

**FEDERAL RESERVE SYSTEM****12 CFR Parts 208 and 250**

[Regulation H; Docket No. R-0964]

**Membership of State Banking Institutions in the Federal Reserve System; Miscellaneous Interpretations****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Final rule.

**SUMMARY:** The Board of Governors of the Federal Reserve System is amending Subpart A of Regulation H, regarding the general provisions for membership in the Federal Reserve System, and Subpart E of Regulation H, regarding Interpretations, in order to reduce regulatory burden, simplify and update requirements, and eliminate several obsolete interpretations. As part of the final rule the Board is reissuing prior Subparts B and C. Prior Subparts B and C have not been significantly amended but have been relettered (as Subparts D and E, respectively) to reflect the fact that prior Subpart A was broken into four new Subparts (Subparts A, B, C and F). Prior Subpart D, regarding safety and soundness standards, has been incorporated into new Subpart A. The final rule does not amend in any way Appendices A through E to Part 208. This final rule to modernize Subpart A of Regulation H is in accordance with the Board's policy of reviewing its regulations as well as the Board's review of regulations under section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.

**EFFECTIVE DATE:** October 1, 1998.

**FOR FURTHER INFORMATION CONTACT:** Rick Heyke, Staff Attorney, Legal Division (202/452-3688), or Jean Anderson, Staff Attorney, Legal Division (202/452-3707). For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Diane Jenkins (202/452-3544).

**SUPPLEMENTARY INFORMATION:****Background**

The Board is adopting amendments to its Regulation H (12 CFR part 208), regarding the general provisions for state bank membership in the Federal Reserve System, as part of its policy of reviewing its regulations, and consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act), Pub. L. 103-328. Section 303 of the Riegle Act requires each Federal banking agency to review and streamline its regulations and written policies to improve efficiency, reduce unnecessary costs, and remove

inconsistencies and outmoded and duplicative requirements. The amendments are designed to reduce regulatory burden and simplify and update the regulation.

The principal amendments are described below. In general, the amendments serve to reorganize, clarify, and reduce the burden of compliance with Subpart A of Regulation H. The amendments modify the procedures for membership and branch applications, incorporate a new section designed to provide guidance to banks regarding permissible investments in securities, expand the circumstances under which the Board will consider waivers of conditions of membership, eliminate existing requirements regarding disclosure of financial condition, eliminate the requirement that banks obtain deposit insurance in order to become State member banks, and generally provide a definition of branch that is consistent with OCC regulations and decisions. The amendments also serve to eliminate a number of interpretations elsewhere; specifically, interpretations: 12 CFR 250.120, 250.121, 250.122, 250.123, 250.140, 250.161, 250.162, 250.300, 250.301 and 250.302. The amended Regulation H replaces the existing Regulation H in its entirety, except for the Appendices to Regulation H, which remain unchanged.

A red-lined version of the amendments to the regulation and commentary is available from the Board's Freedom of Information Office or by calling 202-452-3684.

The Board published Regulation H for comment in the **Federal Register** on March 31, 1997 (62 FR 15272). The Board received 14 comments to the proposed amendments from the following types of institutions:

- Banks/thrifts—1
- Community groups—1
- Trade associations—4
- Federal Reserve Banks—7
- Clearinghouses—1

Twelve of the 14 comments generally supported the proposed amendments as serving to reduce regulatory burden on banks and as clarifying membership requirements. In addition, the comments addressed specific issues raised by the proposed amendments. These comments and issues are discussed below in the section-by-section analysis. Any sections of the regulation which are not discussed in the section-by-section analysis were adopted as originally proposed by the Board.

**Section-by-Section Analysis***Subpart A—General Membership and Branching Requirements***Section 208.2 Definitions**

**Definition of Branch.** The Board proposed to define a branch as any branch bank, branch office, branch agency, additional office, or any branch place of business that receives deposits, pays checks, or lends money. The proposed rule also stated that a branch may include a temporary, seasonal, or mobile facility. In addition to defining what constitutes a branch, the proposed rule specified certain arrangements that do not constitute a branch. The Board proposed that a branch not include a loan origination facility where the proceeds of loans are not disbursed, automated teller machines, remote service units, offices of an affiliated depository institution that provide services to customers of a State member bank on behalf of the State member bank, or a facility that would otherwise qualify as a branch because it engages in one or more branching functions (receipt of deposits, payment of withdrawals, or making loans) but which prohibits access to members of the public for purposes of conducting one or more branching functions.

In this regard the proposed rule requested comment on whether a branch should include offices of an *unaffiliated* depository institution that provide services to customers of a State member bank on behalf of the State member bank. Six commenters, the Federal Reserve Banks of Minneapolis, Atlanta, Philadelphia and San Francisco, the American Community Bankers, and the American Bankers Association, supported excluding unaffiliated depository institutions that provide services to a State member bank from the definition of a branch. In light of these comments, and in light of current case law and consistent with Office of the Comptroller of the Currency (OCC) decisions,<sup>1</sup> the Board is excluding from the definition of branch arrangements where either affiliated or unaffiliated institutions provide services to customers of a State member bank. The final rule provides that a branch does not include an office of an affiliated or unaffiliated institution that provides services to customers of the member bank on behalf of the member

<sup>1</sup> See *Cades versus H & R Block, Inc.*, 43 F.3d 869, 874 (4th Cir. 1994) and OCC letter of October 5, 1993 from William P. Bowden, Jr., Chief Counsel at page 4, which state that institutions that are not affiliated with a bank, but provide services to customers of the bank, do not constitute branches so long as the bank does not "establish or operate" the institution providing the services.

bank so long as the bank does not "establish or operate" the office providing the services. For example, a bank could contract with an unaffiliated or affiliated institution to receive deposits, cash and issue checks, drafts, and money orders, change money and receive payments of existing indebtedness without becoming a branch of that bank so long as that bank: (a) has no ownership or leasehold interest in the institution's offices; (b) has no employees who work for the institution; and (c) exercises no authority or control over the institution's employees or methods of operation.<sup>2</sup>

With respect to the statement in the proposed rule that a branch does not include a "remote service unit," one commenter requested that the Board define the term "remote service unit." The Board is adopting the term "remote service unit" as proposed and without further definition. The Board believes that "remote service units" may take a variety of forms, and that defining the term at this time would be premature. The Board notes that the OCC has determined that a "remote service unit" includes an automated loan machine and believes that "remote service units" may include automated loan machines as well as other arrangements.

**Definition of Capital Stock and Surplus.** The Board proposed to define *capital stock and surplus* in Regulation H to mean Tier 1 and Tier 2 capital, as calculated under the risk-based capital guidelines, plus any allowance for loan and lease losses not already included in Tier 2 capital. The Board proposed applying this definition to all references to capital stock and surplus in the Federal Reserve Act and Regulation H, unless otherwise noted. The Board received one comment that Regulation H should incorporate the term "capital" rather than *capital stock and surplus* because it would help to reduce the historical reference to the more narrow meaning of *capital stock and surplus*, which related only to part of shareholders' equity accounts. Use of the term *capital stock and surplus* is appropriate and consistent with the terms of the Federal Reserve Act. Use of the term *capital stock and surplus* should make it easier for banks to comply with the Board's regulations

since the term *capital stock and surplus*, as defined in the proposal, has been adopted for purposes of section 23A of the Federal Reserve Act (12 U.S.C. 371c) which governs transactions between insured depository institutions) and Regulation O (12 CFR 215) (which governs insider lending). All other commenters supported the proposed definition of *capital stock and surplus*, as well as the use of the term itself, and the Board is adopting the definition and term as proposed.

**Definition of Eligible Bank.** The Board proposed a new definition, *eligible bank*, to serve as the qualification for expedited treatment of membership and branch applications. The Board proposed that eligible bank be defined as a bank that: (a) is well capitalized; (b) has a Uniform Financial Institutions Rating System (CAMELS) rating of 1 or 2 (copies are available at the address specified in § 216.6 of this chapter); (c) has a Community Reinvestment Act (CRA) rating of "Outstanding" or "Satisfactory;" (d) has a compliance rating of 1 or 2; and (e) has no major unresolved supervisory issues outstanding as determined by the Board or the appropriate Federal Reserve Bank.

The Board received one comment that the definition should require a CRA rating of "Outstanding" rather than a rating of "Outstanding" or "Satisfactory." The commenter opposed allowing banks with "Satisfactory" ratings to receive eligible bank status because the commenter stated most banks receive "Satisfactory" ratings and because CRA ratings are not a reliable indicator of the bank's CRA performance. The remainder of the commenters supported the definition of *eligible bank* with one commenter requesting clarification as to whether the Board intended to preclude banks with a compliance rating of three from qualifying as an eligible bank.

The Board is adopting the definition of *eligible bank* as proposed. Allowing membership or branch applications from banks with "Satisfactory" CRA ratings to qualify for expedited treatment continues prior Board policies and provides for consistency with the OCC's standards for determining whether membership or branch applications should receive expedited treatment. The Board has modified its previous standard for receiving expedited treatment by requiring a compliance rating of 1 or 2 rather than 1, 2, or 3. This change provides consistency with the OCC's definition of eligible bank and is being adopted as proposed.

If a bank has not yet received compliance or CRA ratings from a bank regulatory authority, which would be necessary for determining whether it is an eligible bank, the Board will look to the bank's holding company for purposes of determining whether the bank's application should receive expedited processing. If the bank's holding company meets the criteria for expedited processing under § 225.14(c) of Regulation Y (12 CFR 225.14(c)), the bank's membership or branch application will be eligible for expedited processing.

Banks that have not yet received compliance or CRA ratings and that either are not owned by a bank holding company or are owned by a bank holding company that does not meet the criteria for expedited processing under § 225.14(c) of Regulation Y, are not eligible for expedited treatment.

**Definition of Mutual Savings Bank.** The Board proposed deleting the definition of mutual savings bank as unnecessary. One commenter opposed deletion of the definition on the basis that deletion "indirectly suggest[s] that companies should abandon the traditional mutual charter." The Board does not believe that removal of the definition carries this implication and is adopting the proposal. The status of mutual savings banks continues to be addressed in § 208.3(a) of Regulation H, concerning applications for membership and stock, as well as in the Board's Regulation I (12 CFR 209), published elsewhere in today's **Federal Register**, for purposes of determining the amount of Reserve Bank stock mutual savings banks are required to purchase (or in certain special cases the amount of money they must deposit with a Reserve Bank). See 12 CFR 209.4(c).

## Section 208.3 Application and Conditions for Membership

**Publication of Membership Applications.** The proposal stated that public comment on membership applications (including conversions) is not expressly required by statute but that publication might allow the Board to obtain additional information or views relevant to a membership application. The Board requested comment as to whether it should require publication for membership applications.

The Board received comments both supporting and opposing eliminating the publication requirement for membership applications. The majority of commenters favored eliminating the requirement. These commenters stated that no significant information is gained through publication that would

<sup>2</sup> See, e.g., *Cades*, 43 F.3d at 874. Although the bank would be permitted, in contracting with the institution, to control the terms of the services provided by the institution. For example, the bank's contractual relationship with the institution could include such issues as which institution would bear the risk of loss for items in transit or when accounts would be credited with deposits or charged with withdrawals.

outweigh the burden it places on banks. Those opposing eliminating the requirement stated that comments may provide useful information in the context of *de novo* membership applications or that the burden it places on banks is minimal in light of the fact that many banks seek FDIC insurance, which requires a public comment period. The Board is eliminating the requirement that banks seeking to become members of the Federal Reserve System publish notice of membership applications.

Because membership applications no longer confer deposit insurance, the requirement currently contained in the Board's Rules of Procedure (12 CFR 262.3), which states that banks must publish notice of their membership applications, no longer applies. The Board's Rules of Procedure (12 CFR 262.3) will be amended in the future to reflect the fact that membership no longer automatically confers deposit insurance and to reflect the change that banks no longer need to publish notice of membership applications.

*Processing Time Frames for Expedited Membership Applications.* The proposed rule provided that if public comment on membership applications were eliminated, expedited membership applications would be acted on 30 days after receipt of the application. One commenter requested that the Board act on expedited membership applications within 15 days because, under existing guidelines, non-expedited membership applications are acted on within 30 days and expedited membership applications should be acted on sooner than non-expedited membership applications. The Board is adopting a rule under which expedited membership applications will be acted on within 15 days of receipt of the application. Non-expedited membership applications will be acted on promptly, however, in limited situations processing times may be longer if the application involves unusual facts or raises novel policy issues.

*Membership Exams.* The proposed rule did not include information concerning the time frame or conditions under which the Federal Reserve will examine banks seeking membership in the Federal Reserve System. One commenter requested that guidance be provided in Regulation H regarding the time frames for, and necessity of, pre-membership examinations of banks. Another commenter requested that the exam guidelines in SR 95-30 be updated. The Board has decided not to incorporate pre-membership examination guidelines into Regulation H because the necessity for, and

duration of, examinations depends on the individual circumstances of each bank.

*Conditions of Membership.* The proposed rule incorporated a new § 208.3(d) which combined and condensed former §§ 208.6 and 208.7 concerning the general conditions and requirements of membership. The former requirement that the capital and surplus of a State member bank be adequate in relation to its existing and prospective deposit liabilities was modified and placed in proposed § 208.4. Proposed § 208.3(d) also incorporated the provisions of existing Subpart D, "Standards for Safety and Soundness."

In addition, the Board proposed to eliminate existing § 208.6(a), which points out that State member banks retain all charter and statutory rights under state law not preempted by Federal law, and § 208.6(b), which states that State member banks are entitled to all the privileges of membership afforded them under the Federal Reserve Act and other acts of Congress, and must observe all requirements of Federal law. One commenter stated that eliminating existing § 208.6(a) and (b) would create confusion because the sections state important concepts. The Board continues to believe, however, that these propositions are self-evident and do not need to be explicitly stated. Therefore, existing § 208.6(a) and (b) are not included in the final Regulation H.

Another commenter requested that the term "general character of a bank's business" (§ 208.3(d)(2)) be defined. The Board believes that providing a definition of the term could result in an unduly restrictive or inflexible definition and, therefore, has not incorporated such a definition in Regulation H.

#### Section 208.5 Dividends and Other Distributions

Proposed § 208.5 revised the existing provisions concerning payment of dividends and withdrawal of capital, previously located at § 208.19. Proposed § 208.5 also incorporated interpretations previously located at § 208.125 through § 208.127. The final rule retains § 208.5 as proposed, however, in the case of dividends in excess of net income for the year, the final rule clarifies that banks generally are not required to carry forward negative amounts resulting from such excess.<sup>3</sup> The final rule also

contains a cross reference to § 208.45 of Subpart D for purposes of determining restrictions on the payment of capital distributions.

