bank and nonaffiliated financial institutions. National banks may provide courier services for financial institutions under the following circumstances:

- For the bank itself: Transportation of items related solely to the internal operations of the bank.[15]
- For the bank itself and for its affiliated financial institutions: Transportation of items related to banking transactions, such as checks, data processing materials, and interoffice mail.[16]
- For the bank and affiliated and nonaffiliated financial institutions: Transportation of documents related to banking, such as checks, commercial paper, non-negotiable instruments, audit and accounting media, and other business records.[17]

A courier service performing the previously mentioned functions pursuant to the after-the-fact notice procedure must not constitute a branch of any bank)that is, the service must not constitute branching transactions (the receipt of deposits, payment of withdrawals, or

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[13]Interpretive Letter No. 137 (December 27, 1979) *supra.*

[14]Letter from Emory Rushton, Deputy Comptroller (February 16, 1988).

[15]Interpretive Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (March 7, 1983).

[16]Letter from Thomas G. DeShazo, Deputy Comptroller (April 26, 1974).

[17]Letter from J. Michael Shepherd, Senior Deputy Comptroller (June 18, 1990); No-Objection Letter No. 89-04 (July 11, 1989) Fed. Banking L. Rep. (CCH) ¶ 83,061 (July 11, 1989); Letter from Richard V. Fitzgerald, Director, Legal Advisory Services Division (May 22, 1981).

disbursement of loan proceeds) with its customers. If the service does constitute a branch, branching approval must be sought under the procedures set forth in 12 CFR 5.30.

G. Providing check guaranty and verification services. 12 CFR 5.34(e)(3)(ii)(G).

National banks and their operating subsidiaries may agree to "guaranty" or "verify" the checks that will be drawn upon the bank by its customers. In essence, the bank or the operating subsidiary agrees with its customers to extend credit, if necessary, to honor the checks.[18]

H. Data processing and warehousing products, services, and related activities, including associated equipment and technology for the operating subsidiary, its parent bank, and their affiliates. 12 CFR 5.34(e)(2)(ii)(H).

National banks and their operating subsidiaries may use data processing to perform all powers either expressly granted to national banks or powers considered part of, or incidental to, the business of banking.[19] Thus, a national bank operating subsidiary may collect, transcribe, process, analyze and store, for itself and others, banking, financial, and related economic data. Banks may use operating subsidiaries to perform these services for the operations of the bank, the bank's parent holding company (if any), and affiliates.[20]

National banks and their operating subsidiaries should be aware of the risks associated with data communications networks and should conform to applicable Federal Financial Institutions Examination Counsel (FFIEC) and OCC policies.[21]

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[18]Former Interpretive Ruling 7.7015, 12 CFR 7.7015, (deleted as unnecessary or repetitive in 1996, 61 Fed. Reg. 4860 (Feb. 9, 1996).

[19]Interpretive Ruling 7.1019, 12 CFR 7.1019.

[20]Interpretive Letter No. 284 (March 26, 1984) *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,448; Interpretive Letter No. 345 (July 9, 1985) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. ¶ 85,515. The provision of these services to other financial institutions and others that are not financial institutions falls within the expedited review procedures of Part 5, 12 CFR 5.34(e)(3)(ii)(F).

[21]One source of information is the FFIEC's Information Systems Examination Handbook. The current version of the Handbook is available to national banks through OCC's Communications Division. OCC Bulletin 96-39, Data Communications Networks (July 24, 1996), provides guidance on control systems over network environments. OCC Advisory Letter No. 97-6, Year 2000 Issues and Examination Approach (May 16, 1997), provides critical information regarding the requirements for making all information processing systems Year 2000 compliant and should

I. Acting as investment or financial adviser (not involving the exercise of investment discretion) or providing financial counseling. 12 CFR 5.34(e)(2)(ii)(I). This includes:

(1) Serving as the advisory company for a mortgage or real estate investment trust.

(2) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies.

(3) Providing financial advice to state or local governments or foreign governments with respect to issuance of securities.

(4) Providing tax planning and preparation.

(5) Providing consumer financial counseling.

General Description

National banks and their operating subsidiaries may provide investment and financial advisory services and financial counseling as an activity incidental to banking under 12 USC 24(Seventh), or, in the case of activities that are fiduciary in nature, pursuant to their fiduciary powers under 12 USC 92a.[22]

Advisory activities may be provided to individuals, corporations, institutional investors, correspondent financial institutions, pension and other retirement plans, and others.[23] Those activities include individualized investment advice, business advisory services, financial advice, financial planning, investment recommendations, and analyses

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be followed carefully. OCC Bulletin 97-23, Business Resumption and Contingency Planning (May 16,1997), provides guidance on business recovery planning for bank information systems.

[22]Twelve CFR 9.2(e); Interpretive Letter No. 769 (January 28, 1997) *reprinted in* [1996-97 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-133; Interpretive Letter No. 648 (May 4, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; Interpretive Letter No. 367 (August 19, 1986) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,537; Interpretive Letter No. 329 (March 4, 1985) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,499; *Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas, to Establish an Operating Subsidiary to Provide Investment Advice (American National Decision)* September 23, 1983), *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,732.

[23]Interpretive Letter No. 298 (August 1984) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,468;*(American National Decision)*, *supra*.

of economic trends.[24] Various administrative and shareholder functions also are incidental to the provision of advisory services including, but not limited to, recordkeeping, accounting, and other services.[25] Operating subsidiaries seeking to engage in different advisory activities should consult other sections of these guidelines, as applicable, for the scope of permissible activities.

Any operating subsidiary engaging in these activities must comply with applicable provisions of the Interagency Statement on Retail Sales of Nondeposit Investment Products, February 15, 1994.

Depending on the advisory services offered, the operating subsidiary may need to register with the Securities and Exchange Commission (SEC) as an investment adviser under the Investment Advisers Act of 1940 (Advisers Act) and comply with any applicable state securities laws.[26] Although banks are excluded specifically from the definition of investment adviser under the Advisers Act, bank operating subsidiaries are fully subject to it.[27] A bank whose operating subsidiary is registered as an investment adviser under the Advisers Act or as a broker dealer is not required to be granted fiduciary powers (see 12 CFR 5.34(e)(5)).

Specific Activities

(1) Serving as the advisory company for a mortgage or real estate investment trust.

National banks and their operating subsidiaries may provide investment advice and manage a portfolio of real estate loans and equity investments held or proposed to be held by a mortgage or real estate investment trust. Furnishing real estate asset management and advisory services, including servicing, advice, and recommendations for loan participations and mortgages and for real estate held, falls under the

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[24]Interpretive Letter No. 516 (July 12, 1990) *reprinted in* [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220; Interpretive Letter No. 367, *supra*; Letter from Judith A. Walter, Senior

Deputy Comptroller for National Operations dated July 17, 1986; *(American National Decision)*, *supra*.

[25]Interpretive Letter No. 647 (April 15, 1994) *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,558; Interpretive Letter No. 386 (June 19, 1987) *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,610; Interpretive Letter No. 332 (March 8, 1985) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,502.

[26]Interpretive Letter No. 403 (December 9, 1987), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627; Interpretive Letter No. 367, *supra*.

[27]15 USC 80b-2(a)(11).

financial and investment advisory authority of banks in 12 USC 24(Seventh), and a national bank may act as an advisory company for a mortgage or real estate investment trust.[28]

(2) Furnishing general economic information and advice, general economic statistical forecasting services and industry studies.

National banks and their operating subsidiaries may provide advisory services about financial and investment planning and advice on general economic, business, and financial outlooks, and general trends in the stock and bond markets.[29]

(3) Providing financial advice to state or local governments or foreign governments on the issuance of securities.

National banks and their operating subsidiaries may advise state, local, and foreign governments on financing projects and assist them in the marketing of their securities. National banks may provide such advice pursuant to their incidental powers.[30]

(4) Providing tax planning and preparation.

National banks and their operating subsidiaries may assist customers in preparing their tax returns, including providing tax planning advice. A national bank is authorized to conduct the activity, because it is incidental to the business of banking and in the nature of financial advice.[31] A national bank may provide these services to individuals or organizations, and is not restricted to existing customers for other services offered by the national bank.[32]

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[28]Interpretive Letter No. 389 (July 7, 1987); Letter from the Deputy Comptroller of the Currency (April 16, 1970).

[29]Letter from Michael A. Mancusi, Senior Deputy Comptroller (May 30, 1985); Letter from David L. Chew, Senior Deputy Comptroller (August 7, 1984); *American National Decision, supra*.

[30]12 USC 24(Seventh); Interpretive Letter No. 122 (August 1, 1979), *reprinted in* [1981 - 1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,203. *See also The Bank of Tokyo, Ltd.,* 76 Fed. Reserve Bull. 654 (1990); *The Bank of Nova Scotia,* 74 Fed. Reserve Bull. 249 (1988).

[31]12 CFR 7.7430; Letter from Eugene A. Marsico, Jr., Acting Assistant Director, Legal Advisory Services Division (March 6, 1991); Letter from William B. Glidden, Assistant Director, Legal Advisory Services Division (July 27, 1988); Letter from David H. Baris, Regional Counsel (February 11, 1980).

[32]Letter from Alan Priest, Senior Attorney, Legal Advisory Services Division (October 24, 1984).

Operating subsidiaries may not act as expert tax consultants; i.e., engage in the interpretation of tax statutes, a service that requires specialized study and training in the laws of taxation.[33]

(5) Providing consumer financial counseling.

National banks and their operating subsidiaries may provide financial advice to individuals directly or through the use of written materials, computer programs, seminars, or other methods. Providing financial advice includes advising persons on financial matters and marketing by-products of the bank's financial advisory capabilities.[34]

J. Providing financial and transactional advice to customers and assisting customers in structuring, arranging, and executing various financial transactions (provided that the bank and its affiliates do not participate as a principal). 12 CFR 5.34(e)(2)(ii)(J). This includes:

(1) Mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, recapitalizations, capital structurings, and financial transactions (including private and public financings and loan syndications); and conducting financial feasibility studies.

(2) Arranging commercial real estate equity financing.

General Description

National banks and their operating subsidiaries may accept a fee for acting, upon request, as a "finder" when their activity is limited to the introduction and does not extend to the negotiations.[35] "Finders" bring together buyers and sellers of businesses and perform certain additional functions.[36] Depending upon the activity involved, acting as a "finder"

[33]12 CFR 7.1008; Letter from John D. Gwin, Deputy Comptroller (June 11, 1974).

[34]Letter from Wallace Nathan, District Counsel (June 11, 1985).

[35]12 CFR 7.1002.

[36]Interpretive Letter No. 653 (December 22, 1994) *reprinted in* [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601; Interpretive Letter No. 566 (December 2, 1991) *reprinted in* [1991-92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,320. Letter from J. Michael Shepherd, Senior Deputy Comptroller (March 9, 1988); Letter from Judith A. Walter, Senior Deputy Comptroller (July 17, 1986).

has been found to be an activity incidental to banking under 12 USC 24(Seventh),[37] or part of the business of banking itself.[38]

National banks and their operating subsidiaries may provide financial and strategic advisory services to their customers, including those for recapitalizations, mergers, acquisitions, and other means of establishing or expanding business operations.[39] In particular, national banks and their operating subsidiaries may engage in certain additional functions when providing financial counseling or acting as a "finder" including, but not limited to, giving advice on financing a sale or acquisition; capitalizing the business; conducting research into potential buyers and sellers and providing analyses and valuations of businesses; providing strategic planning and corporate development; conducting professional skills training on subjects, such as credit analysis, auditing, and small business management; and evaluating comparable investments.[40]

(1) Mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, recapitalizations, capital structurings, and financial transactions, (including private and public financings and loan syndications); and conducting of financial feasibility studies.

