

MEMO# 11591

January 28, 2000

RULES PROPOSED BY FEDERAL BANK REGULATORS TO IMPLEMENT FEDERAL LEGISLATION RELATING TO FINANCIAL HOLDING COMPANIES AND FINANCIAL SUBSIDIARIES OF A NATIONAL BANK

[11591] January 28, 2000 TO: SEC RULES COMMITTEE No. 14-00 RE: RULES PROPOSED BY FEDERAL BANK REGULATORS TO IMPLEMENT FEDERAL LEGISLATION RELATING TO FINANCIAL HOLDING COMPANIES AND FINANCIAL SUBSIDIARIES OF A NATIONAL BANK

The Federal Reserve Board ("FRB") and the Office of the Comptroller of the Currency ("OCC") have proposed rules to implement provisions of the Gramm-Leach-Bliley Act ("GLB Act") regarding, respectively, procedures under which institutions can elect to become "financial holding companies" ("FHCs") and procedures under which national banks can acquire or establish financial subsidiaries. The proposed rules are described below. The FRB's Interim Rules The GLB Act amended the Bank Holding Company Act to provide for the creation of a new financial institution, an FHC, which may, without prior approval of the FRB, engage in activities that are financial in nature and either incidental or complimentary to a financial activity. A bank holding company ("BHC") may not, however, engage in these activities unless all of its depository institution subsidiaries are "well capitalized" and "well managed" and the BHC has filed with the FRB a declaration that it elects to be, and is qualified to be, an FHC. The provisions from the GLB Act governing FHCs take effect March 11, 2000. The FRB's rules have been adopted on an interim basis, effective March 11, 2000, in order to allow BHCs and foreign banks that meet the applicable qualifications to become FHCs as soon as possible following the March 11th effective date of the FHC provisions. The FRB is also soliciting comments on these interim rules. To implement the FHC provision of the BHCA, the FRB has proposed to amend Regulation Y to add definitions to Rule 225.2 for the terms "well managed" and "well capitalized" and to add a new Subpart I consisting of the following rules: ! Rule 225.81, which would define the term FHC in accordance with the GLB Act. ! Rule 225.82, which would specify the contents of the declaration a BHC must file to become an FHC; specify under what circumstances the FRB would find an election to be ineffective; govern the applicability of CRA ratings to recently acquired depository institutions; and provide for the effectiveness of an FHC election. Of particular note is subsection (d) of this proposed rule, which would authorize the FRB to restrict or limit the commencement or conduct of additional activities or acquisitions of a FHC if the FRB finds that the FHC does not have the financial or managerial resources to engage in such

activities or acquisitions. ! Rule 225.83, which would set forth the procedures to be followed by the FRB and the FHC if depository institutions controlled by the FHC fail to remain well capitalized or well managed. ! Rule 225.84, which would set forth the procedures and limitations on business that would flow from an insured depository institution controlled by the FHC failing to maintain a satisfactory or better rating under the CRA. ! Rules 225.90, 225.91, 225.92, 225.93, and 225.94, which would govern foreign banks that seek treatment as an FHC. According to the FRB's proposal, the FRB will allow BHCs and foreign banks to file FHC elections in accordance with the interim rules and in anticipation of the effective date of the GLB Act. The FRB anticipates that as soon as March 13, 2000, it will begin notifying qualifying BHCs that elections filed in accordance with the interim rules are effective. As a result, BHCs will be able to take advantage of new powers under the GLB Act as early as the first business day following the effective date of the amendments to the Banking Holding Company Act. Comments on the FRB's proposal are due by March 27, 2000. Persons with comments should submit them to the Institute, as provided at the end of this memo, no later than Friday, March 3, 2000. The OCC's Proposed Rules Effective March 11, 2000, the GLB Act authorizes national banks, with the approval of the OCC, to establish or acquire "financial subsidiaries" that may engage in any activity that is financial in nature or incidental to a financial activity as provided in the GLB Act amendments to the Bank Holding Company Act. As with the FHC provisions in the GLB Act, a national bank must be well capitalized and well managed to establish or acquire a financial subsidiary. Financial subsidiaries may also be subject to additional prudent safeguards set forth in the GLB Act. In anticipation of the effectiveness of the GLB amendments affecting national banks, the OCC has published for comment the attached implementing rules. (Unlike the FRB's rules, however, these have not been adopted on an interim basis.) In particular, the OCC has proposed to amend Rule 5.34, relating to operating subsidiaries, and to create Rule 5.39, relating to financial subsidiaries. Rule 5.34 Amendments Under the OCC's proposal, Rule 5.34 would be amended to expand the activities that may be conducted through an operating subsidiary by merely providing the OCC a written notice of such activities. (This obviates the need for the bank to file an application with the OCC prior to engaging in permitted activities.) The rule would also conform the permissible activities for a subsidiary to the GLB Act. In addition, proposed subdivision (e)(3) would clarify, consistent with the functional regulation provisions of the GLB Act, that the OCC's examination and supervision authority over operating subsidiaries is subject to the limitations of the Federal Deposit Insurance Act and the GLB Act. Proposed New Rule 5.39 The OCC has proposed the adoption of new Rule 5.39 to govern the regulation of financial subsidiaries of a national bank. As proposed, this rule would include provisions governing: ! The procedures for the filing and approval of notices prior to a national bank acquiring a financial subsidiary or engaging in authorized activities; ! Permissible and impermissible activities for financial subsidiaries; ! The qualifications with which a national bank must comply to control or hold an interest in a financial subsidiary; ! The safeguards with which a national bank that establishes or maintains a financial subsidiary must comply; ! The impact of CRA on a national bank applying for approval to acquire control of, or hold an interest in, a new financial subsidiary or to commence a new authorized activity; and ! The procedures to be followed by the OCC in the event the national bank fails to continue to meet the qualification requirements set forth in the new rule and the consequences of such failure to the bank. [As proposed, Rule 5.39 does not include any provision analogous to proposed Rule 5.34(e)(3) that would limit the OCC's examination and supervision authority over financial subsidiaries.] Comments are due to the OCC by Monday, February 14, 2000. Accordingly, persons with comments on the proposal should provide them to the Institute no later than Monday, February 7th. Comments on the FRB's or OCC's proposals may be submitted to the undersigned by phone (202-326-5825) or e-mail (tamara@ici.org). Tamara

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