#### Section 208.6 Establishment and Maintenance of Branches

*Duration of Comment Period.* The Board's proposal requested comment on whether it should shorten the public comment period applicable to branch applications from the 30 days that is currently required to 15 days. Those commenters favoring shortening the comment period stated that comments on branch applications rarely raise substantive issues and that shortening the period would serve to reduce regulatory burden on banks. Commenters opposing shortening the comment period stated that shortening the comment period to 15 days would make it difficult for commenters to provide substantive comments to the Board on branch applications. The Board is reducing the public comment period on branch applications from 30 to 15 days but will allow, in its discretion, an extension of the comment period for an additional 15 days.<sup>4</sup> Sections 208.6(a)(3) and (a)(4) describe the new procedural rules for public comment on branch applications, including the new 15 day comment period and the potential 15 day extension. The Board's Rules of Procedure (12 CFR 262.3) will continue to describe the form and location for public notices and will be amended in the future to reflect the 15 day comment period applicable to branch applications.

*Processing Time Frames for Expedited Branch Applications.* The proposed rule provided procedures for processing expedited branch applications that were modified slightly from the Board's existing procedures, located in Administrative Letter 92-82 (November 5, 1992). The proposed rule provided that a branch application by an eligible bank would be deemed approved by the Board or the appropriate Reserve Bank five business days after the close of the public comment period, unless the Board or the appropriate Reserve Bank notifies the bank that the application is approved prior to that date or that the bank is not eligible for expedited processing because: (a) it is not an eligible bank; (b) the application contains a material error or is otherwise deficient; or (c) the application or notice

<sup>3</sup> This clarification addresses only earnings deficits that result from dividends declared in excess of net income for the year and does not apply to other types of current earnings deficits. It is consistent with the OCC's letter dated December 22, 1997, and published as Interpretive Letter #816.

<sup>4</sup> The OCC, in revising its branch application procedures, retained a 30 day comment period for all branch applications other than those involving "short-distance" relocations (which relocations, if within the same neighborhood, would not require a branch application under the Board's final rule).

required under the Board's Rules of Procedure (12 CFR 262.3), raises significant supervisory, Community Reinvestment Act, compliance, policy or legal issues that have not been resolved, or a timely substantive adverse comment is submitted. In addition, the preamble to the proposed rule stated that in no case would an expedited branch application be approved prior to the third day after the close of the public comment period.

In the final rule, the Board is including in the text of the regulation an express statement that expedited branch applications will not be approved prior to the third day after the close of the public comment period. Waiting until the third day enables the Board, or appropriate Reserve Bank, to determine whether it has received any public comments on the application. In all other respects the processing time frames for expedited branch applications remain the same as proposed. The Board will be amending its Rules of Procedure to incorporate the changes adopted in the final rule.

Non-expedited branch applications will be processed in accordance with the Board's *Applications Procedures Manual*.

**Processing Procedures.** The proposed rule required branch applications to be filed in accordance with the Board's Rules of Procedure (12 CFR 262.3). One commenter raised a question as to whether eligible banks must file a "full" branch application. Both eligible and non-eligible banks must comply with the Board's Rules of Procedure. More in-depth review is expected in non-eligible bank branch applications. Accordingly, the Board may require more extensive information regarding non-eligible bank branch applications than eligible bank branch applications. In particular, the Board pays close attention to areas that have caused the bank to become non-eligible.

**Notification of Branch Opening.** Section 208.6(d) of the proposed rule explicitly authorized a single consolidated application for branches that a State member bank plans to establish in a one-year period, provided the bank meets the existing requirement that it notify the appropriate Reserve Bank one week prior to opening any branch covered by the approval. One commenter raised a question as to whether it was necessary for banks to provide prior notification of opening a branch. The Board has reviewed this policy further and concurs with the commenter that prior approval is unnecessary, therefore, § 208.6(d) of the final rule provides for a more flexible time for notification, merely requiring

notice within 30 days after opening the branch.

**Branch Closings.** The proposed rule established a new § 208.6(e) regarding branch closings, which requires branch closings to comply with section 42 of the FDI Act (12 U.S.C. 1831r-1). Section 42(e) requires notice to both customers and, in the case of insured State member banks, the Board, of proposed branch closings. The proposed rule also clarified that a branch relocation is not a closing for purposes of section 42(e) of the FDI Act. Under section 42(e) of the FDI Act, a branch relocation is a movement that occurs within the immediate neighborhood and that does not substantially affect the nature of the business or customers served.

One commenter requested that § 208.6(e) refer to the Interagency Policy Statement on Branch Closings. The Board believes that referring to the policy statement in § 208.6(e) would reduce the flexibility inherent in policy statements and, therefore, is not referring to it in Regulation H.

#### Section 208.7 Prohibition Against Use of Interstate Branches Primarily for Deposit Production

The final rule includes the text of existing § 208.28, as issued in final by the Board on September 10, 1997 (62 FR 47727) with an effective date of October 10, 1997. Existing § 208.28 remains unchanged except that it is being renumbered from § 208.28 to § 208.7.

#### Subpart B—Investments and Loans

##### Section 208.21 Investments in Premises and Securities

**Investments in Premises.** Section 208.21(a) of the proposed rule provided new investment limitations on banks' investments in premises. These new limitations were incorporated into Regulation H as a result of amendments to section 24A of the Federal Reserve Act made by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. 104-208, 110 Stat. 3009, (Economic Growth Act). The Economic Growth Act provides that banks may make investments in bank premises if they either: (a) obtain prior approval from the Board; (b) invest less than or equal to the bank's capital stock; or (c) invest less than or equal to 150 percent of the bank's capital and surplus so long as the bank is well-rated and well-capitalized and provides the Board with notice no later than 30 days after making the investment. The Economic Growth Act creates investment in premises limits based on banks' "capital stock" or "capital and surplus." The proposed rule based the investment

limits on the basis of banks' *capital stock and surplus*, as defined by § 208.2(d) of Regulation H. One commenter stated that limitations on investments in premises for non-well rated and non-well capitalized banks should be based on banks' "capital stock" rather than the banks' *capital stock and surplus* as defined by Regulation H. The commenter stated that liberalizing the investment limit for non-well rated and non-well capitalized banks could result in supervisory concerns, particularly with respect to problem banks.

The Board believes that basing investment in premises limits on *capital stock and surplus* could present supervisory problems, therefore, the Board is basing the investment in premises limits on a bank's perpetual preferred stock and related surplus plus common stock plus surplus, as those terms are defined in the FFIEC Consolidated Reports of Condition and Income. If a well rated and well capitalized bank chooses to invest an amount above 150% of its perpetual preferred stock and related surplus plus common stock plus surplus (or, for a non-well-rated and well-capitalized bank, 100% of its perpetual preferred stock and related surplus plus common stock plus surplus) the bank may do so as long as it provides the appropriate Reserve Bank at least 15 days notice prior to making such investments and has not received notice that the investment is subject to further review by the end of the fifteen day notice period.

Another commenter raised a question as to whether it was necessary for the Board to receive after-the-fact notice of investments in premises that are less than or equal to 150% of banks' perpetual preferred stock and related surplus plus common stock plus surplus as required by § 208.21(a)(3)(ii)(C). The commenter questioned the usefulness of after-the-fact notice of such investments. The Board has concluded that such after-the-fact notice is unnecessary. The Economic Growth Act provides that banks with a CAMELS rating of 1 or 2, as of the most recent examination of the bank, and that are, and continue to be, well capitalized, may make investments in bank premises of less than or equal to 150 percent of the bank's capital and surplus so long as they provide the Board with after-the-fact notice of such investments. Under section 24A the Board also has the authority to grant banks prior approval to make investments in premises. Pursuant to this authority the Board is granting prior approval for state member banks with a CAMELS rating of 1 or 2, as of the most

recent examination of the bank, and that are, and continue to be, well capitalized, to make investments in bank premises of less than or equal to 150 percent of the bank's perpetual preferred stock and related surplus plus common stock plus surplus without providing the Board with after-the-fact notice of such investments.

**Investments in Securities.** The proposal incorporated a new § 208.21(b) which provided guidance to banks regarding permissible investments in securities. For the reasons outlined below under the discussion of the Board's interpretation on Investments in Shares of an Investment Company, the Board is amending § 208.21(b) to clarify generally that, with respect to certain investment company shares and investment securities, a State member bank may look to the OCC's Part 1 rules and interpretations to determine whether a security qualifies as an investment security for the purpose of section 24, paragraph 7th, and for the calculations of the limitations applicable to such investments. Section 208.21(b) is also being amended to clarify that a State member bank should consult the Board for determinations with respect to issues concerning investment securities that have not been addressed by the OCC rules and interpretations.

**Voting Stock in a Fiduciary Capacity.** The proposed rule contained a footnote, footnote four, which several commenters stated would prevent banks from voting shares of stock in a fiduciary capacity. Footnote four was derived from, and was intended to update, a Board interpretation located at 12 CFR 250.220, which was to be removed. The Board is not including footnote four in the final rule and is retaining the Board interpretation found at 12 CFR 250.220 which states that banks may vote shares of stock if they are acting in a fiduciary capacity.

#### **Subpart C—Bank Securities and Securities-Related Activities**

##### **Section 208.34 Recordkeeping and Confirmation of Certain Securities Transactions**

**Effected by State Member Banks.** The final rule includes the text of existing § 208.24, as issued in final by the Board on March 5, 1997 (62 FR 9909), with an effective date of April 1, 1997. Existing § 208.24 remains unchanged except that it is being renumbered from § 208.24 to § 208.34.

##### **Section 208.35 Qualification Requirements for the Recommendation or Sale of Certain Securities**

The final rule includes a place holder for proposed new § 208.35. The Board is seeking public comment on proposed § 208.35 separately.

##### **Section 208.37 Government Securities Sales Practices**

The final rule includes the text of existing § 208.25, as issued in final by the Board on March 19, 1997 (62 FR 13275) with an effective date of July 1, 1997. Existing § 208.25 remains unchanged except that it is being renumbered from § 208.25 to § 208.37.

#### **Subpart D—Prompt Corrective Action**

The proposed rule did not significantly amend the terms of prior Subpart B other than to redesignate it as Subpart D and to amend § 208.41 to provide the Federal Reserve with the option of using period-end total assets rather than average total assets for purposes of defining *total assets*. The Board received two comments regarding Subpart D. The first commenter inquired as to whether other governmental agencies allow the option of using period-end total assets rather than average total assets for purposes of defining *total assets*. In this regard the Board notes that the OCC's definition of total assets, for purposes of its prompt corrective action rule, is the same as the Board's.<sup>5</sup>

The second commenter stated that § 208.43(c)(2) should be updated to reflect all applicable CAMELS components. The Board has added "sensitivity to market risk" as the final CAMELS component.

#### **Subpart F—Miscellaneous Requirements**

##### **Section 208.61 Bank Security Procedures**

Regulation P (12 CFR part 216), as amended by the Board on May 1, 1991, is being incorporated into Regulation H at § 208.61. A final rule removing 12 CFR part 216 is found elsewhere in today's **Federal Register**.

##### **Section 208.64 Frequency of Examination**

The final rule includes the text of existing § 208.26, as issued in final by the Board on April 2, 1998 (63 FR 16378), also effective on April 2, 1998). Existing § 208.26 remains unchanged except that it is being renumbered from § 208.26 to § 208.64.

#### **Subpart G—Interpretations**

##### **Proposed § 208.101 Investments in Federal Agricultural Mortgage Corporation (Farmer Mac) Stock**

This proposed interpretation restated an existing staff opinion<sup>6</sup> regarding the permissibility of banks investing in the stock of the Federal Agricultural Mortgage Corporation (Farmer Mac), which is a government agency. One commenter stated that the Board should either provide a complete list of permissible investments in stocks of governmental agencies or provide no list.

In general, banks are prohibited from owning stock pursuant to paragraph seventh of section 5136 of the Revised Statutes (12 U.S.C. 24 ¶ 7th), which was made applicable to State member banks under paragraph 20 of § 9 of the Federal Reserve Act (12 U.S.C. 335). Although State member banks are generally prohibited from owning stock, the Board has, in the past, allowed banks to own the stock of certain governmental agencies where Congress has evidenced a clear intention that banks be allowed to hold such stock in order to achieve a legislative purpose. Since decisions regarding permissible stock investments in governmental agencies must be made on a case-by-case basis, the Board has decided not to include proposed § 208.101 in the final rule. However, the Board will retain the existing staff opinion regarding investments in Farmer Mac stock in the Federal Reserve Regulatory Service.

##### **Proposed Section 208.102 Investments in Shares of an Investment Company**

The Board proposed to retain its existing interpretation, entitled "Purchase of investment company stock by a State member bank," and rename it "Investments in Shares of an Investment Company," and renumber it from § 208.124 to § 208.102. In addition, the Board requested comment as to whether the existing interpretation should be amended to provide an alternative limit for certain diversified investment companies. Under the alternative limit, a bank could elect not to combine its pro rata interest in a particular security held by an investment company with the bank's direct holdings of the security where: (a) the investment company's holdings of the securities of any one issuer do not exceed 5 percent of its total portfolio; and (b) the bank's total holdings of the investment company's shares do not exceed the most stringent limit applicable to any of the securities in the

<sup>5</sup> 12 CFR 6.2(j).

<sup>6</sup> F.R.R.S. 3-447.13 (July 26, 1988).

company's portfolio if those securities were purchased directly by the bank. This alternative limit is currently available to national banks under OCC rules.

Several commenters pointed to conflicts between the Board's interpretation and the provisions of the OCC's Part 1 concerning investment company shares and recommended that the Board withdraw its interpretation in order to avoid a conflict with the OCC rules. Alternatively, these commenters supported efforts to conform the Board's interpretation to the OCC's current provisions concerning investment companies, including adoption of the alternative limit and other conforming amendments.

In addition to differences concerning calculation of limits, the commenters pointed out that the Board's interpretation generally permits investment only in investment companies that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and the Securities Act of 1933, while the OCC rule provides for case-by-case consideration of investment companies that are exempt from registration where the portfolio of the investment companies consist entirely of assets that a national bank may purchase and sell for its own account. Commenters also pointed out that the OCC's rule requires only that the portfolio of the investment company consist exclusively of assets that a national bank could purchase directly. The Board's interpretation, on the other hand, requires that limits on the investment company's authority be included in the investment company's prospectus, which one commenter argued prevented State member banks from being able to "seed" start-up investment companies where funds were initially invested only in bank eligible securities. The Board's interpretation also differs from the OCC rule in other technical respects and includes requirements that relate to safety and soundness, rather than investment authority.