National banks and their operating subsidiaries may furnish advice on financing the sale, acquisition, or capitalization of a business and other merchant banking transactions and the related activity of acting as an intermediary to arrange third party financing through loans or the private placement of debt or equity interests. Acting as agent for a customer in the private placement of the customer's securities is permitted under 12 USC 24(Seventh).[41]

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[37] Interpretive Letter No. 472 (March 2, 1989) *reprinted in* [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008.

[38]Conditional Approval Letter No. 221 (December 4, 1996).

[39]Conditional Approval Letter No. 164 (December 9, 1994); Letter from J. Michael Shepherd, Senior Deputy Comptroller (March 9, 1988); Letter from Judith A. Walter, Senior Deputy Comptroller (July 17, 1986); Interpretive Letter No. 137 (December 27, 1979) *reprinted in* [1981-82 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218.

[40]Letter from Judith A. Walter, Senior Deputy Comptroller (July 17, 1986); Interpretive Letter No. 137, *supra*. Corporate Decision No. 97-60 (July 1, 1997).

[41]Trust Interpretation No. 256 (July 9, 1990) *reported in* [1990-91 Transfer Binder] Fed. Banking L. Rep (CCH) ¶ 83,227;21, 1983); Letter from J. Michael Shepherd, Senior Deputy Comptroller (June 20, 1988); No-objection letter No. 87-4 (May 19, 1987) *reprinted in* [1988-89 Transfer Binder) Fed. Banking L. Rep. (CCH) ¶ 84,033; *Securities Industry Assn v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052 (D.C. Cir 1987), *cert. denied,* 483 U.S. 1005 (1987).

In conducting private placement activity, the subsidiary must comply with applicable securities laws.

(2) Arranging commercial real estate equity financing.

National banks and their operating subsidiaries may act as an intermediary to arrange for the placement of equity interests in commercial or investment real estate, generally on behalf of owners and developers, to finance the development of the property under the lending and financing authority of national banks in 12 USC 371 and 24(Seventh) and their authority to arrange for private placements of all types of investments pursuant to the incidental powers of a national bank to carry on the business of banking granted in 12 USC 24(Seventh).[42]

Neither the operating subsidiary nor any affiliate should expect to acquire an equity interest in any project financed by the private placement or to have a role in the development, management, or syndication of the project. The fee received by the subsidiary may not be based on the profits earned from the project. The subsidiary may not intend to become a general real estate broker, nor will it list or advertise properties for sale. The subsidiary should deal solely with sophisticated institutional investors. If the subsidiary or the parent bank engages in any lending for this activity, it should be limited to traditional debt financing, but may include taking interests as permitted by 12 CFR 7.1006.

K. Investment advice (not involving the exercise of investment discretion) on futures and options on futures. 12 CFR 5.34(e)(2)(ii)(K).

National banks and their operating subsidiaries may advise customers in transactions involving futures contracts and options on futures contracts, including exchange-traded financial and agricultural futures contracts and options on such futures contracts.[43] Operating subsidiaries also may provide advice on futures and options on futures contracts as an introducing broker (IB) or a commodity trading advisor (CTA). An

[42]Interpretive Letter No. 271 (September 21, 1983) and Interpretive Letter No. 387 (June 22, 1987).

[43]"Financial futures" includes those futures contracts and options on futures contracts relating to assets that a national bank may purchase for its own account; e.g., United States and U.S. government agency securities, domestic and Eurodollar money market instruments, bank certificates of deposit, foreign currencies, and gold, silver, platinum, and palladium. "Agricultural futures" include futures contracts and options on futures contracts for all other financial and nonfinancial assets (agricultural, petroleum, and metals futures contracts and options on such contracts).

operating subsidiary, acting as an IB, is engaged in soliciting or in accepting orders (in more than a clerical capacity) to purchase and sell any commodities futures or options. An IB does not extend credit or accept any money, securities, or property to margin, guarantee, or secure any trades or contracts that result or may result from the solicitation or acceptance of orders. Alternatively, an operating subsidiary, acting as a CTA, advises others, through publications, writings, electronic media, or other direct communication or by the regular issuance of analyses and reports, on the value or advisability of trading in any contract on commodities futures or options on commodities futures.[44] An operating subsidiary, acting as a futures commission merchant (FCM) also may provide advice in connection with its FCM activities (more fully described below in item C, Activities Eligible for Expedited Approval section).[45]

L. Making, purchasing, selling, servicing, or warehousing loans or other extensions of credit, or interests therein, for the subsidiary's account, or for the account of others, including consumer loans, credit card loans, commercial loans, residential mortgage loans, and commercial mortgage loans. The notice procedure is not available for any activity under this paragraph, however, if the notice involves the direct or indirect acquisition by the bank of any low-quality asset from an affiliate in connection with a transaction subject to this section. For purposes of this paragraph (L), the terms "low-quality asset" and "affiliate" have the same meaning as provided in section 23A of the Federal Reserve Act, 12 USC 371c. 12 CFR 5.34(e)(2)(ii)(L).

National banks and their operating subsidiaries possess broad authority to engage in lending and lending-related activities. Subject to safety and soundness or policy considerations, they may engage in originating (including asset-based lending), acquiring (including factoring), servicing, or warehousing loans or other extensions of credit for the bank's or subsidiary's account, or for the account of others. These activities are permitted for any type of loan, or interest therein, including, among other things, consumer loans, accounts receivable, credit card loans, commercial loans, residential mortgage loans, and commercial real estate loans. For purposes of this section, however,

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[44]Interpretive Letter No. 507 (May 5, 1990) *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,205 Interpretive Letter No. 494 (December 20, 1989) *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083; Interpretive Letter No. 422 (April 11, 1988) *reprinted in* [1988-1989 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 85,646; Interpretive Letter No. 380 (December 29, 1986) *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604; Interpretive Letter No. 365 (August 11, 1986) *reprinted in* [1985-1987 Transfer Binder] (CCH) ¶ 85,535.

[45]12 CFR 5.34(e)(3)(ii)(E).

only lending activities that: (1) are well-established activities previously approved by the OCC; and (2) do not raise significant policy or supervisory issues, qualify for after-the-fact notice filings under 12 CFR 5. For example, derivatives transactions are not considered lending transactions for purposes of this section. Also, operating subsidiaries structured as real estate investment trusts do not qualify for after-the-fact notice filings if the size of the minority interest to be created is greater than the lesser of 1 percent of the bank's Tier 1 capital or $1 million. Any bank that considers establishing a REIT as an operating subsidiary is strongly encouraged to consult first with the OCC.

Except for lending limit, affiliate-transaction, and insider-transaction restrictions, lending is generally permitted without a quantitative limit, but when performed for the bank's or subsidiary's own account, may be subject to geographic restrictions under the McFadden Act.

Real estate loans and certain other types of loans are also subject to certain additional restrictions discussed as follows.

Personal and Commercial Loans

National banks and their operating subsidiaries are authorized expressly to lend money on personal security.[46] They may also discount, purchase, and negotiate drafts, bills of exchange, and other evidences of debt. The general power to make and acquire personal and commercial loans essentially is unrestricted, except that certain prudential limitations apply to highly leveraged transactions, as discussed later.

Real Estate Loans and Related Activities

A national bank may make real estate loans pursuant to 12 USC 371 and 12 USC 24(Seventh). Twelve CFR 34 sets forth the standards for real estate-related lending and associated activities by national banks.[47] Real estate lending may be performed for the account of the bank, the operating subsidiary, or for third parties.[48] National banks and their operating subsidiaries may make (or participate in), arrange, purchase, or sell loans or extensions of credit (or interests therein) secured by liens or interests in residential or commercial real estate (including acquisition, development, and construction loans) without any special quantitative limit aside from the general lending limit, but subject to applicable

[46]12 USC 24(Seventh).

[47]Twelve CFR 34 was revised in 1996. *See* 61 Fed. Reg. 11,300 (Mar. 20, 1996).

[48]Interpretive Letter No. 389 (July 7, 1987) [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,613.

restrictions and requirements of the OCC's regulations in 12 CFR 34 and accompanying Interagency Guidelines for Real Estate Lending Policies.

The authority to make such loans includes structuring them as "participating loans," when a portion of the interest, but not the principal, is contingent upon the success of the borrower's enterprise. However, the lender may not take an ownership interest in the underlying real estate.[49]

The OCC interprets the general lending authority of 24(Seventh) as permitting national banks and their operating subsidiaries to act as agent in warehousing or servicing mortgage and other loans.[50] Warehousing loans generally involves holding loans that are closed and awaiting sale or delivery to an investor. National banks and their operating subsidiaries may engage in mortgage collateral warehousing for third parties, which involves the receipt, verification, and storage of loan documentation for lenders.[51] In addition, they may provide warehousing services to extend credit to the loan originator in exchange for an assignment of the loans.

Other Lending-Related Activities

In addition to direct lending activities, national banks and their operating subsidiaries may also engage in lending-related activities on behalf of third parties that are part of or incidental to banking, such as conducting a general mortgage banking business and providing loan brokerage services. For example, national banks and their operating subsidiaries may provide real estate asset management and advisory services, furnish debt collection services, set fees, arrange for the placement of equity interests in commercial real estate between borrowers and investors,[52] market and sell mortgage loans in the secondary market, provide customer service support for a credit card business, negotiate and close loans for third-party lenders, arrange loan commitments from third

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[49]12 CFR 7.7312; Interpretive Letters Nos. 389 (July 7, 1987) *supra*, 244 (Jan. 26, 1982) *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,408; and 204 (June 17, 1981) *reprinted in* [1981-82 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,285.

[50]Interpretive Letter No. 387 (June 22, 1987) *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,611.

[51]Letter from Michael Patriarca, Deputy Comptroller (May 28, 1986).

[52]Subject to the conditions in OCC Interpretive Letter No. 271 (Sept. 21, 1983) *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,435.

parties, and assist state and local governments in placing funds made available through mortgage revenue bonds.[53]

Activities undertaken for third parties, such as brokerage or servicing activities, may be conducted at any location without regard to branching restrictions.

As mentioned above, national bank financing for highly leveraged transactions is permitted, provided that the bank's board of directors and management establish and adhere to policies for highly leveraged transactions. Such policies should include:

- Protection against credit and legal risks.
- Appropriate safety and soundness controls.
- Sound management and information systems.[54]

M. Leasing of personal property. 12 CFR 5.34(e)(2)(ii)(M). This includes:

(1) Leases in which the bank may invest pursuant to 12 USC 24(Seventh).

(2) Leases in which the bank may invest pursuant to 12 USC 24(Tenth).

(3) Acting as agent, broker, or adviser in leases for others. The notice process for any leasing activity under this paragraph is not available, however, if the notice involves the direct or indirect acquisition by the bank of any low-quality asset from an affiliate in connection with a transaction subject to this section. For purposes of this paragraph (M), the terms "low-quality asset" and "affiliate" have the same meaning as provided in section 23A of the Federal Reserve Act, 12 USC 371c.

Pursuant to 12 USC 24(Seventh) and 24(Tenth), national banks and their operating subsidiaries may act as lessors and engage in the financing of

[53]Interpretive Letters Nos. 389 (July 7, 1987) *reprinted in* [1989-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,613; 387 (June 22, 1987) *supra;* and 271 (Sept. 21, 1983) *supra;* S. Rep. No. 536, 97th Cong., 2d Sess. 60 (1982); *See also* Letter from J. Michael Shepherd, Senior Deputy Comptroller (Nov. 19, 1990); Letter from Karen J. Wilson, Deputy Comptroller (Mar. 13, 1990); Letter from Karen J. Wilson, Deputy Comptroller (Nov. 29, 1989) and Letter from Emory W. Rushton, Acting Deputy Comptroller (Dec. 19, 1986).

[54]OCC Banking Bulletin No. 92-1; Examining Circular No. 245.

full-payout, net leases for personal property, subject to the requirements of 12 CFR 23. Section 24(Seventh) leases have long been permitted on the ground that they are the functional equivalent of loans. Section 24(Seventh) leases are authorized for both tangible and intangible personal property and are subject to specific restrictions set forth in Subparts A and C of 12 CFR 23, including a limitation on reliance of residual value. Part 23 requires national banks and their subsidiaries to receive prior OCC approval for certain activities and should be consulted to determine whether a separate filing under that part is needed.

Section 24(Tenth) leases are authorized pursuant to express statutory authority and are subject to specific restrictions set forth in Subparts A and B of 12 CFR 23, including a 10 percent-of-assets limitation on the aggregate book value of section 24(Tenth) leases and a minimum lease term of 90 days. In addition, the authority conferred by section 24(Tenth) is limited to the leasing of *tangible* personal property. Tangible personal property includes such items as vehicles, manufactured homes, machinery, equipment, and furniture. Unlike section 24(Seventh) leases, section 24(Tenth) leases are *not* viewed as a form of lending. Whether property is considered "personal" property depends on state law. Both types of leases are also subject to lending limits and affiliate-transactions restrictions.

National banks and their subsidiaries generally have not been authorized to engage in the lease financing of real property,[55] but may do so when the real estate lease is incidental to a personal property leasing transaction.[56] They may, however, engage in the "placement of real estate lease transactions, specifically, locating investors as potential lessors to a potential lessee and brokering the debt portion of any such lease."[57]

To establish a leasing relationship with a lessee, banks and subsidiaries may acquire property to be leased by purchasing specific property based on a legally binding commitment to lease or a legally binding written agreement, indemnifying the bank against loss from the acquisition of the leased property. Banks and their subsidiaries may also acquire property to be leased in the absence of a commitment to lease or indemnification agreement if the bank satisfies certain conditions (set

[55]Interpretive Letter No. 556 (Aug. 6, 1991) *reprinted in* [1991-92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,306; Letter from Frank Maguire, Acting Senior Deputy Comptroller (May 20, 1993).

[56]61 Fed. Reg. 66554, 66556 (Dec. 18, 1996).

[57]Letter from Wallace S. Nathan, District Counsel (Oct. 28, 1985).

forth in 12 CFR 23.4), demonstrating that the acquisition of property is not speculative. Finally, banks may acquire leases by purchasing them from another lessor, but in the case of section 24(Seventh) leases, the residual value requirement must be met at the time of the lease purchase(s). Thus, if a bank or its subsidiary purchases an existing section 24(Seventh) lease, that lease must be a "conforming lease" (as defined in 12 CFR 23) at the time of its acquisition.

Banks and their subsidiaries may also provide certain lease-related services to third parties to the extent that they are incidental to the business of banking. National banks are expressly authorized to act as finder or similar agent or broker.[58] In addition, the OCC has opined that national banks and their operating subsidiaries may provide lease consulting services (including financial advice); management, brokerage, and finder services; and lease servicing for third parties.[59]

A special category of leasing activities is permitted by 12 CFR 7.3300. National banks and their operating subsidiaries may purchase or construct municipal buildings, such as schools or similar public facilities, for lease to a municipality or other public authority.

Upon expiration of the lease, the lessee must become the owner of the building or facility. The bank lessor must be repaid entirely by the payments from the lessee.

N. Owning, holding, and managing all or part of the parent bank's investment securities portfolio. 12 CFR 5.34(e)(2)(ii)(N).

National banks and their operating subsidiaries may own, hold, and manage all or part of the parent bank's investment securities portfolio in accordance with the bank's investment guidelines. Such activity is permissible as part of, or incidental to, the business of banking. Moreover, a national bank or its operating subsidiary "may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe."[60] The OCC's Investment Securities Regulations at 12 CFR 1 prescribe limitations and restrictions on the purchase of an investment security by a national bank for its own account. These restrictions

[58]12 CFR 7.7200.

[59]Interpretive letter No. 567 (Oct. 29, 1991) *reprinted in* [1991-92 transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,337; Letter from Wallace Nathan, District Counsel (Oct. 28, 1985); Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (June 15, 1981).

[60]12 USC 24(Seventh).

similarly apply to a national bank's operating subsidiary. Limits on securities activities in Part 1 generally are applied to the bank and the operating subsidiary combined.

Activities Eligible for Expedited Approval

A. Providing securities brokerage, related securities credit, and related activities including investment advice. 12 CFR 5.34(e)(3)(ii)(A).

National banks and their operating subsidiaries may provide brokerage services, related securities credit, advisory services, and administrative services as part of or incidental to the business of banking. The specific language of 12 USC 24(Seventh) recognizes that banks may purchase and sell "securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account." 12 USC 24(Seventh).

Securities brokerage services involve the buying and selling of a wide variety of financial investment products as agent upon the order and for the account of customers. Such investment products include annuities, shares of mutual funds, units in unit investment trusts, equity and fixed income securities, sold on an agency basis. In addition, an integral part of the brokerage business is advertising and marketing services and products to attract customers.[61]

Brokerage services include buying and selling securities in the secondary market as "riskless principal." A riskless principal transaction involves the operating subsidiary purchasing or selling a security upon the order of a customer, while conducting a simultaneous offsetting sale or purchase of a security upon the order of another customer.[62] Operating subsidiaries also may act as agent for a customer in the private placement of the customer's securities as described more fully under Section J of the notice procedures, *supra.*

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[61]Conditional Approval Letter No. 164 (December 9, 1994); Interpretive Letter No. 648 (May 4, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; Interpretive Letter No. 647 (April 15, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,558; Interpretive Letter No. 622 (April 9, 1993), *reprinted in* [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,504; *Securities Industry Association v. Board of Governors of the Federal Reserve System,* 468 U.S. 207 (1984); *Securities Industry Association v. Comptroller of the Currency,* 577 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam,* 758 F.2d 739 (D.C. Cir. 1985), *cert. denied,* 474 U.S. 1054 (1986) (brokerage issue).

[62]Interpretive Letter No. 626 (July 7, 1993), *reprinted in* [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,508; Interpretive Letter No. 371 (June 13, 1986), *reprinted in* [1985-87 Transfer Binder] ¶ 85,541.

Related securities credit offered by an operating subsidiary as part of its securities brokerage services involves the extension or maintenance of credit to customers for the purchase or carrying of securities. This activity must be consistent with 12 USC 36 and 12 CFR 7.1004.[63] The Federal Reserve Board's regulations on margin loans are applicable to banks under Regulation U[64] and to brokers under Regulation T.[65]

Operating subsidiaries providing securities brokerage services also may furnish other related activities, including investment advisory and administrative services. Operating subsidiaries seeking to engage in broader advisory activities beyond those that are solely incidental to the operating subsidiary's brokerage business should consult other sections of these guidelines for the scope of permissible activities. Various administrative and shareholder functions are incidental to the provision of the brokerage services, including but, not limited to, recordkeeping, accounting, and other services.[66]

Operating subsidiaries established to engage in these activities also may conduct them in a partnership structure. For example, a subsidiary of a national bank may enter into a general partnership arrangement or joint venture with one or more subsidiaries or affiliates of an investment bank, provided that certain conditions relating to partnership issues are met.[67]

Bank operating subsidiaries that engage in these activities must comply with applicable provisions of the Interagency Statement on Retail Sales of Nondeposit Investment Products, February 15, 1994.

Whenever an applicant bank and its operating subsidiaries and/or affiliates will be engaged in the combination of providing: (1) investment advice to mutual funds; (2) full service brokerage; and (3) administrative

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[63]*Clarke v. Securities Industry Assn.*, 479 U.S. 388 (1987) (branching issue); Interpretive Letter No. 403 (December 9, 1987), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627; American National Decision, *supra*.

[64]12 CFR 221.

[65]12 CFR 220.

[66]Interpretive Letter No. 647, *supra*; Interpretive Letter No. 386, *supra*; Interpretive Letter No. 332 (March 8, 1985), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,502.

[67]Interpretive Letter No. 625 (July 1, 1993), *reprinted in* [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507; Interpretive Letter No. 622, *supra*; Interpretive Letter No. 516 (July 12, 1990), *reprinted in* [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220; Interpretive Letter No. 411 (January 20, 1988), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,635; Interpretive Letter No. 289 (May 15, 1984), *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,453.

services to mutual funds, and the application involves a significant increase in their business in these activities, the OCC will handle the application on a case-by-case basis and may require review by the OCC under the standard application procedures. The OCC also may impose conditions that include: (1) limiting the bank's aggregate direct and indirect investments in and advances to the subsidiary to an amount not exceeding the bank's legal lending limit, and (2) providing that both the bank and its subsidiaries are "affiliates" of any investment company advised by the bank, or the bank's subsidiaries, for purposes of sections 23A and 23B of the Federal Reserve Act, 12 USC 371c and c-1.

B. Underwriting and dealing in securities permissible under 12 USC 24(Seventh) and 12 CFR 1. 12 CFR 5.34(e)(3)(ii)(B).

National banks and their operating subsidiaries may underwrite and deal in Type I and Type II securities.[68] Specifically, they may underwrite and deal in: (1) obligations of the United States, a department or agency of the United States, general obligations of states and their political subdivisions; (2) obligations of certain quasi-governmental corporations, such as the Federal National Mortgage Association and the Government National Mortgage Association; (3) other obligations (such as qualified Canadian government obligations) specifically listed in 12 USC 24(Seventh); and (4) other securities the OCC determines to be eligible Type I securities under 12 USC 24(Seventh). National banks may underwrite and deal in such obligations without limitation, subject to safety and soundness considerations. 12 USC 24(Seventh); 12 CFR 1.2(l) and 1.3(a).

National banks also may underwrite and deal in: (1) obligations of certain international and multilateral development banks, such as the International Bank for Reconstruction and Development (World Bank); (2) obligations issued by any state or political subdivision for housing, university, or dormitory purposes; (3) other obligations listed specifically in 12 USC 24(Seventh); and (4) other securities the OCC determines to be eligible as Type II securities, subject to a limitation that the obligations of any single issuer may not exceed 10 percent of the bank's capital and surplus. 12 USC 24(Seventh); 12 CFR 1.2(j) and 1.3(b).

A national bank may deal in small business-related or mortgage-related Type IV securities that are fully secured by Type I securities. National banks may deal in such obligations without limitation, subject to safety and soundness considerations. 12 CFR 1.3(e).

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[68] *See* 12 CFR *1, as revised,* 61 Fed. Reg. 63,972 (Dec. 2, 1996).

The operating subsidiary must provide the OCC with evidence that it has developed suitable policies and internal controls to ensure the safe and sound conduct of the proposed activity. The operating subsidiary also should coordinate its trading positions with those of the bank itself.[69]

C. Acting as futures commission merchant. 12 CFR 5.34(e)(3)(ii)(C).

National banks and their operating subsidiaries act as futures commission merchants (FCM) if they are engaged in soliciting or accepting orders to purchase or sell financial or agricultural futures contracts and options on such contracts on major exchanges and extend credit or accept any money, securities, or property, to margin, guarantee, or secure any trades or contracts, resulting from the solicitation or acceptance of orders.[70] An FCM may act as intermediary between a customer and exchange members that actually execute or clear trades. Alternatively, an FCM may be a member of an exchange and serve as a clearing member. Operating subsidiaries may also offer advisory services, including financial and market analysis, strategy development, research, and discretionary funds management in connection with its FCM activities.[71]

A national bank may seek authority for an operating subsidiary to join domestic exchanges and clearinghouses under this section. A national bank may also apply for an operating subsidiary to join the following foreign exchanges under this section:

- Bolsa Mercantile & de Futuros, Sao Paulo, Brazil.
- Bolsa de Mercadorias de Sao Paulo, Sao Paulo, Brazil.

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[69]Letter from Jimmy F. Barton, Deputy Comptroller (July 25, 1991).

[70]"Financial futures" includes those futures contracts and options on futures contracts relating to assets that a national bank may purchase for its own account; e.g., United States and U.S. government agency securities, domestic and Eurodollar money market instruments, bank certificates of deposit, foreign currencies, and gold, silver, platinum, and palladium. "Agricultural futures" include futures contracts and options on futures contracts for all other financial and nonfinancial assets (agricultural, petroleum, and metals futures contracts and options on such contracts).