The Board believes that State member banks should be permitted to use the alternative method of calculating investment limits available under the OCC's rules for diversified investment companies. Additionally, although the circumstances under which a State member bank may provide funds to "seed" an investment company are limited, the Board believes that State member banks should be permitted to do so where the activity is consistent with the Glass-Steagall Act. The Board also notes that its interpretation was not

intended to preclude the consideration on a case-by-case basis of investments not covered by its interpretation, including unregistered investment companies.

With respect to the provisions of the interpretation concerning internal procedures for approval and management of investments in investment companies, guidance issued by Board staff concerning risk management practices related to investment and end-user activities provides more thorough guidance concerning appropriate risk management practices than was available at the time the interpretation was adopted.<sup>7</sup> Further, internal procedures and practices discussed in current guidance cover the bank's investment activities generally and are not limited to a particular area. The Board therefore believes that the specific internal procedures required under the Board's interpretation are no longer necessary.

Based on the above considerations, the Board has concluded that its existing interpretation, § 208.124 (proposed § 208.102), no longer serves a useful purpose and is rescinding it. The Board is adding language to the § 208.21(b) on investments in securities to clarify generally that, with respect to certain investment company shares and investment securities, a State member bank may look to the OCC's Part 1 rules and interpretations to determine whether a security qualifies as an investment security for the purpose of section 24, paragraph 7th, and for the calculations of the limitations applicable to such investments. Regulation H also is being amended to clarify that a State member bank should consult the Board for determinations with respect to issues concerning investment securities that have not been addressed by the OCC rules and interpretations.

#### Section 208.101 Obligations Concerning Institutional Customers

The final rule includes the text of existing § 208.129, as issued in final by the Board on March 19, 1997 (62 FR 13275). Existing § 208.129 remains unchanged except that it is being renumbered from § 208.129 to § 208.101.

*Investments in operating subsidiaries.* Several commenters recommended that the Board rescind its 1968 interpretation concerning "operations subsidiaries," published at 12 CFR 250.141, noting that this interpretation was obsolete. The interpretation states that a State member bank may invest in the shares

of a wholly owned "operations subsidiary" without violating the provisions of the Glass-Steagall Act concerning the purchase of stock by member banks. At the present time the Board is retaining the existing interpretation regarding "operations subsidiaries."

*Miscellaneous. Financial Condition.* The Board proposed eliminating existing § 208.17, entitled Disclosure of Financial Information by State member banks, from the proposed Regulation H on the basis that call report information for banks is now available through the internet. In response to this proposal the Board received three comments from Federal Reserve Banks which stated that it was premature to eliminate § 208.17 because a large segment of the public does not have access to the internet. The Board has decided to rescind § 208.17 despite these objections. The Board believes that § 208.17 places a burden on banks by requiring them to make available a potentially unlimited number of copies of statements regarding their financial condition to the public. This burden has been justified in the past because it was the only effective means for the public to obtain information concerning a bank's financial condition. However, now that many private institutions, as well as many public institutions, such as public libraries, offer access to the internet, where such financial information concerning banks can be obtained, the Board does not believe the burden on banks of providing such information continues to be justified, and therefore, is removing existing § 208.17 from the final rule.

#### Final Regulatory Flexibility Analysis

Two of the three requirements of a final regulatory flexibility analysis (5 U.S.C. 604), (1) a succinct statement of the need for and the objectives of the rule and (2) a summary of the issues raised by the public comments, the agency's assessment of the issues, and a statement of the changes made in the final rule in response to the comments, are discussed above. The third requirement of a final regulatory flexibility analysis is a description of significant alternatives to the rule that would minimize the rule's economic impact on small entities and reasons why the alternatives were rejected.

The final amendments will apply to all State member banks, which numbered approximately 997 as of February 1998, regardless of size, and represent changes to the existing rules that should reduce burden for those institutions by reducing regulatory filings, reducing the paperwork burden

<sup>7</sup> See SR 95-17 (SUP), March 28, 1995.

and processing time associated with regulatory filings, reducing the costs associated with complying with regulation, and improving the ability of banks to conduct business on a more cost-efficient basis. For example, the rule is generally designed to reduce burden by removing out-dated material and by re-organizing the remaining material so it is easier to locate and to read.

The rule also seeks to reduce burden by incorporating expedited procedures for membership and branch applications for certain banks and by reducing the processing period for expedited applications from 5 to 3 days after the close of the public comment period. In addition, the rule expands the circumstances under which the Board will consider waivers of conditions of membership, eliminates existing requirements regarding disclosure of financial condition, and eliminates the requirement that banks obtain deposit insurance in order to become State member banks. The rule also provides for an alternate definition of total assets for institutions with rapidly declining asset bases.

The amendments should not have a negative economic effect on small institutions, and, therefore, there were no significant alternatives that would have minimized the economic impact on those institutions.

#### Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR Part 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, these information collections unless they display a currently valid OMB control number. The OMB control numbers for the affected information collections are 7100-0097, 7100-0278, 7100-0046, and 7100-0139.

The sections of the regulation pertaining to the revised information collections are found in 12 CFR 208.2, 208.3, 208.6, 208.21, and 208.22. This information is needed in order for the Federal Reserve System to conduct its supervisory responsibility for state member banks. The respondents and recordkeepers are state member banks. Individual respondent data generally are not regarded as confidential.

No comments specifically addressing the burden estimate were received. Four existing information collections covered by Regulation H are affected by the changes to the regulation. Fewer

Domestic Branch Notifications (FR 4001; OMB No. 7100-0097), which are mandatory, will be submitted resulting from the elimination of the notification requirement for ATMs and certain other offices and from the broadening of the interpretation of "location." The proposed rule also had provided that depository institutions be permitted to file a single notification for prior approval of multiple branches to be established within a year following the notification. The requirement for prior approval was eliminated in the final rule, which only requires notification within thirty days after each branch is opened. Further study, based on an analysis of the types of notifications received in the past, has led the Federal Reserve to increase its initial estimate of the effect of these changes on the annual burden from a decrease of 20 percent to more than 50 percent, from 415 to 201 hours.

The revisions to Regulation H are expected to affect the relative distribution of two of the types of Reports Related to Public Welfare Investments of State Member Banks (OMB No. 7100-0278) that are submitted to the Federal Reserve. The Board is eliminating the requirement that, to avoid applying for Board approval, the investment must be smaller than 2 percent of capital and surplus. This should result in fewer applications and more notices of investments not requiring Board approval. A requirement has been added to the applications for Board approval: if the bank is not permitted to make the investment without Board approval, the institution must explain the reason or reasons why the investment is ineligible. This is expected to increase the burden per response from two and one-half hours to two and three-quarters hours. The estimated burden per response for a notice of investment not requiring Board approval is two hours. There were twenty notices and fourteen applications received during 1997. It is estimated that following the revision there will be twenty-seven notices and seven applications submitted annually. There is estimated to be no effect on the divestiture notice requirements, one of which is expected to be submitted annually. The burden per response for the divestiture notice is estimated to be five hours. Altogether the total amount of annual burden is estimated to be reduced 3 percent from eighty hours to seventy-eight. There is estimated to be no annual cost burden over the annual hour burden and no capital or start-up costs associated with the changes.

The burden for the Membership Application (FR 2083; OMB No. 7100-

0046) will experience a minimal reduction in the current annual burden of 3,450 hours, resulting from the elimination of the publication requirement, the broadened authority of the Board to waive the application, and the reduction in the processing time for expedited applications from thirty to fifteen days.

The final rule contains changes that affect another existing information collection. The proposed rule provided that the Investment in Bank Premises Notification (FR 4014; OMB No. 7100-0139) must be filed by a state member bank whenever it proposes to make an investment in bank premises that results in its total bank premises investment exceeding its capital stock and surplus, or if the bank is well capitalized and in good condition, exceeding 150 percent of its capital stock and surplus. In the final rule, the Board decided to base its analysis on the bank's perpetual preferred stock and related surplus plus common stock plus surplus, which is a more conservative measure than the capital stock and surplus proposed initially. In addition, after-the-fact notification is no longer required from banks for investments within the limits. The net effect of these changes is expected to have a minimal effect on the annual respondent burden for this information collection of eight hours.

The Federal Reserve has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of these collections of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100-0097, 7100-0278, 7100-0046, or 7100-0139), Washington, DC 20503.

#### Derivation Table

This table directs readers to the provision(s) of existing Regulation H, if any, upon which the proposed provision is based.

Revised provision	Original provision
208.1 .....	None
208.2 .....	208.1
208.3(a) .....	208.2
208.3(b) .....	208.4, 208.5
208.3(c) .....	208.5
208.3(d) .....	added
208.3(e) .....	208.7
208.3(f) .....	208.10
208.3(g) .....	208.11
208.4 .....	208.13
208.5 .....	208.19



Revised provision	Original provision
208.6(a) .....	208.9
208.6(b) .....	None
208.6(c) .....	None
208.6(d) .....	None
208.6(e) .....	208.9(b)(7)
208.6(f) .....	None
208.7 .....	208.28
208.20 .....	None
208.21 .....	None
208.22 .....	208.21
208.23 .....	208.15
208.24 .....	208.8(d)
208.25 .....	208.23
208.30 .....	None
208.31 .....	208.8(f)
208.32 .....	208.8(h), 208.8(i)
208.33 .....	208.8(g)
208.34 .....	208.24
208.35 .....	None
208.36 .....	208.16
208.37 .....	208.25
208.40 .....	208.30
208.41 .....	208.31
208.42 .....	208.32
208.43 .....	208.33
208.44 .....	208.34
208.45 .....	208.35
208.50 .....	208.51
208.51 .....	208.52
208.60 .....	None
208.61 .....	None
208.62 .....	208.20
208.63 .....	208.14
208.64 .....	208.26
208.100 .....	208.116
208.101 .....	208.129

## List of Subjects

### 12 CFR Part 208

Accounting, Agriculture, Banks, Banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

### 12 CFR Part 250

Federal Reserve System.

For the reasons set forth in the preamble, the Board is amending chapter II of title 12 of the Code of Federal Regulations as follows:

## PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 is revised to read as follows:

**Authority:** 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1818, 1823(j), 1828(o), 1831o, 1831p–1, 1831r–1, 1835a, 1882, 2901–2907, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 781(b), 781(g), 781(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

2. The table of contents to part 208 is revised to read as follows:

### Subpart A—General Membership and Branching Requirements

Sec.

- 208.1 Authority, purpose, and scope.
- 208.2 Definitions.
- 208.3 Application and conditions for membership in the Federal Reserve System.
- 208.4 Capital adequacy.
- 208.5 Dividends and other distributions.
- 208.6 Establishment and maintenance of branches.
- 208.7 Prohibition against use of interstate branches primarily for deposit production.

### Subpart B—Investments and Loans

- 208.20 Authority, purpose, and scope.
- 208.21 Investments in premises and securities.
- 208.22 Community development and public welfare investments.
- 208.23 Agricultural loan loss amortization.
- 208.24 Letters of credit and acceptances.
- 208.25 Loans in areas having special flood hazards.

### Subpart C—Bank Securities and Securities-Related Activities

- 208.30 Authority, purpose, and scope.
- 208.31 State member banks as transfer agents.
- 208.32 Notice of disciplinary sanctions imposed by registered clearing agency.
- 208.33 Application for stay or review of disciplinary sanctions imposed by registered clearing agency.
- 208.34 Recordkeeping and confirmation of certain securities transactions effected by State member banks.
- 208.35 Qualification requirements for transactions in certain securities. [Reserved]
- 208.36 Reporting requirements for State member banks subject to the Securities Exchange Act of 1934.
- 208.37 Government securities sales practices.

### Subpart D—Prompt Corrective Action

- 208.40 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.
- 208.41 Definitions for purposes of this subpart.
- 208.42 Notice of capital category.
- 208.43 Capital measures and capital category definitions.
- 208.44 Capital restoration plans.
- 208.45 Mandatory and discretionary supervisory actions under section 38.

### Subpart E—Real Estate Lending and Appraisal Standards

- 208.50 Authority, purpose, and scope.
- 208.51 Real estate lending standards.

### Subpart F—Miscellaneous Requirements

- 208.60 Authority, purpose, and scope.
- 208.61 Bank security procedures.
- 208.62 Suspicious activity reports.
- 208.63 Procedures for monitoring Bank Secrecy Act compliance.
- 208.64 Frequency of examination.

### Subpart G—Interpretations

- 208.100 Sale of bank's money orders off premises as establishment of branch office.
- 208.101 Obligations concerning institutional customers.

### Appendix A to Part 208—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

### Appendix B to Part 208—Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure

### Appendix C to Part 208—Interagency Guidelines for Real Estate Lending Policies

### Appendix D to Part 208—Interagency Guidelines Establishing Standards for Safety and Soundness

### Appendix E to Part 208—Capital Adequacy Guidelines for State Member Banks: Market Risk Measure

3. Subparts A through E are revised and Subparts F and G are added to read as follows:

### Subpart A—General Membership and Branching Requirements

#### § 208.1 Authority, purpose, and scope.

(a) *Authority.* Subpart A of Regulation H (12 CFR part 208, Subpart A) is issued by the Board of Governors of the Federal Reserve System (Board) under 12 U.S.C. 24, 36; sections 9, 11, 21, 25 and 25A of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), 481–486, 601 and 611); sections 1814, 1816, 1818, 1831o, 1831p–1, 1831r–1 and 1835a of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1814, 1816, 1818, 1831o, 1831p–1, 1831r–1, and 1835); and 12 U.S.C. 3906–3909.

(b) *Purpose and scope of Part 208.* The requirements of this part 208 govern State member banks and state banks applying for admission to membership in the Federal Reserve System (System) under section 9 of the Federal Reserve Act (Act), except for § 208.7, which also applies to certain foreign banks licensed by a State. This part 208 does not govern banks eligible for membership under section 2 or 19 of the Act.<sup>1</sup> Any bank desiring to be admitted to the System under the provisions of section 2 or 19 should communicate with the Federal Reserve

<sup>1</sup> Under section 2 of the Federal Reserve Act, every national bank in any state shall, upon commencing business, or within 90 days after admission into the Union of the State in which it is located, become a member of the System. Under section 19 of the Federal Reserve Act, national banks and banks organized under local laws, located in a dependency or insular possession or any part of the United States outside of the States of the United States and the District of Columbia, are not required to become members of the System but may, with the consent of the board, become members of the System.



Bank with which it would like to become a member.

(c) *Purpose and scope of Subpart A.* This Subpart A describes the eligibility requirements for membership of state-chartered banking institutions in the System, the general conditions imposed upon members, including capital and dividend requirements, as well as the requirements for establishing and maintaining branches.

#### § 208.2 Definitions.

For the purposes of this part:

(a) *Board of Directors* means the governing board of any institution performing the usual functions of a board of directors.

(b) *Board* means the Board of Governors of the Federal Reserve System.

(c) *Branch.* (1) Branch means any branch bank, branch office, branch agency, additional office, or any branch place of business that receives deposits, pays checks, or lends money. A branch may include a temporary, seasonal, or mobile facility that meets these criteria.

(2) *Branch* does not include:

(i) A loan origination facility where the proceeds of loans are not disbursed;

(ii) An office of an affiliated or unaffiliated institution that provides services to customers of the member bank on behalf of the member bank so long as the institution is not established or operated by the bank;

(iii) An automated teller machine;

(iv) A remote service unit;

(v) A facility to which the bank does not permit members of the public to have physical access for purposes of making deposits, paying checks, or borrowing money (such as an office established by the bank that receives deposits only through the mail); or

(vi) A facility that is located at the site of, or is an extension of, an approved main office or branch. The Board determines whether a facility is an extension of an existing main or branch office on a case-by-case basis.

(d) *Capital stock and surplus* means, unless otherwise provided in this part, or by statute, Tier 1 and Tier 2 capital included in a member bank's risk-based capital (under the guidelines in appendix A of this part) and the balance of a member bank's allowance for loan and lease losses not included in its Tier 2 capital for calculation of risk-based capital, based on the bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 324.

(e) *Eligible bank* means a member bank that:

(1) Is well capitalized as defined in subpart D of this part;

(2) Has a composite Uniform Financial Institutions Rating System (CAMELS) rating of 1 or 2;

(3) Has a Community Reinvestment Act (CRA) (12 U.S.C. 2906) rating of "Outstanding" or "Satisfactory;"

(4) Has a compliance rating of 1 or 2; and

(5) Has no major unresolved supervisory issues outstanding (as determined by the Board or appropriate Federal Reserve Bank in its discretion).

(f) *State bank* means any bank incorporated by special law of any State, or organized under the general laws of any State, or of the United States, including a Morris Plan bank, or other incorporated banking institution engaged in a similar business.

(g) *State member bank or member bank* means a state bank that is a member of the Federal Reserve System.

#### § 208.3 Application and conditions for membership in the Federal Reserve System.

(a) *Applications for membership and stock.* (1) State banks applying for membership in the Federal Reserve System shall file with the appropriate Federal Reserve Bank an application for membership in the Federal Reserve System and for stock in the Reserve Bank,<sup>2</sup> in accordance with this part and § 262.3 of the Rules of Procedure, located at 12 CFR 262.3.

(2) *Board approval.* If an applying bank conforms to all the requirements of the Federal Reserve Act and this section, and is otherwise qualified for membership, the Board may approve its application subject to such conditions as the Board may prescribe.

(3) *Effective date of membership.* A State bank becomes a member of the Federal Reserve System on the date its Federal Reserve Bank stock is credited to its account (or its deposit is accepted, if it is a mutual savings bank not authorized to purchase Reserve Bank stock) in accordance with the Board's Regulation I (12 CFR part 209).

(b) *Factors considered in approving applications for membership.* Factors given special consideration by the Board in passing upon an application are:

(1) *Financial condition and management.* The financial history and condition of the applying bank and the general character of its management.

(2) *Capital.* The adequacy of the bank's capital in accordance with

§ 208.4, and its future earnings prospects.

(3) *Convenience and needs.* The convenience and needs of the community.

(4) *Corporate powers.* Whether the bank's corporate powers are consistent with the purposes of the Federal Reserve Act.

(c) *Expedited approval for eligible banks and bank holding companies.* (1) *Availability of expedited treatment.* The expedited membership procedures described in paragraph (c)(2) of this section are available to:

(i) An eligible bank; and

(ii) A bank that cannot be determined to be an eligible bank because it has not received compliance or CRA ratings from a bank regulatory authority, if it is controlled by a bank holding company that meets the criteria for expedited processing under § 225.14(c) of Regulation Y (12 CFR 225.14(c)).

(2) *Expedited procedures.* A completed membership application filed with the appropriate Reserve Bank will be deemed approved on the fifteenth day after receipt of the complete application by the Board or appropriate Reserve Bank, unless the Board or the appropriate Reserve Bank notifies the bank that the application is approved prior to that date or the Board or the appropriate Federal Reserve Bank notifies the bank that the application is not eligible for expedited review for any reason, including, without limitation, that:

(i) The bank will offer banking services that are materially different from those currently offered by the bank, or by the affiliates of the proposed bank;

(ii) The bank or bank holding company does not meet the criteria under § 208.3(c)(1);

(iii) The application contains a material error or is otherwise deficient; or

(iv) The application raises significant supervisory, compliance, policy or legal issues that have not been resolved, or a timely substantive adverse comment is submitted. A comment will be considered substantive unless it involves individual complaints, or raises frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues.

(d) *Conditions of membership.* (1) *Safety and soundness.* Each member bank shall at all times conduct its business and exercise its powers with due regard to safety and soundness. (The Interagency Guidelines Establishing Standards for Safety and Soundness prescribed pursuant to section 39 of the FDI Act (12 U.S.C.

<sup>2</sup> A mutual savings bank not authorized to purchase Federal Reserve Bank stock may apply for membership evidenced initially by a deposit, but if the laws under which the bank is organized are not amended at the first session of the legislature after its admission to authorize the purchase, or if the bank fails to purchase the stock within six months of the amendment, its membership shall be terminated.

1831p-1), as set forth as appendix D to this part apply to all member banks.)

(2) *General character of bank's business.* A member bank may not, without the permission of the Board, cause or permit any change in the general character of its business or in the scope of the corporate powers it exercises at the time of admission to membership.

(3) *Compliance with conditions of membership.* Each member bank shall comply at all times with this Regulation H (12 CFR part 208) and any other conditions of membership prescribed by the Board.

(e) *Waivers.* (1) *Conditions of membership.* A member bank may petition the Board to waive a condition of membership. The Board may grant a waiver of a condition of membership upon a showing of good cause and, in its discretion, may limit, among other items, the scope, duration, and timing of the waiver.

(2) *Reports of affiliates.* Pursuant to section 21 of the Federal Reserve Act (12 U.S.C. 486), the Board waives the requirement for the submission of reports of affiliates of member banks, unless such reports are specifically requested by the Board.

(f) *Voluntary withdrawal from membership.* Voluntary withdrawal from membership becomes effective upon cancellation of the Federal Reserve Bank stock held by the member bank, and after the bank has made due provision to pay any indebtedness due or to become due to the Federal Reserve Bank in accordance with the Board's Regulation I (12 CFR part 209).

#### **§ 208.4 Capital adequacy.**

(a) *Adequacy.* A member bank's capital, as defined in appendix A to this part, shall be at all times adequate in relation to the character and condition of its assets and to its existing and prospective liabilities and other corporate responsibilities. If at any time, in light of all the circumstances, the bank's capital appears inadequate in relation to its assets, liabilities, and responsibilities, the bank shall increase the amount of its capital, within such period as the Board deems reasonable, to an amount which, in the judgment of the Board, shall be adequate.

(b) *Standards for evaluating capital adequacy.* Standards and guidelines by which the Board evaluates the capital adequacy of member banks include those in appendices A and E to this part for risk-based capital purposes and appendix B to this part for leverage measurement purposes.

#### **§ 208.5 Dividends and other distributions.**

(a) *Definitions.* For the purposes of this section:

(1) *Capital surplus* means the total of surplus as reportable in the bank's Reports of Condition and Income and surplus on perpetual preferred stock.

(2) *Permanent capital* means the total of the bank's perpetual preferred stock and related surplus, common stock and surplus, and minority interest in consolidated subsidiaries, as reportable in the Reports of Condition and Income.

(b) *Limitations.* The limitations in this section on the payment of dividends and withdrawal of capital apply to all cash and property dividends or distributions on common or preferred stock. The limitations do not apply to dividends paid in the form of common stock.

(c) *Earnings limitations on payment of dividends.* (1) A member bank may not declare or pay a dividend if the total of all dividends declared during the calendar year, including the proposed dividend, exceeds the sum of the bank's net income (as reportable in its Reports of Condition and Income) during the current calendar year and the retained net income of the prior two calendar years, unless the dividend has been approved by the Board.

(2) "Retained net income" in a calendar year is equal to the bank's net income (as reported in its Report of Condition and Income for such year), less any dividends declared during such year.<sup>3</sup> The bank's net income during the current year and its retained net income from the prior two calendar years is reduced by any net losses incurred in the current or prior two years and any required transfers to surplus or to a fund for the retirement of preferred stock.<sup>4</sup>

<sup>3</sup> In the case of dividends in excess of net income for the year, a bank generally is not required to carry forward negative amounts resulting from such excess. Instead, the bank may attribute the excess to the prior two years, attributing the excess first to the earlier year and then to the immediately preceding year. If the excess is greater than the bank's previously undistributed net income for the preceding two years, prior Board approval of the dividend is required and a negative amount would be carried forward in future dividend calculations. However, in determining any such request for approval, the Board could consider any request for different treatment of such negative amount, including advance waivers for future periods. This applies only to earnings deficits that result from dividends declared in excess of net income for the year and does not apply to other types of current earnings deficits.

<sup>4</sup> State member banks are required to comply with state law provisions concerning the maintenance of surplus funds in addition to common capital. Where the surplus of a State member bank is less than what applicable state law requires the bank to maintain relative to its capital stock account, the bank may be required to transfer amounts from its undivided profits account to surplus.

(d) *Limitation on withdrawal of capital by dividend or otherwise.* (1) A member bank may not declare or pay a dividend if the dividend would exceed the bank's undivided profits as reportable on its Reports of Condition and Income, unless the bank has received the prior approval of the Board and of at least two-thirds of the shareholders of each class of stock outstanding.

(2) A member bank may not permit any portion of its permanent capital to be withdrawn unless the withdrawal has been approved by the Board and by at least two-thirds of the shareholders of each class of stock outstanding.

(3) If a member bank has capital surplus in excess of that required by law, the excess amount may be transferred to the bank's undivided profits account and be available for the payment of dividends if:

(i) The amount transferred came from the earnings of prior periods, excluding earnings transferred as a result of stock dividends;

(ii) The bank's board of directors approves the transfer of funds; and

(iii) The transfer has been approved by the Board.

(e) *Payment of capital distributions.* All member banks also are subject to the restrictions on payment of capital distributions contained in § 208.45 of subpart D of this part implementing section 38 of the FDI Act (12 U.S.C. 1831o).

(f) *Compliance.* A member bank shall use the date a dividend is declared to determine compliance with this section.

#### **§ 208.6 Establishment and maintenance of branches.**

(a) *Branching.* (1) To the extent authorized by state law, a member bank may establish and maintain branches (including interstate branches) subject to the same limitations and restrictions that apply to the establishment and maintenance of national bank branches (12 U.S.C. 36 and 1831u), except that approval of such branches shall be obtained from the Board rather than from the Comptroller of the Currency.

(2) *Branch applications.* A State member bank wishing to establish a branch in the United States or its territories must file an application in accordance with the Board's Rules of Procedure, located at 12 CFR 262.3, and must comply with the public notice and comment rules contained in paragraphs (a)(3) and (a)(4) of this section. Branches of member banks located in foreign nations, in the overseas territories, dependencies, and insular possessions of those nations and of the United States, and in the Commonwealth of

Puerto Rico, are subject to the Board's Regulation K (12 CFR part 211).

(3) *Public notice of branch applications.* (i) *Location of publication.* A State member bank wishing to establish a branch in the United States or its territories must publish notice in a newspaper of general circulation in the form and at the locations specified in § 262.3 of the Rules of Procedure (12 CFR 262.3).

(ii) *Contents of notice.* The newspaper notice referred to in paragraph (a)(3) of this section shall provide an opportunity for interested persons to comment on the application for a period of at least 15 days.

(iii) *Timing of publication.* Each newspaper notice shall be published no more than 7 calendar days before and no later than the calendar day on which an application is filed with the appropriate Reserve Bank.

(4) *Public comment.* (i) *Timely comments.* Interested persons may submit information and comments regarding a branch application under § 208.6. A comment shall be considered timely for purposes of this subpart if the comment, together with all supplemental information, is submitted in writing in accordance with the Board's Rules of Procedure (12 CFR 262.3) and received by the Board or the appropriate Reserve Bank prior to the expiration of the public comment period provided in paragraph (a)(3)(ii) of this section.

(ii) *Extension of comment period.* The Board may, in its discretion, extend the public comment period regarding any application under § 208.6. In the event that an interested person requests a copy of an application submitted under § 208.6, the Board may, in its discretion and based on the facts and circumstances, grant such person an extension of the comment period for up to 15 calendar days.

(b) *Factors considered in approving domestic branch applications.* Factors given special consideration by the Board in passing upon a branch application are:

(1) *Financial condition and management.* The financial history and condition of the applying bank and the general character of its management;

(2) *Capital.* The adequacy of the bank's capital in accordance with § 208.4, and its future earnings prospects;

(3) *Convenience and needs.* The convenience and needs of the community to be served by the branch;

(4) *CRA performance.* In the case of branches with deposit-taking capability, the bank's performance under the Community Reinvestment Act (12

U.S.C. 2901 *et seq.*) and Regulation BB (12 CFR part 228); and

(5) *Investment in bank premises.* Whether the bank's investment in bank premises in establishing the branch is consistent with § 208.21.

(c) *Expedited approval for eligible banks and bank holding companies.* (1) *Availability of expedited treatment.* The expedited branch application procedures described in paragraph (c)(2) of this section are available to:

(i) An eligible bank; and  
(ii) A bank that cannot be determined to be an eligible bank because it has not received compliance or CRA ratings from a bank regulatory authority, if it is controlled by a bank holding company that meets the criteria for expedited processing under § 225.14(c) of Regulation Y (12 CFR 225.14(c)).

(2) *Expedited procedures.* A completed domestic branch application filed with the appropriate Reserve Bank will be deemed approved on the fifth day after the close of the comment period, unless the Board or the appropriate Reserve Bank notifies the bank that the application is approved prior to that date (but in no case will an application be approved before the third day after the close of the public comment period) or the Board or the appropriate Federal Reserve Bank notifies the bank that the application is not eligible for expedited review for any reason, including, without limitation, that:

(i) The bank or bank holding company does not meet the criteria under § 208.6(c)(1);

(ii) The application contains a material error or is otherwise deficient; or

(iii) The application or the notice required under paragraph (a)(3) of this section, raises significant supervisory, Community Reinvestment Act, compliance, policy or legal issues that have not been resolved, or a timely substantive adverse comment is submitted. A comment will be considered substantive unless it involves individual complaints, or raises frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues.