[71]Interpretive Letter No. 507 (May 5, 1990), *reprinted in* [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,205; Interpretive Letter No. 494 (December 20, 1989), *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083; Interpretive Letter No. 422 (April 11, 1988), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,646; Interpretive Letter No. 380 (December 29, 1986), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604; Interpretive Letter No. 365 (August 11, 1986), *reprinted in* [1985-1987 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 85,535.

- Bolsa Brasileria de Futuros, Rio de Janeiro, Brazil.
- Deutsche Terminborse GmbH.
- Financiele Termijnmarkt Amsterdam NV (Financial Futures Market Amsterdam), Amsterdam, The Netherlands.
- Hong Kong Futures Exchange Ltd.
- International Petroleum Exchange.
- London Platinum and Palladium Market.
- London International Financial Futures and Options Exchange.
- London Metals Exchange (Omnibus Trading Only).
- Marche a Terme International de France (Paris).
- Mercado de Productos Financieros Derividos De Renta Fija (Barcelona).
- Mercato Italiano Futures (Milano).
- The Montreal Exchange.
- New Zealand Futures and Option Exchange Ltd.
- Osaka Securities Exchange.
- Singapore International Monetary Exchange Ltd.
- Sydney Futures Exchange.
- Tokyo International Financial Futures Exchange.
- Tokyo Stock Exchange.

A national bank's FCM may not join any exchange or clearing association that requires the bank or any other of its subsidiaries to guarantee or otherwise become liable for trades executed and/or cleared by the FCM. Moreover, a national bank's FCM may not become a clearing member of any exchange or clearing association that requires the bank to also become a member of that exchange or clearing association, unless the bank obtains a waiver of that requirement. Finally, a national bank may not guarantee or assume responsibility for any liability of its FCM.

A national bank establishing an operating subsidiary to engage in the activities described in this section is subject to the following condition, which is a "condition imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 USC 1818:

> A national bank's loans to, and investments in, its FCM (and its partnership interests) in the aggregate may not exceed its legal lending limit at the time of the loan or investment. A national bank may not make investments of equity capital in its FCM (or its partnership interest) that exceed the lending limit without the OCC's prior written consent. To calculate the lending limit according to this limitation, a national bank's investment in its FCM is deemed unsecured. A national bank may, however, lend its FCM (and its partnership interest) in the aggregate an additional 10 percent of its unimpaired capital and surplus, if secured by readily marketable collateral as provided in 12 USC 84.

D. Serving as an investment adviser for investment companies under the Investment Company Act of 1940, 15 USC 80a-1 et. seq. 12 CFR 5.34(e)(2)(ii)(D).

National banks and their operating subsidiaries may provide investment advice as part of or incidental to the business of banking under 12 USC 24(Seventh), or pursuant to their fiduciary powers under 12 USC 92a, including acting as an investment adviser to an investment company.[72] Various administrative and shareholder functions are incidental to the provision of investment advisory services, including, but not limited to, recordkeeping, accounting and other services.[73] Further, operating subsidiaries may sponsor, organize, manage, and act as investment advisers to closed-end investment companies.[74]

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[72]Conditional Approval Letter No. 164 (December 9, 1994); Interpretive Letter No. 648 (May 4, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; Interpretive Letter No. 647 (April 15, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,558; Interpretive Letter No. 622 (April 9, 1993), *reprinted in* [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,504; Interpretive Letter No. 403 (December 9, 1987), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627; *Board of Governors of the Federal Reserve System v. Investment Company Institute,* 450 U.S. 46 (1981); *Securities Industry Association v. Board of Governors of the Federal Reserve System,* 821 F.2d 810 (D.C. Cir. 1987), *cert. denied,* 484 U.S. 1005 (1988).

[73]Interpretive Letter No. 647, *supra*; Interpretive Letter No. 386, *supra*; Interpretive Letter No. 332 (March 8, 1985), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,502.

[74]Conditional Approval Letter No. 164 (December 9, 1994); 12 CFR 225.28(b)6)(I).

The Investment Company Act of 1940 governs the formation, operation, and registration with the Securities and Exchange Commission (SEC) of investment companies.[75] Serving as an investment adviser to an investment company is defined in section 2(a)(20) of the Investment Company Act of 1940 and includes furnishing advice to the investment company on the desirability of investing in, purchasing, or selling securities.[76]

In addition, investment advisers to investment companies must register with the SEC under the Investment Advisers Act of 1940 (Advisers Act), unless an exemption is available.[77] Banks specifically are excluded from the definition of investment adviser under the Advisers Act, but bank operating subsidiaries are fully subject to it.[78] Operating subsidiaries also must comply with any applicable state securities laws. This section of the guidelines is limited to operating subsidiaries registered under the Advisers Act that serve as investment advisers to investment companies. Operating subsidiaries seeking to engage in different advisory activities should consult other sections of these guidelines for the scope of permissible activities.

Whenever an applicant bank and its operating subsidiaries and/or affiliates will be engaged in the combination of providing: (1) investment advice to mutual funds; (2) full service brokerage; and (3) administrative services to mutual funds, and the application involves a significant increase in their business in these activities, the OCC will handle the application on a case-by-case basis and may require review by the OCC under the standard application procedures. The OCC also may impose conditions that include: (1) limiting the bank's aggregate direct and indirect investments in and advances to the subsidiary to an amount not exceeding the bank's legal lending limit, and (2) providing that both the bank and its subsidiaries are "affiliates" of any investment company advised by the bank, or the bank's subsidiaries, for purposes of sections 23A and 23B of the Federal Reserve Act, 12 USC 371c and 371c-1.

E. Providing financial and transactional advice to customers and assisting customers in structuring, arranging, and executing various financial transactions relating to swaps and other derivatives and foreign

[75] 15 USC 80a-1 *et. seq.*

[76] 15 USC 80a-2(a)(20).

[77] 15 USC 80b-1 *et. seq.*

[78] 15 USC 80b-2(a)(11).

exchange, coin and bullion, and related transactions. 12 CFR 5.34(e)(3)(ii)(E).

National banks and their operating subsidiaries may advise, structure, arrange, and execute transactions, as agent or principal, in connection with interest rate, basis rate, currency, currency coupon, and cash-settled commodity, commodity price index, equity and equity index swaps, and other related derivative products, such as caps, collars, floors, swaptions, forward rate agreements, and other similar products commonly known as derivatives. National banks may originate, trade, and make markets in these products. National banks may arrange matched swaps or enter into unmatched swaps on an individual or portfolio basis and may offset unmatched positions with exchange-traded futures and options contracts or over-the-counter cash-settled options. National banks may provide financial advice and counseling for these activities as permissible incidental activities under 12 USC 24(Seventh).[79]

National banks and their operating subsidiaries are expressly authorized to engage in the business of "buying and selling exchange, coin, and bullion." Pursuant to this authority, a national bank and its operating subsidiary may buy and sell gold, silver, platinum, and palladium coins and bullion. The express power to buy and sell exchange, coin, and bullion encompasses transactions for the account of the operating subsidiary and its parent bank. Operating subsidiaries are also authorized to buy and sell foreign currency, because it is a form of exchange.[80]

National banks and their operating subsidiaries may provide customer advice and structure, arrange, and execute financial transactions involving foreign exchange, coin, and bullion for its own account and for the account of customers. An operating subsidiary may become a member of an exchange and act as specialist, market-maker, floor trader, and broker-dealer of exchange-traded options on foreign exchange, coin, and bullion to execute trades for its own account and that of affiliated

[79]Interpretive Letter No. 652 (September 13, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,600; Letter from Jimmy F. Barton, Deputy Comptroller (May 13, 1992); Letter from Horace G. Sneed, Senior Attorney, Legal Advisory Services Division (March 2, 1992); No-Objection Letter No. 90-1 (February 16, 1990), *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,095; Interpretive Letter No. 462 (December 19, 1988), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,686; No-Objection Letter No. 87-5 (July 20, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,034; Interpretive Letter No. 365 (August 11, 1986), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,535.

[80]Interpretive Letter No. 685 (August 4, 1995) *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,999; Interpretive Letter No. 553 (May 2, 1991), *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,300.

and unaffiliated customers. An operating subsidiary may obtain clearing membership to clear such trades for its own account, for the parent bank, and for customers. Operating subsidiaries may also engage in over-the-counter (OTC) trading in the cash and spot markets, and in forwards, futures, swaps, and options contracts on foreign exchange, coin, and bullion. Operating subsidiaries of national banks may maintain partnership interests in partnerships that engage in foreign currency options and futures transactions provided that the parent bank notifies the OCC of any change in potential liability arising from the partnership's exchange registrations and memberships.[81]

A national bank may seek authority for an operating subsidiary to join domestic exchanges and clearinghouses to engage in foreign exchange and coin and bullion activities under this section. A national bank may also apply for an operating subsidiary to join the following foreign exchanges under this section:

- London International Financial Futures and Options Exchange.
- London Metal Exchange (Omnibus Trading Only).
- London Platinum and Palladium Market.
- Marche a Terme International de France (Paris).
- Mercado de Productos Financieros Derividos De Renta Fija (Barcelona).
- The Montreal Exchange.
- New Zealand Futures and Option Exchange Limited.
- Singapore International Monetary Exchange Limited.
- Tokyo International Financial Futures Exchange.

[81] 12 USC 24(Seventh); Interpretive Letter No. 624 (June 30, 1993), *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,506; Letter from Jimmy F. Barton, Deputy Comptroller (May 13, 1992) Interpretive Letter No. 494 (December 20, 1989), *reprinted in*, [1989-1990 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 83,083; Interpretive Letter No. 433 (June 3, 1988), *reprinted in* [198-1989 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 85,657; Interpretive Letter No. 422 (April 11, 1988), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,646; Interpretive Letter 384 (May 19, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,608; Interpretive Letter No. 372 (November 7, 1986), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,542; Interpretive Letter No. 365 (August 11, 1986), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,535.

A national bank's operating subsidiary may not join any exchange or clearing association that requires the bank or any other of its subsidiaries to guarantee or otherwise become liable for trades executed and/or cleared by the operating subsidiary. Moreover, a national bank's operating subsidiary may not become a clearing member of any exchange or clearing association that requires the bank also to become a member of that exchange or clearing association, unless the bank obtains a waiver of that requirement. Finally, a national bank may not guarantee or assume responsibility for any liability of its operating subsidiary.

A national bank establishing an operating subsidiary to engage in the activities described in this section is subject to the following condition, which is a "condition imposed in writing by the agency in connection with the granting of any application or other request" withing the meaning of 12 USC 1818:

> A national bank's loans to, and investments in, its operating subsidiary (and its partnership interests) in the aggregate may not exceed its legal lending limit at the time of the loan or investment. A national bank may not make investments of equity capital in its operating subsidiary or its partnership interest) that exceed the lending limit without the OCC's prior written consent. To calculate the lending limit according to this limitation, a national bank's investment in its operating subsidiary is deemed unsecured. A national bank may, however, lend its operating subsidiary (and its partnership interest) in the aggregate an additional 10 percent of its unimpaired capital and surplus, if secured by readily marketable collateral as provided in 12 USC 84.

F. Data processing and warehousing products, services, and related activities, including associated equipment and technology permissible under 12 USC 24(Seventh) and 12 CFR 7.1019. 12 CFR 5.34(e)(3)(ii)(F).

National banks and their operating subsidiaries may perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide, or deliver. [82]

Operating subsidiaries may provide data processing services to other unrelated financial institutions as a type of correspondent services,

[82]The provision of these services for the operations of the bank, its parent holding company and affiliates falls within the after-the-fact notice procedures of Part 5, 12 CFR 5.34(e)(2)(ii)(H).

whereby banks perform a wide range of services on behalf of other banks.[83]

Banks may use operating subsidiaries approved under expedited procedures to provide data processing services to purchasers that are not financial institutions, if one of the following applies:

- The underlying service being performed using technology is a service that the OCC has found that national banks are otherwise authorized to perform or provide.
- Such services, as previously mentioned, relate to banking, financial, or related economic data.
- Such services originally were developed and used by the bank or its operating subsidiary in good faith to conduct its banking business. This includes certain by-products, such as software or databases that necessarily result from, or contribute to, the performance of permissible services.
- Such services are made available as excess capacity acquired in good faith that results from the underutilization of data processing equipment and personnel at certain times, because of fluctuations in workflow requirements to conduct the business of banking. However, only the equipment and operating personnel may be included.[84]

In addition, computer software and hardware may be sold as part of a package involving permissible data processing services as long as the hardware package is incidental to and does not dominate the packaged data processing service provided to the subsidiary's customers.[85] Software and hardware sold as part of a data processing package must be necessary, convenient, and useful to the services being provided, and

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[83]Interpretive Letter No. 754 (Nov. 6, 1996).

[84]Interpretive Letter No. 50 (July 28, 1978) *reprinted in* [1978-79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,125; Interpretive Letter No. 449, *supra*.; No-objection Letter 87-11 (November 30, 1987) *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,040; Interpretive Letter No. 516, *supra*.

[85]Interpretive Letter No. 137 (December 27, 1979) *reprinted in* [1981-82 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218; Interpretive Letter No. 345 (July 9, 1985) *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,515; Interpretive Letter No. 449 (August 23, 1988) *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,673; Interpretive Letter No. 513 (June 18, 1990) *reprinted in* [1990-91 Transfer Binder] Federal Banking L. Rep. (CCH) ¶ 83,215. Interpretive Letter 516 (July 12, 1990) *reprinted in* [1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220. Interpretive Letter No. 611 (November 23, 1992) *reprinted in* [1992-93 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449.

must be subordinate to the package. A 30 percent of total cost or gross profits limitation has been determined to be permissible.[86]

The following activities illustrate the kinds of activities covered under this provision: billing services and accounts receivable services;[87] funds transfer, cash management and credit extensions;[88] electronic data interchange services for financial information;[89] credit card processing;[90] and health insurance claims processing and related activities.[91] National banks should consult with appropriate district or Washington personnel if uncertain whether their particular activity is within the scope of "data processing" covered by this provision.

National banks and their operating subsidiaries should be aware of the risks associated with data communications networks and should conform to applicable FFIEC and OCC policies.[92]

G. Real estate appraisal services for subsidiary, parent bank, or other financial institution. 12 CFR 5.34(e)(3)(ii)(G).

National banks and their operating subsidiaries may offer appraisal and evaluation services. These services may be performed for the subsidiary, parent bank, or other financial institutions. Federally regulated institutions must obtain appraisals prepared by a certified or licensed appraiser in connection with federally related transactions. A federally related transaction is any real estate-related financial transaction made

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[86]Interpretive Letter No. 345, *supra*.; Interpretive Letter No. 516, *supra*.; Interpretive Letter No. 742 (Aug. 19, 1996); Interpretive Letter No. 754 (Nov. 6, 1996).

[87]Interpretive Letter No. 419, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,643 (Feb. 16, 1988).

[88]*Id.*; Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (Dec. 13, 1985); Interpretive Letter No. 611, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449 (Nov. 23, 1992); Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (Aug. 15, 1983).

[89]Interpretive Letter No. 653, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (Dec. 22, 1994).

[90]Interpretive Letter No. 689, [Current] Fed. Banking L. Rep. (CCH) ¶ 81-004 (Aug. 9, 1995).

[91]Letter from Gail W. Pohn, Director, Bank Organization and Structure Division (Nov. 19, 1975); Interpretive Letter No. 419, *supra*.; Letter from Julie L. Williams, Chief Counsel (March 12, 1996).

[92]*See* note 22, *supra*.

on or after August 9, 1990 by a regulated institution that requires the services of an appraiser.

Title 12 CFR 34, Subpart C sets forth the occasions upon which appraisals are required and the standards that appraisals must meet. Certain real estate-related financial transactions are exempt from the requirements of 12 CFR 34 but require an evaluation to be prepared in accordance with the Interagency Appraisal and Evaluation Guidelines.[93] Banks and operating subsidiaries should consult the Guidelines for specific information about the regulatory standards for appraisals and evaluations. If appraisal or evaluation services are offered to other financial institutions, the proper controls must be in place to ensure confidentiality.

[93] *Comptroller's Handbook*, Real Estate and Construction Lending, Appendix E (October 27, 1994).

Interagency Statement on Retail Sales of Nondeposit Investment Products

Introduction

Recently many insured depository institutions have expanded their activities in recommending or selling to retail customers nondeposit investment products, such as mutual funds and annuities. Many depository institutions are providing these services at the retail level, directly or through various types of arrangements with third parties.

Sales activities for nondeposit investment products should ensure that customers for these products are clearly and fully informed of the nature and risks associated with these products. In particular, where nondeposit investment products are recommended or sold to retail customers, depository institutions should ensure that customers are fully informed that the products:

- Are not insured by the FDIC,
- Are not deposits or other obligations of the institution and are not guaranteed by the institution, and
- Are subject to investment risks, including possible loss of the principal invested.

Moreover, sales activities involving these investment products should be designed to minimize the possibility of customer confusion and to safeguard the institution from liability under the applicable anti-fraud provisions of the federal securities laws, which, among other things, prohibit materially misleading or inaccurate representations in connection with the sale of securities.

The four federal banking agencies—the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision—are issuing this Statement to provide uniform guidance to depository institutions engaging in these activities.[1]

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[1]Each of the four banking agencies has in the past issued guidelines addressing various aspects of the retail sale of nondeposit investment products. OCC Banking Circular 274 (July 19, 1993); FDIC Supervisory Statement FIL-71-93 (October 8, 1993); Federal Reserve Letters SR 93-35 (June 17, 1993) and SR 91-14 (June 6, 1991); and OTS Thrift Bulletin 23-1 (Sept. 7, 1993). This Statement is intended to consolidate and make uniform the guidance contained in the various existing statements of each of the agencies, all of which are superseded by this Statement. Some of the banking agencies have adopted additional guidelines covering the sale of certain specific types of instruments by depository institutions, i.e., obligations of the institution itself or of an affiliate of the institution. These guidelines remain in effect except where clearly inapplicable.

Scope

This Statement applies when retail recommendations or sales of nondeposit investment products are made by:

- Employees of the depository institution;
- Employees of a third party, which may or may not be affiliated with the institution,[2] occurring on the premises of the institution (including telephone sales or recommendations by employees or from the institution's premises and sales or recommendations initiated by mail from its premises); and
- Sales resulting from a referral of retail customers by the institution to a third party when the depository institution receives a benefit for the referral.

These guidelines generally do not apply to the sale of nondeposit investment products to non-retail customers, such as sales to fiduciary accounts administered by an institution.[3] However, as part of its fiduciary responsibility, an institution should take appropriate steps to avoid potential customer confusion when providing nondeposit investment products to the institution's fiduciary customers.

Adoption of Policies and Procedures

Program Management. A depository institution involved in the activities described above for the sale of nondeposit investment products to its retail customers should adopt a written statement that addresses the risks associated with the sales program and contains a summary of policies and procedures outlining the features of the institution's program and addressing, at a minimum, the concerns described in this Statement. The written statement should address the scope of activities of any third party involved, as well as

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[2]This Statement does not apply to the subsidiaries of insured state nonmember banks, which are subject to separate provisions, contained in 12 CFR 337.4, relating to securities activities. For OTS-regulated institutions that conduct sales of nondeposit investment products through a subsidiary, these guidelines apply to the subsidiary. 12 CFR 545.74 also applies to such sales. Branches and agencies of U.S. foreign banks should follow these guidelines with respect to their nondeposit investment sales programs.

[3]Restrictions on a national bank's use as fiduciary of the bank's brokerage service or other entity with which the bank has a conflict of interest, including purchases of the bank's proprietary and other products, are set out in 12 CFR 9.12. Similar restrictions on transactions between funds held by a federal savings association as fiduciary and any person or organization with whom there exists an interest that might affect the best judgment of the association acting in its fiduciary capacity are set out in 12 CFR 550.10.

the procedures for monitoring compliance by third parties in accordance with the guidelines below. The scope and level of detail of the statement should appropriately reflect the level of the institution's involvement in the sale or recommendation of nondeposit investment products. The institution's statement should be adopted and reviewed periodically by its board of directors. Depository institutions are encouraged to consult with legal counsel with regard to the implementation of a nondeposit investment product sales program.

The institution's policies and procedures should include the following:

- Compliance procedures. The procedures for ensuring compliance with applicable laws and regulations and consistency with the provisions of this Statement.

- Supervision of personnel involved in sales. A designation by senior managers of specific individuals to exercise supervisory responsibility for each activity outlined in the institution's policies and procedures.

- Types of products sold. The criteria governing the selection and review of each type of product sold or recommended.

- Permissible use of customer information. The procedures for the use of information regarding the institution's customers for any purpose in connection with the retail sale of nondeposit investment products.

- Designation of employees to sell investment products. A description of the responsibilities of those personnel authorized to sell nondeposit investment products and of other personnel who may have contact with retail customers concerning the sales program; and a description of any appropriate and inappropriate referral activities and the training requirements and compensation arrangements for each class of personnel.

Arrangements with Third Parties. If a depository institution directly or indirectly, including through a subsidiary or service corporation, engages in activities as described above under which a third party sells or recommends nondeposit investment products, the institution should, prior to entering into the arrangement, conduct an appropriate review of the third party. The institution should have a written agreement with the third party that is approved by the institution's board of directors. Compliance with the agreement should be periodically monitored by the institution's senior management. At a minimum, the written agreement should:

- Describe the duties and responsibilities of each party, including a description of permissible activities by the third party on the institution's premises, terms as to the use of the institution's space, personnel, and

equipment, and compensation arrangements for personnel of the institution and the third party.

- Specify that the third party will comply with all applicable laws and regulations, and will act consistently with the provisions of this Statement and, in particular, with the provisions relating to customer disclosures.

- Authorize the institution to monitor the third party and periodically review and verify that the third party and its sales representatives are complying with its agreement with the institution.

- Authorize the institution and the appropriate banking agency to have access to such records of the third party as are necessary or appropriate to evaluate such compliance.

- Require the third party to indemnify the institution for potential liability resulting from actions of the third party with regard to the investment product sales program.

- Provide for written employment contracts, satisfactory to the institution, for personnel who are employees of both the institution and the third party.

General Guidelines

1. Disclosures and Advertising

The banking agencies believe that recommending or selling nondeposit investment products to retail customers should occur in a manner that assures that the products are clearly differentiated from insured deposits. Conspicuous and easy to comprehend disclosures concerning the nature of nondeposit investment products and the risk inherent in investing in these products are one of the most important ways of ensuring that the differences between nondeposit products and insured deposits are understood.

Content and Form of Disclosure. Disclosures with respect to the sale or recommendation of these products should, at a minimum, specify that the product is:

- Not insured by the FDIC.

- Not a deposit or other obligation of, or guaranteed by, the depository institution.

- Subject to investment risks, including possible loss of the principal amount invested.

The written disclosures described above should be conspicuous and presented in a clear and concise manner. Depository institutions may provide any additional disclosures that further clarify the risks involved with particular nondeposit investment products.

Timing of Disclosure. The minimum disclosures should be provided to the customer:

- Orally during any sales presentation;
- Orally when investment advice concerning nondeposit investment products is provided;
- Orally and in writing prior to or at the time an investment account is opened to purchase these products; and
- In advertisements and other promotional materials, as described below.

A statement, signed by the customer, should be obtained at the time such an account is opened, acknowledging that the customer has received and understands the disclosures. For investment accounts established prior to the issuance of these guidelines, the institution should consider obtaining such a signed statement at the time of the next transaction.