(d) *Consolidated Applications.* (1) *Proposed branches; notice of branch opening.* A member bank may seek approval in a single application or notice for any branches that it proposes to establish within one year after the approval date. The bank shall, unless notification is waived, notify the appropriate Reserve Bank not later than 30 days after opening any branch approved under a consolidated application. A bank is not required to

open a branch approved under either a consolidated or single branch application.

(2) *Duration of branch approval.* Branch approvals remain valid for one year unless the Board or the appropriate Reserve Bank notifies the bank that in its judgment, based on reports of condition, examinations, or other information, there has been a change in the bank's condition, financial or otherwise, that warrants reconsideration of the approval.

(e) *Branch closings.* A member bank shall comply with section 42 of the FDI Act (FDI Act), 12 U.S.C. 1831r-1, with regard to branch closings.

(f) *Branch relocations.* A relocation of an existing branch does not require filing a branch application. A relocation of an existing branch, for purposes of determining whether to file a branch application, is a movement that does not substantially affect the nature of the branch's business or customers served.

#### **§ 208.7 Prohibition against use of interstate branches primarily for deposit production.**

(a) *Purpose and scope—(1) Purpose.* The purpose of this section is to implement section 109 (12 U.S.C. 1835a) of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act).

(2) *Scope.* (i) This section applies to any State member bank that has operated a covered interstate branch for a period of at least one year, and any foreign bank that has operated a covered interstate branch licensed by a State for a period of at least one year.

(ii) This section describes the requirements imposed under 12 U.S.C. 1835a, which requires the appropriate Federal banking agencies (the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) to prescribe uniform rules that prohibit a bank from using any authority to engage in interstate branching pursuant to the Interstate Act, or any amendment made by the Interstate Act to any other provision of law, primarily for the purpose of deposit production.

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

(1) *Bank* means, unless the context indicates otherwise:

(i) A State member bank as that term is defined in 12 U.S.C. 1813(d)(2); and

(ii) A foreign bank as that term is defined in 12 U.S.C. 3101(7) and 12 CFR 211.21.

(2) *Covered interstate branch* means any branch of a State member bank, and any uninsured branch of a foreign bank licensed by a State, that:

(i) Is established or acquired outside the bank's home state pursuant to the interstate branching authority granted by the Interstate Act or by any amendment made by the Interstate Act to any other provision of law; or

(ii) Could not have been established or acquired outside of the bank's home state but for the establishment or acquisition of a branch described in paragraph (b)(2)(i) of this section.

(3) *Home state* means:

(i) With respect to a state bank, the state that chartered the bank;

(ii) With respect to a national bank, the state in which the main office of the bank is located; and

(iii) With respect to a foreign bank, the home state of the foreign bank as determined in accordance with 12 U.S.C. 3103(c) and 12 CFR 211.22.

(4) *Host state* means a state in which a bank establishes or acquires a covered interstate branch.

(5) *Host state loan-to-deposit ratio* generally means, with respect to a particular host state, the ratio of total loans in the host state relative to total deposits from the host state for all banks (including institutions covered under the definition of "bank" in 12 U.S.C. 1813(a)(1)) that have that state as their home state, as determined and updated periodically by the appropriate Federal banking agencies and made available to the public.

(6) *State* means state as that term is defined in 12 U.S.C. 1813(a)(3).

(7) *Statewide loan-to-deposit ratio* means, with respect to a bank, the ratio of the bank's loans to its deposits in a state in which the bank has one or more covered interstate branches, as determined by the Board.

(c) *Loan-to-deposit ratio screen*—(1) *Application of screen.* Beginning no earlier than one year after a bank establishes or acquires a covered interstate branch, the Board will consider whether the bank's statewide loan-to-deposit ratio is less than 50 percent of the relevant host state loan-to-deposit ratio.

(2) *Results of screen.* (i) If the Board determines that the bank's statewide loan-to-deposit ratio is 50 percent or more of the host state loan-to-deposit ratio, no further consideration under this section is required.

(ii) If the Board determines that the bank's statewide loan-to-deposit ratio is less than 50 percent of the host state loan-to-deposit ratio, or if reasonably available data are insufficient to calculate the bank's statewide loan-to-deposit ratio, the Board will make a credit needs determination for the bank as provided in paragraph (d) of this section.

(d) *Credit needs determination*—(1) *In general.* The Board will review the loan portfolio of the bank and determine whether the bank is reasonably helping to meet the credit needs of the communities in the host state that are served by the bank.

(2) *Guidelines.* The Board will use the following considerations as guidelines when making the determination pursuant to paragraph (d)(1) of this section:

(i) Whether covered interstate branches were formerly part of a failed or failing depository institution;

(ii) Whether covered interstate branches were acquired under circumstances where there was a low loan-to-deposit ratio because of the nature of the acquired institution's business or loan portfolio;

(iii) Whether covered interstate branches have a high concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state;

(iv) The Community Reinvestment Act ratings received by the bank, if any, under 12 U.S.C. 2901 *et seq.*;

(v) Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches;

(vi) The safe and sound operation and condition of the bank; and

(vii) The Board's Regulation BB—Community Reinvestment (12 CFR part 228) and interpretations of that regulation.

(e) *Sanctions*—(1) *In general.* If the Board determines that a bank is not reasonably helping to meet the credit needs of the communities served by the bank in the host state, and that the bank's statewide loan-to-deposit ratio is less than 50 percent of the host state loan-to-deposit ratio, the Board:

(i) May order that a bank's covered interstate branch or branches be closed unless the bank provides reasonable assurances to the satisfaction of the Board, after an opportunity for public comment, that the bank has an acceptable plan under which the bank will reasonably help to meet the credit needs of the communities served by the bank in the host state; and

(ii) Will not permit the bank to open a new branch in the host state that would be considered to be a covered interstate branch unless the bank provides reasonable assurances to the satisfaction of the Board, after an opportunity for public comment, that the bank will reasonably help to meet the credit needs of the community that the new branch will serve.

(2) *Notice prior to closure of a covered interstate branch.* Before exercising the Board's authority to order the bank to close a covered interstate branch, the Board will issue to the bank a notice of the Board's intent to order the closure and will schedule a hearing within 60 days of issuing the notice.

(3) *Hearing.* The Board will conduct a hearing scheduled under paragraph (e)(2) of this section in accordance with the provisions of 12 U.S.C. 1818(h) and 12 CFR part 263.

## Subpart B—Investments and Loans

### § 208.20 Authority, purpose, and scope.

(a) *Authority.* Subpart B of Regulation H (12 CFR part 208, subpart B) is issued by the Board of Governors of the Federal Reserve System under 12 U.S.C. 24; sections 9, 11 and 21 of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), and 481–486); sections 1814, 1816, 1818, 1823(j), 1831o, 1831p–1 and 1831r–1 of the FDI Act (12 U.S.C. 1814, 1816, 1818, 1823(j), 1831o, 1831p–1 and 1831r–1); and the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(b) *Purpose and scope.* This subpart B describes certain investment limitations on member banks, statutory requirements for amortizing losses on agricultural loans and extending credit in areas having special flood hazards, as well as the requirements for issuing letters of credit and acceptances.

### § 208.21 Investments in premises and securities.

(a) *Investment in bank premises.* No state member bank shall invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank, or make loans to or upon the security of any such corporation unless:

(1) The bank notifies the appropriate Reserve Bank at least fifteen days prior to such investment and has not received notice that the investment is subject to further review by the end of the fifteen day notice period;

(2) The aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation that is an affiliate of the bank (as defined in section 2 of the Banking Act of 1933, as amended, 12 U.S.C. 221a), is less than or equal to the bank's perpetual preferred stock and related surplus plus common stock plus surplus, as those terms are defined in the FFIEC Consolidated Reports of Condition and Income; or

(3)(i) The aggregate of all such investments and loans, together with the

amount of any indebtedness incurred by any such corporation that is an affiliate of the bank, is less than or equal to 150 percent of the bank's perpetual preferred stock and related surplus plus common stock plus surplus, as those terms are defined in the FFIEC Consolidated Reports of Condition and Income; and

(ii) The bank:

(A) Has a CAMELS composite rating of 1 or 2 under the Uniform Interagency Bank Rating System<sup>5</sup> (or an equivalent rating under a comparable rating system) as of the most recent examination of the bank; and

(B) Is well capitalized and will continue to be well capitalized, in accordance with subpart D of this part, after the investment or loan.

(b) *Investments in securities.* Member banks are subject to the same limitations and conditions with respect to purchasing, selling, underwriting, and holding investment securities and stocks as are national banks under 12 U.S.C. 24, ¶ 7th. To determine whether an obligation qualifies as an investment security for the purposes of 12 U.S.C. 24, ¶ 7th, and to calculate the limits with respect to the purchase of such obligations, a state member bank may look to part 1 of the rules of the Comptroller of the Currency (12 CFR part 1) and interpretations thereunder. A state member bank may consult the Board for a determination with respect to the application of 12 U.S.C. 24, ¶ 7th, with respect to issues not addressed in 12 CFR part 1. The provisions of 12 CFR part 1 do not provide authority for a state member bank to purchase securities of a type or amount that the bank is not authorized to purchase under applicable state law.

#### § 208.22 Community development and public welfare investments.

(a) *Definitions.* For purposes of this section:

(1) *Low- or moderate-income area* means:

(i) One or more census tracts in a Metropolitan Statistical Area where the median family income adjusted for family size in each census tract is less than 80 percent of the median family income adjusted for family size of the Metropolitan Statistical Area; or

(ii) If not in a Metropolitan Statistical Area, one or more census tracts or block-numbered areas where the median family income adjusted for family size in each census tract or block-numbered area is less than 80 percent of the

median family income adjusted for family size of the State.

(2) *Low- and moderate-income persons* has the same meaning as low- and moderate-income persons as defined in 42 U.S.C. 5302(a)(20)(A).

(3) *Small business* means a business that meets the size-eligibility standards of 13 CFR 121.802(a)(2).

(b) *Investments not requiring prior Board approval.* Notwithstanding the provisions of section 5136 of the Revised Statutes (12 U.S.C. 24, ¶ 7th) made applicable to member banks by paragraph 20 of section 9 of the Federal Reserve Act (12 U.S.C. 335), a member bank may make an investment, without prior Board approval, if the following conditions are met:

(1) The investment is in a corporation, limited partnership, or other entity, and:

(i) The Board has determined that an investment in that entity or class of entities is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), or a community development investment under Regulation Y (12 CFR 225.25(b)(6)); or

(ii) The Comptroller of the Currency has determined, by order or regulation, that an investment in that entity by a national bank is a public welfare investment under section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh)); or

(iii) The entity is a community development financial institution as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5)); or

(iv) The entity, directly or indirectly, engages solely in or makes loans solely for the purposes of one or more of the following community development activities:

(A) Investing in, developing, rehabilitating, managing, selling, or renting residential property if a majority of the units will be occupied by low- and moderate-income persons, or if the property is a "qualified low-income building" as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));

(B) Investing in, developing, rehabilitating, managing, selling, or renting nonresidential real property or other assets located in a low- or moderate-income area and targeted towards low- and moderate-income persons;

(C) Investing in one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(D) Investing in, developing, or otherwise assisting job training or

placement facilities or programs that will be targeted towards low- and moderate-income persons;

(E) Investing in an entity located in a low- or moderate-income area if the entity creates long-term employment opportunities, a majority of which (based on full-time equivalent positions) will be held by low- and moderate-income persons; and

(F) Providing technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development;

(2) The investment is permitted by state law;

(3) The investment will not expose the member bank to liability beyond the amount of the investment;

(4) The aggregate of all such investments of the member bank does not exceed the sum of five percent of its capital stock and surplus;

(5) The member bank is well capitalized or adequately capitalized under §§ 208.43(b) (1) and (2);

(6) The member bank received a composite CAMELS rating of "1" or "2" under the Uniform Financial Institutions Rating System as of its most recent examination and an overall rating of "1" or "2" as of its most recent consumer compliance examination; and

(7) The member bank is not subject to any written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, or memorandum of understanding issued by the Board or a Federal Reserve Bank.

(c) *Notice to Federal Reserve Bank.* Not more than 30 days after making an investment under paragraph (b) of this section, the member bank shall advise its Federal Reserve Bank of the investment, including the amount of the investment and the identity of the entity in which the investment is made.

(d) *Investments requiring Board approval.* (1) With prior Board approval, a member bank may make public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), other than those specified in paragraph (b) of this section.

(2) Requests for Board approval under this paragraph (d) shall include, at a minimum:

(i) The amount of the proposed investment;

(ii) A description of the entity in which the investment is to be made;

(iii) An explanation of why the investment is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a);

<sup>5</sup> See FRRS 3-1575 for an explanation of the Uniform Interagency Bank Rating System. (For availability, see 12 CFR 261.10(f).)

(iv) A description of the member bank's potential liability under the proposed investment;

(v) The amount of the member bank's aggregate outstanding public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act;

(vi) The amount of the member bank's capital stock and surplus; and

(vii) If the bank investment is not eligible under paragraph (b) of this section, explain the reason or reasons why it is ineligible.

(3) The Board shall act on a request under this paragraph (d) within 60 calendar days of receipt of a request that meets the requirements of paragraph (d)(2) of this section, unless the Board notifies the requesting member bank that a longer time period will be required.

(e) *Divestiture of investments.* A member bank shall divest itself of an investment made under paragraph (b) or (d) of this section to the extent that the investment exceeds the scope of, or ceases to meet, the requirements of paragraphs (b)(1) through (b)(4) or paragraph (d) of this section. The divestiture shall be made in the manner specified in 12 CFR 225.140, Regulation Y, for interests acquired by a lending subsidiary of a bank holding company or the bank holding company itself in satisfaction of a debt previously contracted.

#### **§ 208.23 Agricultural loan loss amortization.**

(a) *Definitions.* For purposes of this section:

(1) *Accepting official* means:

(i) The Reserve Bank in whose district the bank is located; or

(ii) The Director of the Division of Banking Supervision and Regulation in cases in which the Reserve Bank cannot determine that the bank qualifies.

(2) *Agriculturally related other property* means any property, real or personal, that the bank owned on January 1, 1983, and any additional property that it acquired prior to January 1, 1992, in connection with a qualified agricultural loan. For the purposes of paragraph (d) of this section, the value of such property shall include the amount previously charged off as a loss.