Confirmations and account statements for such products should contain at least the minimum disclosures if the confirmations or account statements contain the name or the logo of the depository institution or an affiliate.[4] If a customer's periodic deposit account statement includes account information concerning the customer's nondeposit investment products, the information concerning these products should be clearly separate from the information concerning the deposit account, and should be introduced with the minimum disclosures and the identity of the entity conducting the nondeposit transaction.

Advertisements and Other Promotional Material. Advertisements and other promotional and sales material, written or otherwise, about nondeposit investment products sold to retail customers should conspicuously include at least the minimum disclosures discussed above and must not suggest or convey any inaccurate or misleading impression about the nature of the product or its lack of FDIC insurance. The minimum disclosures should also be emphasized in telemarketing contacts. Any third party advertising or promotional material should clearly identify the company selling the nondeposit investment product and should not suggest that the depository

[4]These disclosures should be made in addition to any other confirmation disclosures that are required by law or regulation. E.g., 12 CFR Parts 12 and 344, and 12 CFR 208.8(k)(3).

institution is the seller. If brochures, signs, or other written material contain information about both FDIC-insured deposits and nondeposit investment products, these materials should clearly segregate information about nondeposit investment products from the information about deposits.

Additional Disclosures. Where applicable, the depository institution should disclose the existence of an advisory or other material relationship between the institution or an affiliate of the institution and an investment company whose shares are sold by the institution and any material relationship between the institution and an affiliate involved in providing nondeposit investment products. In addition, where applicable, the existence of any fees, penalties, or surrender charges should be disclosed. These additional disclosures should be made prior to or at the time an investment account is opened to purchase these products.

If sales activities include any written or oral representations concerning insurance coverage provided by any entity other than the FDIC, e.g., the Securities Investor Protection Corporation (SIPC), a state insurance fund, or a private insurance company, then clear and accurate written or oral explanations of the coverage must also be provided to customers when the representations concerning insurance coverage are made, in order to minimize possible confusion with FDIC insurance. Such representations should not suggest or imply that any alternative insurance coverage is the same as or similar to FDIC insurance.

Because of the possibility of customer confusion, a nondeposit investment product must not have a name that is identical to the name of the depository institution. Recommending or selling a nondeposit investment product with a name similar to that of the depository institution should only occur pursuant to a sales program designed to minimize the risk of customer confusion. The institution should take appropriate steps to assure that the issuer of the product has complied with any applicable requirements established by the Securities and Exchange Commission regarding the use of similar names.

2. Setting and Circumstances

Selling or recommending nondeposit investment products on the premises of a depository institution may give the impression that the products are FDIC-insured or are obligations of the depository institution. To minimize customer confusion with deposit products, sales or recommendations of nondeposit investment products on the premises of a depository institution should be conducted in a physical location distinct from the area where retail deposits are taken. Signs or other means should be used to distinguish the investment sales area from the retail deposit-taking area of the institution. However, in the limited situation where physical considerations prevent sales of nondeposit products from being conducted in a distinct area, the

institution has a heightened responsibility to ensure appropriate measures are in place to minimize customer confusion.

In no case, however, should tellers and other employees, while located in the routine deposit-taking area, such as the teller window, make general or specific investment recommendations regarding nondeposit investment products, qualify a customer as eligible to purchase such products, or accept orders for such products, even if unsolicited. Tellers and other employees who are not authorized to sell nondeposit investment products may refer customers to individuals who are specifically designated and trained to assist customers interested in the purchase of such products.

3. Qualifications and Training

The depository institution should ensure that its personnel who are authorized to sell nondeposit investment products or to provide investment advice with respect to such products are adequately trained with regard to the specific products being sold or recommended. Training should not be limited to sales methods, but should impart a thorough knowledge of the products involved, of applicable legal restrictions, and of customer protection requirements. If depository institution personnel sell or recommend securities, the training should be the substantive equivalent of that required for personnel qualified to sell securities as registered representatives.[5] Depository institution personnel with supervisory responsibilities should receive training appropriate to that position. Training should also be provided to employees of the depository institution who have direct contact with customers to ensure a basic understanding of the institution's sales activities and the policy of limiting the involvement of employees who are not authorized to sell investment products to customer referrals. Training should be updated periodically and should occur on an ongoing basis.

Depository institutions should investigate the backgrounds of employees hired for their nondeposit investment products sales programs, including checking for possible disciplinary actions by securities and other regulators if the employees have previous investment industry experience.

4. Suitability and Sales Practices

Depository institution personnel involved in selling nondeposit investment products must adhere to fair and reasonable sales practices and be subject to effective management and compliance reviews with regard to such practices.

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[5]Savings associations are not exempt from the definitions of "broker" or "dealer" in Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; therefore, all securities sales personnel in savings associations must be registered representatives.

In this regard, if depository institution personnel recommend nondeposit investment products to customers, they should have reasonable grounds for believing that the specific product recommended is suitable for the particular customer on the basis of information disclosed by the customer. Personnel should make reasonable efforts to obtain information directly from the customer regarding, at a minimum, the customer's financial and tax status, investment objectives, and other information that may be useful or reasonable in making investment recommendations to that customer. This information should be documented and updated periodically.

5. Compensation

Depository institution employees, including tellers, may receive a one-time nominal fee of a fixed dollar amount for each customer referral for nondeposit investment products. The payment of this referral fee should not depend on whether the referral results in a transaction.

Personnel who are authorized to sell nondeposit investment products may receive incentive compensation, such as commissions, for transactions entered into by customers. However, incentive compensation programs must not be structured in such a way as to result in unsuitable recommendations or sales being made to customers.

Depository institution compliance and audit personnel should not receive incentive compensation directly related to results of the nondeposit investment sales program.

6. Compliance

Depository institutions should develop and implement policies and procedures to ensure that nondeposit investment product sales activities are conducted in compliance with applicable laws and regulations, the institution's internal policies and procedures, and in a manner consistent with this Statement. Compliance procedures should identify any potential conflicts of interest and how such conflicts should be addressed. The compliance procedures should also provide for a system to monitor customer complaints and their resolution. Where applicable, compliance procedures also should call for verification that third party sales are being conducted in a manner consistent with the governing agreement with the depository institution.

The compliance function should be conducted independently of nondeposit investment product sales and management activities. Compliance personnel should determine the scope and frequency of their own review, and findings of compliance reviews should be periodically reported directly to the institution's board of directors, or to a designated committee of the board.

Appropriate procedures for the nondeposit investment product program should also be incorporated into the institution's audit program.

Supervision by Banking Agencies

The federal banking agencies will continue to review a depository institution's policies and procedures governing recommendations and sales of nondeposit investment products, as well as management's implementation and compliance with such policies and all other applicable requirements. The banking agencies will monitor compliance with the institution's policies and procedures by third parties that participate in the sale of these products. The failure of a depository institution to establish and observe appropriate policies and procedures consistent with this Statement in connection with sales activities involving nondeposit investment products will be subject to criticism and appropriate corrective action.

Guidance to National Banks on Insurance and Annuity Sales Activities

Advisory Letter No. 96-8
October 8, 1996

TO: Chief Executive Officers of all National Banks, Department and Division Heads, and all Examining Personnel

Purpose

This advisory provides guidance to national banks on various issues raised by insurance and annuities sales. Each bank's management should address these issues in a manner appropriate to the nature and extent of insurance and annuity sales activities conducted by its organization.

Discussion

A. Introduction

The ability of national banks to sell diverse and complementary financial products and services, including insurance products and annuities, helps bank customers to meet specific financial objectives, benefits consumers by promoting competition, and can make insurance products and annuities available to customers that are underserved or unserved by other distribution systems. The Supreme Court's March 1996 decision in *Barnett Bank of Marion County N.A. v. Nelson, Florida Insurance Commissioner* (Barnett) provided important clarification of the authority of national banks to sell insurance. The Court's 1995 decision in *NationsBank v. Variable Annuity Life Insurance Co.* also upheld the broad authority of national banks to engage in the "business of banking" and sustained the OCC's determination that the power to sell annuities is part of that authority. Thus, insurance and annuity sales have been, and promise to continue to be, an important line of business for national banks.

Adequate consumer protections, qualified employees, and appropriate sales practices are key to responsible insurance and annuity sales activities—by any type of seller. The OCC is committed to ensuring that national bank' insurance and annuity sales activities meet high standards.

The following sections of this advisory (1) review the federal statutory anti-tying rules applicable to banks; (2) discuss how state laws apply to national banks; (3) highlight issues raised by insurance and annuities sales

that national banks should evaluate and address when they structure their sales programs and oversee their sales activities; and (4) summarize the OCC's basic approach to oversight of national banks' sales of insurance and annuities.[1]

B. Federal Prohibitions on Tying

Tying the availability of credit from the bank to the purchase of insurance or annuities offered by the bank or a bank affiliate is illegal. Under 12 USC 1972, a bank is prohibited (subject to certain exceptions)[2] from requiring a customer to obtain credit, property, or services as a prerequisite to obtaining other credit, property, or services. This standard applies whether the customer is retail or institutional, or the transaction is on bank premises or off. The OCC has extended these protections to cover national bank operating subsidiaries.

The OCC remains committed to enforcing 12 USC 1972 and expects national banks to have adequate policies and procedures in place to prevent violations. OCC Bulletin 95-20 describes measures that help to ensure compliance with the tying prohibitions. The measures include:

- Monitoring to eliminate impermissible coercion when offering customers multiple products or services.
- Training bank employees about the tying prohibitions, including providing examples of prohibited practices and sensitizing employees to the concerns raised by tying.
- Involving management in reviewing training, audit, and compliance programs, and updating any policies and procedures to reflect changes in products, services, or applicable law.

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[1]National banks also are reminded that the Interagency Statement on Retail Sales of Nondeposit Investment Products (February 15, 1994) contains guidelines for the sale of nondeposit investment products, which include annuities. The provisions of 12 CFR Part 2 also apply to sales of credit life insurance, which is defined as "credit life, health, and accident insurance, sometimes referred to as credit life and disability insurance, and mortgage life and disability insurance." In addition, 12 CFR 7.3001 applies when banks share space and employees with other businesses. Products that are securities under the federal securities laws also are subject to additional requirements and standards under rules of the Securities and Exchange Commission and the National Association of Securities Dealers.

[2]In addition to statutorily enumerated exceptions, the statute authorizes the Federal Reserve Board to permit, by order or regulation, additional exceptions to the tying prohibitions. National banks can avail themselves of the Federal Reserve Board's exceptions to the extent they are applicable. Banks should also note that the Federal Reserve Board has recently proposed changes to its tying regulations. *See* 61 Fed. Reg. 47242 (Sept. 6, 1966).

- Reviewing customer files to determine whether any extension of credit is conditioned impermissibly on obtaining an insurance product or annuity from the bank or its affiliates.

- Monitoring incentives, such as commissions and fee splitting arrangements, that may encourage tying.

- Responding to any customer allegations of prohibited tying arrangements.

The tying prohibitions do not prevent bank sales personnel from informing a customer that insurance is required in order to obtain a loan or that loan approval is contingent on the customer obtaining acceptable insurance. In such circumstances, sales personnel may indicate that insurance is available from the bank and may provide instructions on how the customer can obtain additional information.

However, the bank should take steps necessary to make clear to the customer that the bank's decisions with respect to a loan application are independent of the customer's decision where to obtain insurance. For example, in the situation described above, when a customer is first informed that insurance is available from the bank, the customer also should be clearly and unambiguously informed that he or she need not purchase insurance from the bank, its subsidiary, an affiliate, or any particular unaffiliated third party, that insurance is available through brokers or agents other than the bank, and that the customer's choice of insurance provider will not affect the bank's credit decision or credit terms in any way. These disclosures are particularly important in situations where it is not feasible to have different bank employees involved in the loan and the insurance transactions. See also "Sales of Insurance in Connection with Extending a Loan."