(3) *Participating bank* means an agricultural bank (as defined in 12 U.S.C. 1823(j)(4)(A)) that, as of January 1, 1992, had a proposal for a capital restoration plan accepted by an accepting official and received permission from the accepting official, subject to paragraphs (d) and (e) of this section, to amortize losses in accordance

with paragraphs (b) and (c) of this section.

(4) *Qualified agricultural loan* means:

(i) Loans that finance agricultural production or are secured by farm land for purposes of Schedule RC-C of the FFIEC Consolidated Report of Condition or such other comparable schedule;

(ii) Loans secured by farm machinery;

(iii) Other loans that a bank proves to be sufficiently related to agriculture for classification as an agricultural loan by the Board; and

(iv) The remaining unpaid balance of any loans described in paragraphs (a)(4) (i), (ii) and (iii) of this section that have been charged off since January 1, 1984, and that qualify for deferral under this section.

(b)(1) Provided there is no evidence that the loss resulted from fraud or criminal abuse on the part of the bank, the officers, directors, or principal shareholders, a participating bank may amortize in its Reports of Condition and Income:

(i) Any loss on a qualified agricultural loan that the bank would be required to reflect in its financial statements for any period between and including 1984 and 1991; or

(ii) Any loss that the bank would be required to reflect in its financial statements for any period between and including 1983 and 1991 resulting from a reappraisal or sale of agriculturally-related other property.

(2) Amortization under this section shall be computed over a period not to exceed seven years on a quarterly straight-line basis commencing in the first quarter after the loan was or is charged off so as to be fully amortized not later than December 31, 1998.

(c) *Accounting for amortization.* Any bank that is permitted to amortize losses in accordance with paragraph (b) of this section may restate its capital and other relevant accounts and account for future authorized deferrals and authorizations in accordance with the instructions to the FFIEC Consolidated Reports of Condition and Income. Any resulting increase in the capital account shall be included in qualifying capital pursuant to appendix A of this part.

(d) *Conditions of participation.* In order for a bank to maintain its status as a participating bank, it shall:

(1) Adhere to the approved capital plan and obtain the prior approval of the accepting official before making any modifications to the plan;

(2) Maintain accounting records for each asset subject to loss deferral under the program that document the amount and timing of the deferrals, repayments, and authorizations;

(3) Maintain the financial condition of the bank so that it does not deteriorate to the point where it is no longer a viable, fundamentally sound institution;

(4) Make a reasonable effort, consistent with safe and sound banking practices, to maintain in its loan portfolio a percentage of agricultural loans, including agriculturally-related other property, not less than the percentage of such loans in its loan portfolio on January 1, 1986; and

(5) Provide the accepting official, upon request, with any information the accepting official deems necessary to monitor the bank's amortization, its compliance with the conditions of participation, and its continued eligibility.

(e) *Revocation of eligibility for loss amortization.* The failure to comply with any condition in an acceptance, with the capital restoration plan, or with the conditions stated in paragraph (d) of this section, is grounds for revocation of acceptance for loss amortization and for an administrative action against the bank under 12 U.S.C. 1818(b). In addition, acceptance of a bank for loss amortization shall not foreclose any administrative action against the bank that the Board may deem appropriate.

(f) *Expiration date.* The terms of this section will no longer be in effect as of January 1, 1999.

#### **§ 208.24 Letters of credit and acceptances.**

(a) *Standby letters of credit.* For the purpose of this section, standby letters of credit include every letter of credit (or similar arrangement however named or designated) that represents an obligation to the beneficiary on the part of the issuer:

(1) To repay money borrowed by or advanced to or for the account of the account party; or

(2) To make payment on account of any evidence of indebtedness undertaken by the account party; or

(3) To make payment on account of any default by the party procuring the issuance of the letter of credit in the performance of an obligation.<sup>6</sup>

(b) *Ineligible acceptance.* An ineligible acceptance is a time draft accepted by a bank, which does not meet the requirements for discount with a Federal Reserve Bank.

(c) *Bank's lending limits.* Standby letters of credit and ineligible

<sup>6</sup>A standby letter of credit does not include: (1) Commercial letters of credit and similar instruments, where the issuing bank expects the beneficiary to draw upon the issuer, and which do not guaranty payment of a money obligation; or (2) a guaranty or similar obligation issued by a foreign branch in accordance with and subject to the limitations of 12 CFR part 211 (Regulation K).

acceptances count toward member banks' lending limits imposed by state law.

(d) *Exceptions.* A standby letter of credit or ineligible acceptance is not subject to the restrictions set forth in paragraph (c) of this section if prior to or at the time of issuance of the credit:

(1) The issuing bank is paid an amount equal to the bank's maximum liability under the standby letter of credit; or

(2) The party procuring the issuance of a letter of credit or ineligible acceptance has set aside sufficient funds in a segregated, clearly earmarked deposit account to cover the bank's maximum liability under the standby letter of credit or ineligible acceptance.

#### **§ 208.25 Loans in areas having special flood hazards.**

(a) *Purpose and scope.* (1) *Purpose.* The purpose of this section is to implement the requirements of the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(2) *Scope.* This section, except for paragraphs (f) and (h) of this section, applies to loans secured by buildings or mobile homes located or to be located in areas determined by the Director of the Federal Emergency Management Agency to have special flood hazards. Paragraphs (f) and (h) of this section apply to loans secured by buildings or mobile homes, regardless of location.

(b) *Definitions.* For purposes of this section:

(1) *Act* means the National Flood Insurance Act of 1968, as amended (42 U.S.C. 4001–4129).

(2) *Building* means a walled and roofed structure, other than a gas or liquid storage tank, that is principally above ground and affixed to a permanent site, and a walled and roofed structure while in the course of construction, alteration, or repair.

(3) *Community* means a State or a political subdivision of a State that has zoning and building code jurisdiction over a particular area having special flood hazards.

(4) *Designated loan* means a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in which flood insurance is available under the Act.

(5) *Director of FEMA* means the Director of the Federal Emergency Management Agency.

(6) *Mobile home* means a structure, transportable in one or more sections, that is built on a permanent chassis and designed for use with or without a permanent foundation when attached to

the required utilities. The term *mobile home* does not include a recreational vehicle. For purposes of this section, the term *mobile home* means a mobile home on a permanent foundation. The term *mobile home* includes a manufactured home as that term is used in the National Flood Insurance Program.

(7) *NFIP* means the National Flood Insurance Program authorized under the Act.

(8) *Residential improved real estate* means real estate upon which a home or other residential building is located or to be located.

(9) *Servicer* means the person responsible for:

(i) Receiving any scheduled, periodic payments from a borrower under the terms of a loan, including amounts for taxes, insurance premiums, and other charges with respect to the property securing the loan; and

(ii) Making payments of principal and interest and any other payments from the amounts received from the borrower as may be required under the terms of the loan.

(10) *Special flood hazard area* means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Director of FEMA.

(11) *Table funding* means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.

(c) *Requirement to purchase flood insurance where available.* (1) *In general.* A member bank shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located.

(2) *Table funded loans.* A member bank that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purposes of this section.

(d) *Exemptions.* The flood insurance requirement prescribed by paragraph (c) of this section does not apply with respect to:

(1) Any State-owned property covered under a policy of self-insurance

satisfactory to the Director of FEMA, who publishes and periodically revises the list of States falling within this exemption; or

(2) Property securing any loan with an original principal balance of \$5,000 or less and a repayment term of one year or less.

(e) *Escrow requirement.* If a member bank requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by *residential improved real estate* or a mobile home that is made, increased, extended, or renewed after October 1, 1996, the member bank shall also require the escrow of all premiums and fees for any flood insurance required under paragraph (c) of this section. The member bank, or a servicer acting on its behalf, shall deposit the flood insurance premiums on behalf of the borrower in an escrow account. This escrow account will be subject to escrow requirements adopted pursuant to section 10 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2609) (RESPA), which generally limits the amount that may be maintained in escrow accounts for certain types of loans and requires escrow account statements for those accounts, only if the loan is otherwise subject to RESPA. Following receipt of a notice from the Director of FEMA or other provider of flood insurance that premiums are due, the member bank, or a servicer acting on its behalf, shall pay the amount owed to the insurance provider from the escrow account by the date when such premiums are due.

(f) *Required use of standard flood hazard determination form.* (1) *Use of form.* A member bank shall use the standard flood hazard determination form developed by the Director of FEMA (as set forth in appendix A of 44 CFR part 65) when determining whether the building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area in which flood insurance is available under the Act. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner.

(2) *Retention of form.* A member bank shall retain a copy of the completed standard flood hazard determination form, in either hard copy or electronic form, for the period of time the bank owns the loan.

(g) *Forced placement of flood insurance.* If a member bank, or a servicer acting on behalf of the bank, determines at any time during the term of a designated loan that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered



by flood insurance in an amount less than the amount required under paragraph (c) of this section, then the bank or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required under paragraph (c) of this section, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the member bank or its servicer shall purchase insurance on the borrower's behalf. The member bank or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance.

(h) *Determination fees.* (1) *General.* Notwithstanding any Federal or State law other than the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001-4129), any member bank, or a servicer acting on behalf of the bank, may charge a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a special flood hazard area. A determination fee may also include, but is not limited to, a fee for life-of-loan monitoring.

(2) *Borrower fee.* The determination fee authorized by paragraph (h)(1) of this section may be charged to the borrower if the determination:

(i) Is made in connection with a making, increasing, extending, or renewing of the loan that is initiated by the borrower;

(ii) Reflects the Director of FEMA's revision or updating of flood plain areas or flood-risk zones;

(iii) Reflects the Director of FEMA's publication of a notice or compendium that:

(A) Affects the area in which the building or mobile home securing the loan is located; or

(B) By determination of the Director of FEMA, may reasonably require a determination whether the building or mobile home securing the loan is located in a special flood hazard area;

(iv) Results in the purchase of flood insurance coverage by the lender or its servicer on behalf of the borrower under paragraph (g) of this section.

(3) *Purchaser or transferee fee.* The determination fee authorized by paragraph (h)(1) of this section may be charged to the purchaser or transferee of a loan in the case of the sale or transfer of the loan.

(i) *Notice of special flood hazards and availability of Federal disaster relief assistance.* When a member bank makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a

special flood hazard area, the bank shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

(1) *Contents of notice.* The written notice must include the following information:

(i) A warning, in a form approved by the Director of FEMA, that the building or the mobile home is or will be located in a special flood hazard area;

(ii) A description of the flood insurance purchase requirements set forth in section 102(b) of the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4012a(b));

(iii) A statement, where applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers; and

(iv) A statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally declared disaster.

(2) *Timing of notice.* The member bank shall provide the notice required by paragraph (i)(1) of this section to the borrower within a reasonable time before the completion of the transaction, and to the servicer as promptly as practicable after the bank provides notice to the borrower and in any event no later than the time the bank provides other similar notices to the servicer concerning hazard insurance and taxes. Notice to the servicer may be made electronically or may take the form of a copy of the notice to the borrower.

(3) *Record of receipt.* The member bank shall retain a record of the receipt of the notices by the borrower and the servicer for the period of time the bank owns the loan.

(4) *Alternate method of notice.*

Instead of providing the notice to the borrower required by paragraph (i)(1) of this section, a member bank may obtain satisfactory written assurance from a seller or lessor that, within a reasonable time before the completion of the sale or lease transaction, the seller or lessor has provided such notice to the purchaser or lessee. The member bank shall retain a record of the written assurance from the seller or lessor for the period of time the bank owns the loan.

(5) *Use of prescribed form of notice.* A member bank will be considered to be in compliance with the requirement for notice to the borrower of this paragraph (i) by providing written notice to the borrower containing the language presented in appendix A of this section within a reasonable time before the completion of the transaction. The

notice presented in appendix A of this section satisfies the borrower notice requirements of the Act.

(j) *Notice of servicer's identity.* (1) *Notice requirement.* When a member bank makes, increases, extends, renews, sells, or transfers a loan secured by a building or mobile home located or to be located in a special flood hazard area, the bank shall notify the Director of FEMA (or the Director's designee) in writing of the identity of the servicer of the loan. The Director of FEMA has designated the insurance provider to receive the member bank's notice of the servicer's identity. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee.

(2) *Transfer of servicing rights.* The member bank shall notify the Director of FEMA (or the Director's designee) of any change in the servicer of a loan described in paragraph (j)(1) of this section within 60 days after the effective date of the change. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee. Upon any change in the servicing of a loan described in paragraph (j)(1) of this section, the duty to provide notice under this paragraph (j)(2) shall transfer to the transferee servicer.

## Appendix A to § 208.25 Sample Form of Notice

### Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's *Flood Insurance Rate Map* or the *Flood Hazard Boundary Map* for the following community:

\_\_\_\_\_. This area has a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

\_\_\_\_\_ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood

insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance also may be available from private insurers that do not participate in the NFIP.

- At a minimum, flood insurance purchased must cover *the lesser of*:

- (1) the outstanding principal balance of the loan; or

- (2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

\_\_\_\_\_ Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally declared flood disaster.

### Subpart C—Bank Securities and Securities-Related Activities

#### § 208.30 Authority, purpose, and scope.

(a) *Authority.* Subpart C of Regulation H (12 CFR part 208, subpart C) is issued by the Board of Governors of the Federal Reserve System under 12 U.S.C. 24, 92a, 93a; sections 1818 and 1831p-1(a)(2) of the FDI Act (12 U.S.C. 1818, 1831p-1(a)(2)); and sections 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78o-5, 78q, 78q-1, and 78w of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78o-5, 78q, 78q-1, 78w).

(b) *Purpose and scope.* This subpart C describes the requirements imposed upon member banks acting as transfer agents, registered clearing agencies, or sellers of securities under the Securities Exchange Act of 1934. This subpart C also describes the reporting requirements imposed on member banks whose securities are subject to registration under the Securities Exchange Act of 1934.

#### § 208.31 State member banks as transfer agents.

(a) The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) prescribing procedures for registration of transfer agents for which the SEC is the appropriate regulatory agency (17 CFR 240.17Ac2-1) apply to member bank transfer agents. References to the "Commission" are deemed to refer to the Board.

(b) The rules adopted by the SEC pursuant to section 17A prescribing operational and reporting requirements for transfer agents (17 CFR 240.17Ac2-2 and 240.17Ad-1 through 240.17Ad-16) apply to member bank transfer agents.