The same concerns are equally pertinent and potentially more acute, if a type of insurance that is unrelated to or not required in connection with a pending loan application is offered to a loan applicant as part of the loan application process. In that situation, banks should use heightened care to dispel any impression that the unrelated products are being mentioned because of a potential connection to the bank's credit decision, and should ensure that, if such offers are permitted, they are adequately monitored by the bank's compliance systems.

C. Applicability of State Laws

The application of state laws to national banks' insurance and annuity sales can present complex issues.[3] In general, however, the OCC anticipates that a state law that applies generally to regulate insurance agents and agencies will apply to national banks provided the law does not effectively prevent national banks from conducting activities authorized under federal law, and provided that, if the law interferes with those authorized activities, the interference is insignificant. When state laws result in special burdens on the ability of national banks to exercise the powers granted to them under federal law, however, the possibility of federal preemption of state law arises.

For example, the Supreme Court's decision in Barnett clarified that traditional judicial standards of federal preemption should govern whether 12 USC 92, which authorizes national banks to sell insurance in an agency capacity, preempts state laws (or rules) that interfere with a bank's exercise of that authority.[4] In Barnett, the Supreme Court first noted that courts have historically interpreted "grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily preempting, contrary state law."[5] But, the Court then noted, this does not "deprive States of the power to regulate national banks, where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers."[6] Thus, if a state law only interferes with a national bank's exercise of its powers in an insignificant way, the state law would not be preempted and would be applicable.[7]

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[3]This advisory is designed to complement, not to displace, state laws that may apply to national banks' sales of insurance and annuity products. It is intended to highlight for national banks particular issues and aspects of insurance and annuity sales activities that the OCC believes should be areas of attention for bank management. In addition, the advisory addresses certain issues not covered by some state laws, such as particular disclosure requirements that are intended to differentiate insurance products or annuities from insured deposits. Banks should also note that, for purposes of state law, many states regulate annuities as insurance products.

[4]Section 92 provides that national banks "located and doing business in any place the population of which does not exceed 5,000 inhabitants, is shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the [OCC], act as the agent for any fire, life or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State...."

[5]*Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner,* 116 S. Ct. 1103, 1108 (1996).

[6]*Id.,* at 1109.

[7]This threshold reflects the Barnett decision's discussion of federal preemption and the cases cited by the Supreme Court in its description of the federal preemption test. These cases use terms such as "interfere with, or impair" (*First National Bank v. Commonwealth of Kentucky,* 76 U.S. (9 Wall.) 353, 362 (1870)); "incapacitates" (*Id.*); "hinders" (*Id. at 363*); "infringe" (*Anderson National Bank v. Luckett,* 321 U.S. 233, 248 (1944)); "infringe or interfere" (*Id.,* at 249);

In practice, these principles should mean that most state laws that apply generally to regulate insurance agents and agencies and that do not discriminate against or have a disparate impact on banks would not be preempted because, ordinarily, they would not prevent national banks from exercising their federally authorized powers and the extent to which they might actually interfere with or impair the ability of a national bank to exercise those powers would be insignificant. If a state law prevented or impaired significantly the ability of national banks to exercise their powers, however, that state law would not be applicable because it would be preempted under the standards set by the Supreme Court.[8]

Thus, for example, and provided a particular law is not preempted, the types of state laws applicable to national banks would include non-discriminatory requirements, such as:

- Licensing requirements establishing character, experience, and educational qualifications for individuals selling insurance as agent.
- Testing and continuing education requirements, and requirements for license renewals, for individuals selling insurance as agent.
- Licensing requirements pertaining to different types of insurance that apply to individuals selling particular types of insurance in an agency capacity.
- Market conduct and unfair trade practices standards prohibiting insurance agents from making unfair and deceptive statements; falsifying financial statements; engaging in defamation, boycott, coercion and intimidation; unfairly discriminating; improperly rebating; coercing

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"encroachment" (*Id.*, at 249); "frustrate the purpose" (*McClellan v. Chipman,* 164 U.S. 347, 357 (1896)); "hampered" (*Id.,* at 358); and "impairs the efficiency" (*Davis v. Elmira Savings Bank,* 161 U.S. 275, 283 (1895)) to reflect that a relatively small level of impact on the authority of national banks is sufficient to result in federal preemption of the state law at issue.

[8]Because of the variety of state laws that could raise this concern, the OCC would need to do a factual analysis of the impact of each particular law on the operations of national banks, as well as a complete legal analysis, both of which are beyond the scope of this advisory, in order to reach conclusions about preemption. If asked by national banks or state insurance regulatory authorities, the OCC expects that it would opine on state law preemption questions on a case-by-case basis. Various preemption issues also may be subject to a public notice and comment process pursuant to section 114 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. 103-328 (12 USC 43). In any case, the OCC will apprise the relevant state insurance regulator and will consult with that regulator, when such a question is posed.

customers; improperly disclosing confidential information;[9] and engaging in unfair claims settlement practices.

When state laws are not preempted, the OCC recognizes the role and ability of state insurance regulators to administer and oversee compliance with those laws.

D. Management Oversight

Bank management is responsible for ensuring that a bank's insurance and annuity sales are conducted in a safe and sound manner and in accordance with applicable law. Sound management practices include active oversight by senior management, competent personnel, and internal controls that effectively identify, monitor, and control significant aspects of the seller's insurance and annuity sales operations. These principles apply not just to banks, but to all sellers of insurance and annuities.

The practices and policies each bank applies will depend on the activities it undertakes and the manner in which it offers products. For example, although certain issues arise in all circumstances, the complexity of the products offered and the volume of insurance and annuities sales may require some banks to establish more elaborate internal controls or management processes than banks with relatively simple insurance and annuities sales activities. A bank's approach should be tailored to its goals and resources and should be well understood by bank personnel engaged in insurance and annuity sales. Banks also are encouraged to seek advice from professionals with expertise in the insurance and annuities field who can provide guidance with respect to legal, regulatory, and business considerations presented by the bank's insurance and annuities sales activities.

The following sections describe issues that may arise when sales and recommendations for insurance products and annuities are made by a national bank and its employees, as well as by employees of any third party (a national bank subsidiary or affiliate, or an unrelated third party), when the third party sells from bank premises. If these issues arise from a national bank's insurance and annuities sales program, bank management should address them in a manner appropriate and effective for the particular bank. Considerations that apply to both insurance and annuity sales are set forth first, then issues distinct to sales of insurance and annuities, respectively.

General Considerations

[9]Recent amendments to the Fair Credit Reporting Act may expressly preempt state laws, however, in connection with certain disclosures of customer information. *See* Section 624(b) of the Fair Credit Reporting Act (15 USC 1681t(b)), as amended by section 2419(2) of the Economic Growth and Regulatory Paperwork Reduction Act of 1966 (Pub. Law 104-208, 110 Stat. 3009).

1. Evaluation and Selection of Products

The success of a sales program and the satisfaction of the bank's customers are directly related to the quality and nature of the insurance products and annuities sold by the bank. Bank customers benefit from bank sales of insurance and annuities when the bank offers products responsive to the diverse needs of its customers and those products perform as customers expect. The safety, soundness, and claims paying ability of the companies that originate the insurance and annuity products sold by a bank are considerations for bank customers and may also present risks for the reputation of the bank's other products and services, as well as the potential for future claims against the bank. The company originating the products sold by the bank should be in good standing and maintain the necessary licenses required to operate its insurance business. A bank's selection of the products it offers should be founded on the quality and customer benefits of the products available from those companies, not on a company's commission structure. In addition, a bank should help to ensure the quality of the insurance products and annuities that it sells, and protect itself from future complaints, by evaluating at the outset and periodically thereafter:

The company's rating by a nationally recognized rating service and other readily available information on the historical performance of the company (or companies), as well as its current financial and managerial strength.

- When available, the number and substance of material complaints filed against the company, and the existence of any criminal judgments against the company or its senior management.

- The extent to which particular products are available from various companies.

- The pricing of the insurance products or annuities, including the premium rates, compared with that of similar products offering the same benefits or coverage (if such similar products are available).

- The sales support provided by the company, including the marketing and sales strategy for the products it provides.

- Readily available information concerning the first hand experience of other financial institutions with products of the company.

2. Qualifications and Training

Knowledgeable, experienced, and qualified personnel help to ensure that the bank's sales program is carried out in a manner that provides customers with competitive products, sound advice, and accurate information. Familiarity with the bank's policies and procedures also ensures better compliance with

the bank's internal guidelines and facilitates management oversight. Timely and regularly scheduled training can keep personnel aware of the latest innovations in financial products, changes in bank policies, and developments in applicable laws or regulations. Measures the bank should use to achieve these goals include:

- Clearly defining the responsibilities of personnel authorized to sell insurance products or annuities and the scope of the activities of any third party involved in the sales program.

- Verifying that sales personnel are licensed and in good standing under applicable state and, if appropriate, federal law, and, where feasible, ascertaining whether individuals have been the subject of disciplinary action.

- Limiting the involvement of tellers and individuals not qualified to sell insurance or annuities to directing customers to qualified personnel who can provide authoritative information.

3. Inappropriate Recommendations or Sales

Customers interested in purchasing insurance products or annuities may have particular needs based on their financial status, current insurance coverage, or other circumstances. Customers inexperienced in dealing with financial products, particularly those involving an investment risk component, may also require more detailed information about the products offered. Bank management should evaluate, for the types of insurance and annuity products it offers, the extent to which it is necessary to inquire into the appropriateness of the product for a particular customer in order to assist the customer in making informed product selections, and the nature of the inquiry that is desirable (or that may be required by other regulatory requirements). In addition, regardless of the product involved, management should clearly communicate to its sales personnel that it is unacceptable to recommend and sell new or replacement insurance or annuity policies to customers on the basis of commissions to the seller rather than the benefits of the policy.[10] Such "churning" may also violate applicable state laws.

4. Employee Compensation

Commission-based compensation is a common method of selling insurance and annuities and may help to increase customer awareness of the availability of the insurance products and annuities offered by a bank. However,

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[10]The OCC has recently revised Part 2 of its regulations, which governs aspects of national bank sales of credit life, health and accident insurance, to state specifically that recommendations to customers to buy insurance should be based on the benefits of the policy, not the commissions received from the sale. *See* 12 CFR 2.3(b); 61 Fed. Reg. 51777 (October 4, 1996).

whenever an employee is compensated for a sale or referral, management needs to be sensitive to the concern that the employee might be motivated by the prospect of financial reward for the sale or referral rather than the best interests of the customer. As noted above, sales should not be driven by commissions and management should clearly communicate to its sales personnel that it is unacceptable to engage in high pressure sales tactics, sell duplicative or unnecessary insurance, or recommend and sell new or replacement insurance policies to customers on the basis of commissions to the seller rather than the benefits of the policy.

5. Complaints and Compliance

Even the most well-managed insurance and annuity sales program can be subject to some customer complaints. Both customers and the bank will benefit if the bank has an orderly process for assessing and addressing customer complaints and resolving compliance issues. A process that keeps track of customer complaints also helps the bank to identify and monitor any systemic problems in its sales program that could harm its franchise. This process might include maintaining records concerning the number, nature, and disposition of customer complaints received by a bank, subsidiary, or affiliated or unaffiliated third party. For non-complex banks, the process could take the form of a complete and orderly "complaint" file. Management should also ensure that there is an effective process through which management receives information about complaints or other concerns in connection with a bank's insurance and annuity sales so that management may implement corrective measures. The bank's systems must be sufficient to monitor compliance with the bank's own policies, applicable federal and state laws, and OCC guidance.

National banks also should comply with state laws that require copies of any customer complaints to be forwarded to the appropriate state insurance regulatory authority, or that require that when an insurance sale is consummated, the customer be advised that he or she may forward any complaints to that state insurance authority.