#### § 208.32 Notice of disciplinary sanctions imposed by registered clearing agency.

(a) *Notice requirement.* Any member bank or any of its subsidiaries that is a registered clearing agency pursuant to section 17A(b) of the Securities Exchange Act of 1934 (the Act), and that:

- (1) Imposes any final disciplinary sanction on any participant therein;

- (2) Denies participation to any applicant; or

- (3) Prohibits or limits any person in respect to access to services offered by the clearing agency, shall file with the Board (and the appropriate regulatory agency, if other than the Board, for a participant or applicant) notice thereof in the manner prescribed in this section.

(b) *Notice of final disciplinary actions.* (1) Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final disciplinary action with respect to any participant shall promptly file a notice thereof with the Board in accordance with paragraph (c) of this section. For the purposes of this paragraph (b), *final disciplinary action* means the imposition of any disciplinary sanction pursuant to section 17A(b)(3)(G) of the Act, or other action of a registered clearing agency which, after notice and opportunity for hearing, results in final disposition of charges of:

- (i) One or more violations of the rules of the registered clearing agency; or

- (ii) Acts or practices constituting a statutory disqualification of a type defined in paragraph (iv) or (v) (except prior convictions) of section 3(a)(39) of the Act.

(2) However, if a registered clearing agency fee schedule specifies certain charges for errors made by its participants in giving instructions to the registered clearing agency which are *de*

*minimis* on a per error basis, and whose purpose is, in part, to provide revenues to the clearing agency to compensate it for effort expended in beginning to process an erroneous instruction, such error charges shall not be considered a final disciplinary action for purposes of this paragraph (b).

(c) *Contents of final disciplinary action notice.* Any notice filed pursuant to paragraph (b) of this section shall consist of the following, as appropriate:

- (1) The name of the respondent and the respondent's last known address, as reflected on the records of the clearing agency, and the name of the person, committee, or other organizational unit that brought the charges. However, identifying information as to any respondent found not to have violated a provision covered by a charge may be deleted insofar as the notice reports the disposition of that charge and, prior to the filing of the notice, the respondent does not request that identifying information be included in the notice;

- (2) A statement describing the investigative or other origin of the action;

- (3) As charged in the proceeding, the specific provision or provisions of the rules of the clearing agency violated by the respondent, or the statutory disqualification referred to in paragraph (b)(2) of this section, and a statement describing the answer of the respondent to the charges;

- (4) A statement setting forth findings of fact with respect to any act or practice in which the respondent was charged with having engaged in or omitted; the conclusion of the clearing agency as to whether the respondent violated any rule or was subject to a statutory disqualification as charged; and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceedings;

- (5) A statement describing any sanction imposed, the reasons therefor, and the date upon which the sanction became or will become effective; and

- (6) Such other matters as the clearing agency may deem relevant.

(d) *Notice of final denial, prohibition, termination or limitation based on qualification or administrative rules.* (1) Any registered clearing agency, for which the Board is the appropriate regulatory agency, that takes any final action that denies or conditions the participation of any person, or prohibits or limits access, to services offered by the clearing agency, shall promptly file notice thereof with the Board (and the appropriate regulatory agency, if other than the Board, for the affected person) in accordance with paragraph (e) of this section; but such action shall not be

considered a final disciplinary action for purposes of paragraph (b) of this section where the action is based on an alleged failure of such person to:

(i) Comply with the qualification standards prescribed by the rules of the registered clearing agency pursuant to section 17A(b)(4)(B) of the Act; or

(ii) Comply with any administrative requirements of the registered clearing agency (including failure to pay entry or other dues or fees, or to file prescribed forms or reports) not involving charges of violations that may lead to a disciplinary sanction.

(2) However, no such action shall be considered final pursuant to this paragraph (d) that results merely from a notice of such failure to comply to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted the administrative remedies within the registered clearing agency with respect to such a matter.

(e) *Contents of notice required by paragraph (d) of this section.* Any notice filed pursuant to paragraph (d) of this section shall consist of the following, as appropriate:

(1) The name of each person concerned and each person's last known address, as reflected in the records of the clearing agency;

(2) The specific grounds upon which the action of the clearing agency was based, and a statement describing the answer of the person concerned;

(3) A statement setting forth findings of fact and conclusions as to each alleged failure of the person to comply with qualification standards or administrative obligations, and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceeding;

(4) The date upon which such action became or will become effective; and

(5) Such other matters as the clearing agency deems relevant.

(f) *Notice of final action based on prior adjudicated statutory disqualifications.* Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final action shall promptly file notice thereof with the Board (and the appropriate regulatory agency, if other than the Board, for the affected person) in accordance with paragraph (g) of this section, where the final action:

(1) Denies or conditions participation to any person, or prohibits or limits access to services offered by the clearing agency; and

(2) Is based upon a statutory disqualification of a type defined in paragraph (A), (B) or (C) of section 3(a)(39) of the Act, consisting of a prior

conviction, as described in subparagraph (E) of section 3(a)(39) of the Act. However, no such action shall be considered final pursuant to this paragraph (f) that results merely from a notice of such disqualification to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted the administrative remedies within the clearing agency with respect to such a matter.

(g) *Contents of notice required by paragraph (f) of this section.* Any notice filed pursuant to paragraph (f) of this section shall consist of the following, as appropriate:

(1) The name of each person concerned and each person's last known address, as reflected in the records of the clearing agency;

(2) A statement setting forth the principal issues raised, the answer of any person concerned, and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceeding;

(3) Any description furnished by or on behalf of the person concerned of the activities engaged in by the person since the adjudication upon which the disqualification is based;

(4) A copy of the order or decision of the court, appropriate regulatory agency, or self-regulatory organization that adjudicated the matter giving rise to the statutory disqualification;

(5) The nature of the action taken and the date upon which such action is to be made effective; and

(6) Such other matters as the clearing agency deems relevant.

(h) *Notice of summary suspension of participation.* Any registered clearing agency for which the Board is the appropriate regulatory agency that summarily suspends or closes the accounts of a participant pursuant to the provisions of section 17A(b)(5)(C) of the Act shall, within one business day after such action becomes effective, file notice thereof with the Board and the appropriate regulatory agency for the participant, if other than the Board, of such action in accordance with paragraph (i) of this section.

(i) *Contents of notice of summary suspension.* Any notice pursuant to paragraph (h) of this section shall contain at least the following information, as appropriate:

(1) The name of the participant concerned and the participant's last known address, as reflected in the records of the clearing agency;

(2) The date upon which the summary action became or will become effective;

(3) If the summary action is based upon the provisions of section

17A(b)(5)(C)(i) of the Act, a copy of the relevant order or decision of the self-regulatory organization, if available to the clearing agency;

(4) If the summary action is based upon the provisions of section 17A(b)(5)(C)(ii) of the Act, a statement describing the default of any delivery of funds or securities to the clearing agency;

(5) If the summary action is based upon the provisions of section 17A(b)(5)(C)(iii) of the Act, a statement describing the financial or operating difficulty of the participant based upon which the clearing agency determined that the suspension and closing of accounts was necessary for the protection of the clearing agency, its participants, creditors, or investors;

(6) The nature and effective date of the suspension; and

(7) Such other matters as the clearing agency deems relevant.

#### **§ 208.33 Application for stay or review of disciplinary sanctions imposed by registered clearing agency.**

(a) *Stays.* The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for stays of disciplinary sanctions or summary suspensions imposed by registered clearing agencies (17 CFR 240.19d-2) apply to applications by member banks. References to the "Commission" are deemed to refer to the Board.

(b) *Reviews.* The regulations adopted by the Securities and Exchange Commission pursuant to section 19 of the Securities and Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for reviews of final disciplinary sanctions, denials of participation, or prohibitions or limitations of access to services imposed by registered clearing agencies (17 CFR 240.19d-3(a)-(f)) apply to applications by member banks. References to the "Commission" are deemed to refer to the Board. The Board's Uniform Rules of Practice and Procedure (12 CFR part 263) apply to review proceedings under this § 208.33 to the extent not inconsistent with this § 208.33.

#### **§ 208.34 Recordkeeping and confirmation of certain securities transactions effected by State member banks.**

(a) *Exceptions and safe and sound operations.* (1) A State member bank may be excepted from one or more of the requirements of this section if it

meets one of the following conditions of paragraphs (a)(1)(i) through (a)(1)(iv) of this section:

(i) *De minimis transactions.* The requirements of paragraphs (c)(2) through (c)(4) and paragraphs (e)(1) through (e)(3) of this section shall not apply to banks having an average of less than 200 securities transactions per year for customers over the prior three calendar year period, exclusive of transactions in government securities;

(ii) *Government securities.* The recordkeeping requirements of paragraph (c) of this section shall not apply to banks effecting fewer than 500 government securities brokerage transactions per year; provided that this exception shall not apply to government securities transactions by a State member bank that has filed a written notice, or is required to file notice, with the Federal Reserve Board that it acts as a government securities broker or a government securities dealer;

(iii) *Municipal securities.* The municipal securities activities of a State member bank that are subject to regulations promulgated by the Municipal Securities Rulemaking Board shall not be subject to the requirements of this section; and

(iv) *Foreign branches.* The requirements of this section shall not apply to the activities of foreign branches of a State member bank.

(2) Every State member bank qualifying for an exemption under paragraph (a)(1) of this section that conducts securities transactions for customers shall, to ensure safe and sound operations, maintain effective systems of records and controls regarding its customer securities transactions that clearly and accurately reflect appropriate information and provide an adequate basis for an audit of the information.

(b) *Definitions.* For purposes of this section:

(1) *Asset-backed security* shall mean a security that is serviced primarily by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.

(2) *Collective investment fund* shall mean funds held by a State member bank as fiduciary and, consistent with local law, invested collectively as follows:

(i) In a common trust fund maintained by such bank exclusively for the collective investment and reinvestment of monies contributed thereto by the

bank in its capacity as trustee, executor, administrator, guardian, or custodian under the Uniform Gifts to Minors Act; or

(ii) In a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or similar trusts which are exempt from Federal income taxation under the Internal Revenue Code (26 U.S.C.).

(3) *Completion of the transaction* effected by or through a state member bank shall mean:

(i) For purchase transactions, the time when the customer pays the bank any part of the purchase price (or the time when the bank makes the book-entry for any part of the purchase price if applicable); however, if the customer pays for the security prior to the time payment is requested or becomes due, then the transaction shall be completed when the bank transfers the security into the account of the customer; and

(ii) For sale transactions, the time when the bank transfers the security out of the account of the customer or, if the security is not in the bank's custody, then the time when the security is delivered to the bank; however, if the customer delivers the security to the bank prior to the time delivery is requested or becomes due then the transaction shall be completed when the bank makes payment into the account of the customer.

(4) *Crossing of buy and sell orders* shall mean a security transaction in which the same bank acts as agent for both the buyer and the seller.

(5) *Customer* shall mean any person or account, including any agency, trust, estate, guardianship, or other fiduciary account, for which a State member bank effects or participates in effecting the purchase or sale of securities, but shall not include a broker, dealer, bank acting as a broker or dealer, municipal securities broker or dealer, or issuer of the securities which are the subject of the transactions.

(6) *Debt security* as used in paragraph (c) of this section shall mean any security, such as a bond, debenture, note or any other similar instrument which evidences a liability of the issuer (including any security of this type that is convertible into stock or similar security) and fractional or participation interests in one or more of any of the foregoing; provided, however, that securities issued by an investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, shall not be included in this definition.

(7) *Government security* shall mean:

(i) A security that is a direct obligation of, or obligation guaranteed

as to principal and interest by, the United States;

(ii) A security that is issued or guaranteed by a corporation in which the United States has a direct or indirect interest and which is designated by the Secretary of the Treasury for exemption as necessary or appropriate in the public interest or for the protection of investors;

(iii) A security issued or guaranteed as to principal and interest by any corporation whose securities are designated, by statute specifically naming the corporation, to constitute exempt securities within the meaning of the laws administered by the Securities and Exchange Commission; or

(iv) Any put, call, straddle, option, or privilege on a security as described in paragraphs (b)(7) (i), (ii), or (iii) of this section other than a put, call, straddle, option, or privilege that is traded on one or more national securities exchanges, or for which quotations are disseminated through an automated quotation system operated by a registered securities association.

(8) *Investment discretion* with respect to an account shall mean if the State member bank, directly or indirectly, is authorized to determine what securities or other property shall be purchased or sold by or for the account, or makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions.

(9) *Municipal security* shall mean a security which is a direct obligation of, or obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in 26 U.S.C. 103(c)(2) the interest on which is excludable from gross income under 26 U.S.C. 103(a)(1), by reason of the application of paragraph (4) or (6) of 26 U.S.C. 103(c) (determined as if paragraphs (4)(A), (5) and (7) were not included in 26 U.S.C. 103(c)), paragraph (1) of 26 U.S.C. 103(c) does not apply to such security.

(10) *Periodic plan* shall mean:

(i) A written authorization for a State member bank to act as agent to purchase or sell for a customer a specific security or securities, in a specific amount (calculated in security units or dollars) or to the extent of dividends and funds available, at specific time intervals, and setting forth the commission or charges to be paid by the customer or the manner of calculating them (including

dividend reinvestment plans, automatic investment plans, and employee stock purchase plans); or

(ii) Any prearranged, automatic transfer or sweep of funds from a deposit account to purchase a security, or any prearranged, automatic redemption or sale of a security with the funds being transferred into a deposit account (including cash management sweep services).

(11) *Security* shall mean:

(i) Any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, for a security, any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.

(ii) But does not include a deposit or share account in a federally or state insured depository institution, a loan participation, a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, currency, any note, draft, bill of exchange, or bankers acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, units of a collective investment fund, interests in a variable amount (master) note of a borrower of prime credit, or U.S. Savings Bonds.

(c) *Recordkeeping.* Except as provided in paragraph (a) of this section, every State member bank effecting securities transactions for customers, including transactions in government securities, and municipal securities transactions by banks not subject to registration as municipal securities dealers, shall maintain the following records with respect to such transactions for at least three years. Nothing contained in this section shall require a bank to maintain the records required by this paragraph in any given manner, provided that the information required to be shown is clearly and accurately reflected and provides an adequate basis for the audit of such information. Records may be maintained in hard copy, automated, or electronic form provided the records are easily retrievable, readily available for inspection, and capable of being

reproduced in a hard copy. A bank may contract with third party service providers, including broker/dealers, to maintain records required under this part.