6. Advertising

Advertising is a fundamental marketing tool, and banks often disseminate information, written or otherwise, including by telephone or other electronic means, to bank customers and the general public describing insurance products or annuities that are available from the bank, its subsidiaries or affiliates, or unaffiliated third parties. Banks also communicate with their customers on how to obtain more information about insurance products or annuities. These communications must not suggest or convey any inaccurate information, and should be designed with care to avoid misunderstanding, confusion, or misrepresentation to the bank's customers. Accordingly, bank management should ensure that:

- To the extent disclosed, the nature, terms, or conditions of any insurance product or annuity, and the financial condition of any person, entity, or legal reserve system in any way related to an insurance product or annuity, are not misrepresented.

- Disclosures regarding particular products identify clearly the company that is underwriting the insurance or annuity product and that the company is not the bank.

- Steps are taken through other disclosures, including prominent and distinct signage, separate business cards, and distinctive promotional material, to minimize customer confusion about the nature of the product and to clarify that the product is not guaranteed by the bank and is not insured by the FDIC.

- Terminology customarily associated with insured bank products that obscures the nature of a payment or policy is avoided, e.g., use of the word "deposit" to describe a premium payment, or referring to an insurance policy or annuity as an "account."

7. Customer Privacy

In the course of providing banking and other services, banks will acquire various types of financial and personal information about their customers. Bank management should be sensitive to privacy expectations of the bank's customers regarding this information. Management should take appropriate internal measures to safeguard the security of customer information as well as developing internal policies on the use of customer information. These considerations apply generally to all aspects of a bank's operations. Insurance and annuity sales activities are but one context in which questions regarding the use and sharing of customer information arise. Nor are banks unique in facing issues relating to customer privacy.

Banks' policies on use of customer information should also recognize that different types of information can present different degrees of sensitivity from a customer perspective. Information of an especially personal nature, such as information regarding the health or physical well-being of a customer, may be viewed as particularly sensitive and thus warrant safeguards or restrictions under the bank's policies.

Use of certain customer information in connection with the sale of insurance products, such as that bearing on a customer's credit standing, as well as disclosure of this information to third parties, including bank affiliates, can present various legal issues and may be restricted by law. Banks should consider especially whether any provisions of the Fair Credit Reporting Act

are applicable before using or disclosing customer information.[11] That Act allows banks to share with third parties information about their transactions with a customer. Recent amendments to that Act also allow parties related by common ownership or affiliated by corporate control to share other information that is not a consumer report provided the customer in question is given an opportunity to object.[12] In addition, among other things, the Act permits banks and affiliates to obtain limited information from a consumer report for use in connection with firm offers to provide consumer related insurance products to potential customer.

8. Third-Party Arrangements

If a national bank, directly or indirectly, including through a subsidiary, sells insurance products or annuities through a third party, the performance and reputation of the third party reflect on the bank and might even give rise to liabilities that the bank must bear. Developing knowledge and understanding about the third party's qualifications and operations can assist the bank in avoiding problems and uncertainties. Particularly when a bank is using an unrelated third party to sell insurance and annuities on bank premises, it is important for the agreement with the third party to:

- Describe the duties and responsibilities of each party, including the permissible activities by the third party on the national bank's premises; the terms governing the use of the national bank's space, personnel, and equipment; and the compensation arrangements for personnel of the national bank and the third party. Where a bank and a third-party subsidiary, affiliate, or unrelated entity utilize joint employees, the duties, responsibilities, and job responsibilities should be clearly articulated in the agreement with the third party, as well as communicated to these employees.

- Authorize the national bank to monitor the third party as appropriate to the volume and complexity of the products offered, in order to effectively review and verify that the third party and its sales representatives are complying with the agreement.

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[11]Additional requirements and standards may also impact the extent to which the bank can share information with third parties. For example, if the third party is a securities broker-dealer, special rules may apply to it as well. *See,* e.g., National Association of Securities Dealers, Inc. Conduct Rules, National Association of Securities Dealers, Inc. Manual (CCH), page 4101 et. seq.; see also Self-regulatory Organizations, Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Regulating the Conduct of Broker/Dealers Operating on the Premises of a Financial Institution, 61 Fed. Reg. 11913 (Mar. 22, 1996).

[12]See Section 603(d)(2)(A)(iii) of the Fair Credit Reporting Act (15 USC 1681a(d)(2)(A)(iii), as amended by section 2402(e) of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. Law 104-208, 110 Stat. 3009).

- Require the third party to indemnify the national bank for potential liability resulting from actions of the third party with respect to the insurance product or annuity sales program.

- Require the third party to forward any customer complaints to appropriate state insurance authorities and to the bank.

Insurance Sales

The following issues are applicable to situations in which the Interagency Statement on Retail Sales of Nondeposit Investment Products does not apply. (See "Annuities and Investment Product Sales," below, for a summary of the Interagency Statement.)

1. Sales of Insurance in Connection with Extending a Loan

When a bank requires a customer to obtain insurance in connection with a loan and the insurance is available through the bank, under some circumstances, a customer may believe either that the insurance must be purchased from the bank or that a purchase from the bank will improve the customer's chances of a favorable credit decision.[13] As discussed in section B., above, sales personnel may inform customers that insurance is required in order to obtain a loan or that loan approval is contingent on the customer obtaining acceptable insurance. Sales personnel may inform customers that insurance is available from the bank, its subsidiary, an affiliate, or particular unaffiliated third parties, and indicate how to obtain additional information.

However, the bank should take steps necessary to make clear to its customer that the bank's decisions with respect to the loan application are independent of the customer's decision of where to obtain insurance. For example, to avoid the impression that a linkage exists between the bank's credit decision and the customer's choice of insurance seller, the customer should also be clearly and unambiguously informed that he or she need not purchase insurance from the bank, its subsidiary, an affiliate, or any particular unaffiliated third party, that the insurance is available through brokers or agents other than the bank, and that the customer's choice of insurance provider will not affect the bank's credit decision or credit terms in any way. These disclosures should be provided when the bank first informs a customer that insurance required in connection with a loan is available from the bank, a subsidiary, affiliate, or unaffiliated third party selling insurance on bank premises. Banks should also consider:

[13]This situation does not include when the bank places insurance on real or personal property because a customer has failed to provide reasonable evidence of required insurance in accordance with the terms of a loan or extension of credit.

- Providing the disclosures described above in writing, and obtaining a signed statement from the customer, at or prior to closing the insurance sale, acknowledging that the customer has received, has read, and understands the disclosures.

- Whether any customer confusion arises because the bank uses combined documentation for related credit and insurance transactions and whether separate and independent documents would effectively reduce this confusion.

As also discussed in section B., if a type of insurance that is unrelated to, or not required in connection with, a loan is offered to a loan applicant as part of the loan application process, banks should use heightened care to dispel any impression that the unrelated product is being mentioned because of a potential connection to the bank's credit decision, and to monitor this aspect of its insurance and annuity sales activities.

2. Setting and Circumstances of Insurance Sales Activities and Specific Disclosures

The way in which insurance products are sold within a bank can help customers distinguish between deposits that are insured or are obligations of the bank and uninsured products offered by the bank or another entity. A bank's objective should be to avoid misunderstanding, confusion or misrepresentation to its customers. Although the particular measures that are most effective to accomplish this may vary on a case-by-case basis, several steps are most important.

Banks should define clearly and limit the roles of bank employees when they operate in a traditional physical setting, generally a "teller window," that is closely associated with and predominantly services insured deposit account transactions. To the extent practicable, a bank's sales of insurance should take place in a location that is distinct from such a traditional teller window setting. The involvement of tellers and individuals not qualified to sell insurance products also should be limited to directing customers to qualified personnel who can provide information. When physical considerations, such as the size or design of a particular bank facility, prevent sales from being conducted in a location distinct from the common teller area, the bank should make every effort to minimize customer confusion.

In addition, during any customer contact, including communication by telephone or other electronic means, banks should disclose to customers that an insurance product is not FDIC insured, is not a deposit or obligation of the bank, is not guaranteed by the bank, and (if applicable) is subject to investment risk, including possible loss of principal, unless the bank affirmatively determines, for specific products, that customers would not reasonably benefit from, or might in fact be confused by, these disclosures.

Management should address the manner in which the disclosures are provided to a proposed insured, and the point or points during the solicitation or sales transaction at which written or oral disclosures should be furnished to customers. Other aids to customers distinguishing between products include:

- Specifying how individuals selling or recommending insurance products identify themselves and their sales role.

- Conspicuous signage in the areas where insurance is sold that clarifies that the insurance sold by or through the bank is not a deposit or obligation of the bank, is not guaranteed by the bank, and is not insured by the FDIC.

Annuities and Investment Product Sales

The Interagency Statement on Retail Sales of Nondeposit Investment Products contains standards for sales and recommendations of nondeposit "investment products," which include fixed and variable annuities. Under the Interagency Statement, when a bank recommends or sells to retail customers nondeposit "investment products," the bank should, among other things and at a minimum, inform the customer that the nondeposit investment products are (a) not insured by the FDIC; (b) not a deposit or other obligation of, or guaranteed by, the depository institution; and (c) subject to investment risks, including possible loss of the principal amount invested. The Interagency Statement calls for these disclosures to be provided (a) orally during any sales presentation; (b) orally when investment advice concerning the nondeposit investment products is provided; (c) orally and in writing prior to or at the time an investment account is opened to purchase these products; and (d) in advertisement and other promotional material, as specified in the Interagency Statement. In addition, a bank should obtain a signed statement from the customer at the time an account is opened, acknowledging that the customer has received and understands these disclosures. Any written disclosures should be conspicuous and presented in a clear and concise manner.

The Interagency Statement provides that confirmations and account statements for nondeposit investment products should contain the minimum disclosures if they contain the name or logo of the bank or an affiliate, in addition to any other required disclosures. If a customer's periodic deposit account statement includes account information concerning the customer's nondeposit investment products, the information concerning these products should be clearly separate from the information concerning the deposit account and should be introduced with the minimum disclosures and the identity of the entity conducting the nondeposit transaction. In addition, where applicable, the bank should disclose the existence of any advisory or material relationship between the bank or an affiliate of the bank and an investment company whose shares are sold by the bank and any material

relationship between the bank and an affiliate involved in providing nondeposit investment products.

The foregoing is only a summary of provisions of the Interagency Statement. Bank management should be familiar with the standards contained in the Statement if the bank sells annuities or other investment products covered by the Statement and managers should address those standards in the bank's sales practices.

E. OCC Supervision

The OCC's evaluation of a bank's insurance and annuity sales activities will be guided by the OCC's supervision-by-risk approach, which focuses on identifying problems, or potential problems, in individual banks or the banking system, and ensuring that problems are appropriately corrected. The OCC applies this philosophy in all supervisory activities it conducts, including safety and soundness, compliance, and fiduciary.

The types of risk most likely to arise in connection with insurance and annuity sales include reputation risk, compliance risk, transaction risk, and strategic risk. In general, experience has demonstrated that national banks conduct their insurance and annuity sales activities in a safe and sound manner and that their activities have been responsive to the interests of their customers. Thus, insurance and annuity sales should be a relatively low risk activity.

The OCC believes that it can identify and focus on key indicators of potential problems with a bank's sales of insurance and annuities as part of the examination process, and will be developing additional instructions to guide its examiners in this area. (The considerations specified in this advisory, therefore, are not intended for use as an examination checklist by OCC examiners, but are designed to help national banks identify and manage relevant risk areas for each institution.) For example, customer complaints can be valuable signals of problems in each of the risk areas mentioned above. Thus, the OCC anticipates that as part of national banks' regularly scheduled examinations for compliance with applicable federal requirements, including compliance with anti-tying standards, OCC examiners will review the level and nature of customer complaints concerning the bank's insurance and annuity sales activities.

The OCC also expects to work cooperatively with state insurance regulators and recognizes their role and their ability to administer and oversee compliance with the types of state laws, discussed in section B., that are applicable to national banks.

Further Information

For further information or questions relating to this advisory, please contact the Legislative and Regulatory Activities Division, (202) 874-5090.

/s/

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