(1) Chronological records of original entry containing an itemized daily record of all purchases and sales of securities. The records of original entry shall show the account or customer for which each such transaction was effected, the description of the securities, the unit and aggregate purchase or sale price (if any), the trade date and the name or other designation of the broker/dealer or other person from whom purchased or to whom sold;

(2) Account records for each customer which shall reflect all purchases and sales of securities, all receipts and deliveries of securities, and all receipts and disbursements of cash with respect to transactions in securities for such account and all other debits and credits pertaining to transactions in securities;

(3) A separate memorandum (order ticket) of each order to purchase or sell securities (whether executed or canceled), which shall include:

(i) The account(s) for which the transaction was effected;

(ii) Whether the transaction was a market order, limit order, or subject to special instructions;

(iii) The time the order was received by the trader or other bank employee responsible for effecting the transaction;

(iv) The time the order was placed with the broker/dealer, or if there was no broker/dealer, the time the order was executed or canceled;

(v) The price at which the order was executed; and

(vi) The broker/dealer utilized;

(4) A record of all broker/dealers selected by the bank to effect securities transactions and the amount of commissions paid or allocated to each such broker during the calendar year; and

(5) A copy of the written notification required by paragraphs (d) and (e) of this section.

(d) *Content and time of notification.* Every State member bank effecting a securities transaction for a customer shall give or send to such customer either of the following types of notifications at or before completion of the transaction or; if the bank uses a broker/dealer's confirmation, within one business day from the bank's receipt of the broker/dealer's confirmation:

(1) A copy of the confirmation of a broker/dealer relating to the securities transaction; and if the bank is to receive remuneration from the customer or any other source in connection with the transaction, and the remuneration is not

determined pursuant to a prior written agreement between the bank and the customer, a statement of the source and the amount of any remuneration to be received; or

(2) A written notification disclosing:

(i) The name of the bank;

(ii) The name of the customer;

(iii) Whether the bank is acting as agent for such customer, as agent for both such customer and some other person, as principal for its own account, or in any other capacity;

(iv) The date of execution and a statement that the time of execution will be furnished within a reasonable time upon written request of such customer specifying the identity, price and number of shares or units (or principal amount in the case of debt securities) of such security purchased or sold by such customer;

(v) The amount of any remuneration received or to be received, directly or indirectly, by any broker/dealer from such customer in connection with the transaction;

(vi) The amount of any remuneration received or to be received by the bank from the customer and the source and amount of any other remuneration to be received by the bank in connection with the transaction, unless remuneration is determined pursuant to a written agreement between the bank and the customer, provided, however, in the case of Government securities and municipal securities, this paragraph (d)(2)(vi) shall apply only with respect to remuneration received by the bank in an agency transaction. If the bank elects not to disclose the source and amount of remuneration it has or will receive from a party other than the customer pursuant to this paragraph (d)(2)(vi), the written notification must disclose whether the bank has received or will receive remuneration from a party other than the customer, and that the bank will furnish within a reasonable time the source and amount of this remuneration upon written request of the customer. This election is not available, however, if, with respect to a purchase, the bank was participating in a distribution of that security; or with respect to a sale, the bank was participating in a tender offer for that security;

(vii) The name of the broker/dealer utilized; or, where there is no broker/dealer, the name of the person from whom the security was purchased or to whom it was sold, or the fact that such information will be furnished within a reasonable time upon written request;

(viii) In the case of a transaction in a debt security subject to redemption before maturity, a statement to the effect

that the debt security may be redeemed in whole or in part before maturity, that the redemption could affect the yield represented and that additional information is available on request;

(ix) In the case of a transaction in a debt security effected exclusively on the basis of a dollar price:

(A) The dollar price at which the transaction was effected;

(B) The yield to maturity calculated from the dollar price; provided, however, that this paragraph (c)(2)(ix)(B) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(x) In the case of a transaction in a debt security effected on the basis of yield:

(A) The yield at which the transaction was effected, including the percentage amount and its characterization (e.g., current yield, yield to maturity, or yield to call) and if effected at yield to call, the type of call, the call date, and the call price; and

(B) The dollar price calculated from the yield at which the transaction was effected; and

(C) If effected on a basis other than yield to maturity and the yield to maturity is lower than the represented yield, the yield to maturity as well as the represented yield; provided, however, that this paragraph (c)(2)(x)(C) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest rate payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(xi) In the case of a transaction in a debt security that is an asset-backed security which represents an interest in or is secured by a pool of receivables or other financial assets that are subject continuously to prepayment, a statement indicating that the actual yield of such asset-backed security may vary according to the rate at which the underlying receivables or other financial assets are prepaid and a statement of the fact that information concerning the factors that affect yield (including at a minimum, the estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon written request of such customer; and

(xii) In the case of a transaction in a debt security, other than a government security, that the security is unrated by a nationally recognized statistical rating organization, if that is the case.

(e) *Notification by agreement; alternative forms and times of notification.* A State member bank may elect to use the following alternative procedures if a transaction is effected for:

(1) Accounts (except periodic plans) where the bank does not exercise investment discretion and the bank and the customer agree in writing to a different arrangement as to the time and content of the notification; provided, however, that such agreement makes clear the customer's right to receive the written notification pursuant to paragraph (c) of this section at no additional cost to the customer;

(2) Accounts (except collective investment funds) where the bank exercises investment discretion in other than an agency capacity, in which instance the bank shall, upon request of the person having the power to terminate the account or, if there is no such person, upon the request of any person holding a vested beneficial interest in such account, give or send to such person the written notification within a reasonable time. The bank may charge such person a reasonable fee for providing this information;

(3) Accounts, where the bank exercises investment discretion in an agency capacity, in which instance:

(i) The bank shall give or send to each customer not less frequently than once every three months an itemized statement which shall specify the funds and securities in the custody or possession of the bank at the end of such period and all debits, credits and transactions in the customer's accounts during such period; and

(ii) If requested by the customer, the bank shall give or send to each customer within a reasonable time the written notification described in paragraph (c) of this section. The bank may charge a reasonable fee for providing the information described in paragraph (c) of this section;

(4) A collective investment fund, in which instance the bank shall at least annually furnish a copy of a financial report of the fund, or provide notice that a copy of such report is available and will be furnished upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. This report shall be based upon an audit made by independent public accountants or

internal auditors responsible only to the board of directors of the bank;

(5) A periodic plan, in which instance the bank:

(i) Shall (except for a cash management sweep service) give or send to the customer a written statement not less than every three months if there are no securities transactions in the account, showing the customer's funds and securities in the custody or possession of the bank; all service charges and commissions paid by the customer in connection with the transaction; and all other debits and credits of the customer's account involved in the transaction; or

(ii) Shall for a cash management sweep service or similar periodic plan as defined in § 208.34(b)(10)(ii) give or send its customer a written statement in the same form as prescribed in paragraph (e)(3) above for each month in which a purchase or sale of a security takes place in a deposit account and not less than once every three months if there are no securities transactions in the account subject to any other applicable laws or regulations;

(6) Upon the written request of the customer the bank shall furnish the information described in paragraph (d) of this section, except that any such information relating to remuneration paid in connection with the transaction need not be provided to the customer when paid by a source other than the customer. The bank may charge a reasonable fee for providing the information described in paragraph (d) of this section.

(f) *Settlement of securities transactions.* All contracts for the purchase or sale of a security shall provide for completion of the transaction within the number of business days in the standard settlement cycle for the security followed by registered broker dealers in the United States unless otherwise agreed to by the parties at the time of the transaction.

(g) *Securities trading policies and procedures.* Every State member bank effecting securities transactions for customers shall establish written policies and procedures providing:

(1) Assignment of responsibility for supervision of all officers or employees who:

(i) Transmit orders to or place orders with broker/dealers;

(ii) Execute transactions in securities for customers; or

(iii) Process orders for notification and/or settlement purposes, or perform other back office functions with respect to securities transactions effected for customers; provided that procedures established under this paragraph

(g)(1)(iii) should provide for supervision and reporting lines that are separate from supervision of personnel under paragraphs (g)(1)(i) and (g)(1)(ii) of this section;

(2) For the fair and equitable allocation of securities and prices to accounts when orders for the same security are received at approximately the same time and are placed for execution either individually or in combination;

(3) Where applicable and where permissible under local law, for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction; and

(4) That bank officers and employees who make investment recommendations or decisions for the accounts of customers, who participate in the determination of such recommendations or decisions, or who, in connection with their duties, obtain information concerning which securities are being purchased or sold or recommended for such action, must report to the bank, within ten days after the end of the calendar quarter, all transactions in securities made by them or on their behalf, either at the bank or elsewhere in which they have a beneficial interest. The report shall identify the securities purchased or sold and indicate the dates of the transactions and whether the transactions were purchases or sales. Excluded from this requirement are transactions for the benefit of the officer or employee over which the officer or employee has no direct or indirect influence or control, transactions in mutual fund shares, and all transactions involving in the aggregate \$10,000 or less during the calendar quarter. For purposes of this paragraph (g)(4), the term securities does not include government securities.

**§ 208.35 Qualification requirements for transactions in certain securities.**

[Reserved]

**§ 208.36 Reporting requirements for State member banks subject to the Securities Exchange Act of 1934.**

(a) *Filing requirements.* Except as otherwise provided in this section, a member bank whose securities are subject to registration pursuant to section 12(b) or section 12(g) of the Securities Exchange Act of 1934 (the 1934 Act) (15 U.S.C. 78l (b) and (g)) shall comply with the rules, regulations, and forms adopted by the Securities and Exchange Commission (Commission) pursuant to sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act (15 U.S.C. 78l, 78m, 78n(a), (c), (d), (f) and 78p). The term "Commission" as used in those rules and regulations shall with

respect to securities issued by member banks be deemed to refer to the Board unless the context otherwise requires.

(b) *Elections permitted for member banks with total assets of \$150 million or less.* (1) Notwithstanding paragraph (a) of this section or the rules and regulations promulgated by the Commission pursuant to the 1934 Act a member bank that has total assets of \$150 million or less as of the end of its most recent fiscal year, and no foreign offices, may elect to substitute for the financial statements required by the Commission's Form 10-Q, the balance sheet and income statement from the quarterly report of condition required to be filed by the bank with the Board under section 9 of the Federal Reserve Act (12 U.S.C. 324) (Federal Financial Institutions Examination Council Form 033 or 034).

(2) A member bank qualifying for and electing to file financial statements from its quarterly report of condition pursuant to paragraph (b)(1) of this section in its form 10-Q shall include earnings per share or net loss per share data prepared in accordance with GAAP and disclose any material contingencies, as required by Article 10 of the Commission's Regulation S-X (17 CFR 210.10-01), in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of Form 10-Q.

(c) *Required filings.* (1) *Place and timing of filing.* All papers required to be filed with the Board, pursuant to the 1934 Act or regulations thereunder, shall be submitted to the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Material may be filed by delivery to the Board, through the mails, or otherwise. The date on which papers are actually received by the Board shall be the date of filing thereof if all of the requirements with respect to the filing have been complied with.

(2) *Filing fees.* No filing fees specified by the Commission's rules shall be paid to the Board.

(3) *Public inspection.* Copies of the registration statement, definitive proxy solicitation materials, reports, and annual reports to shareholders required by this section (exclusive of exhibits) shall be available for public inspection at the Board's offices in Washington, DC, as well as at the Federal Reserve Banks of New York, Chicago, and San Francisco and at the Reserve Bank in the district in which the reporting bank is located.

(d) *Confidentiality of filing.* Any person filing any statement, report, or

document under the 1934 Act may make written objection to the public disclosure of any information contained therein in accordance with the following procedure:

(1) The person shall omit from the statement, report, or document, when it is filed, the portion thereof that the person desires to keep undisclosed (hereinafter called the confidential portion). The person shall indicate at the appropriate place in the statement, report, or document that the confidential portion has been omitted and filed separately with the Board.

(2) The person shall file the following with the copies of the statement, report, or document filed with the Board:

(i) As many copies of the confidential portion, each clearly marked "CONFIDENTIAL TREATMENT," as there are copies of the statement, report, or document filed with the Board. Each copy of the confidential portion shall contain the complete text of the item and, notwithstanding that the confidential portion does not constitute the whole of the answer, the entire answer thereto; except that in case the confidential portion is part of a financial statement or schedule, only the particular financial statement or schedule need be included. All copies of the confidential portion shall be in the same form as the remainder of the statement, report, or document; and

(ii) An application making objection to the disclosure of the confidential portion. The application shall be on a sheet or sheets separate from the confidential portion, and shall:

(A) Identify the portion of the statement, report, or document that has been omitted;

(B) Include a statement of the grounds of objection; and

(C) Include the name of each exchange, if any, with which the statement, report, or document is filed.

(3) The copies of the confidential portion and the application filed in accordance with this paragraph shall be enclosed in a separate envelope marked "CONFIDENTIAL TREATMENT," and addressed to Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551.

(4) Pending determination by the Board on the objection filed in accordance with this paragraph, the confidential portion shall not be disclosed by the Board.

(5) If the Board determines to sustain the objection, a notation to that effect shall be made at the appropriate place in the statement, report, or document.

(6) If the Board determines not to sustain the objection because disclosure of the confidential portion is in the



public interest, a finding and determination to that effect shall be entered and notice of the finding and determination sent by registered or certified mail to the person.

(7) If the Board determines not to sustain the objection, pursuant to paragraph (d)(6) of this section, the confidential portion shall be made available to the public:

(i) 15 days after notice of the Board's determination not to sustain the objection has been given, as required by paragraph (d)(6) of this section, provided that the person filing the objection has not previously filed with the Board a written statement that he intends, in good faith, to seek judicial review of the finding and determination; or

(ii) 60 days after notice of the Board's determination not to sustain the objection has been given as required by paragraph (d)(6) of this section and the person filing the objection has filed with the Board a written statement of intent to seek judicial review of the finding and determination, but has failed to file a petition for judicial review of the Board's determination; or

(iii) Upon final judicial determination, if adverse to the party filing the objection.

(8) If the confidential portion is made available to the public, a copy thereof shall be attached to each copy of the statement, report, or document filed with the Board.

#### **§ 208.37 Government securities sales practices.**

(a) *Scope.* This subpart is applicable to state member banks that have filed notice as, or are required to file notice as, government securities brokers or dealers pursuant to section 15C of the Securities Exchange Act (15 U.S.C. 78o-5) and Department of the Treasury rules under section 15C (17 CFR 400.1(d) and part 401).

(b) *Definitions.* For purposes of this section:

(1) *Bank that is a government securities broker or dealer* means a state member bank that has filed notice, or is required to file notice, as a government securities broker or dealer pursuant to section 15C of the Securities Exchange Act (15 U.S.C. 78o-5) and Department of the Treasury rules under section 15C (17 CFR 400.1(d) and Part 401).

(2) *Customer* does not include a broker or dealer or a government securities broker or dealer.

(3) *Government security* has the same meaning as this term has in section 3(a)(42) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(42)).

(4) *Non-institutional customer* means any customer other than:

(i) A bank, savings association, insurance company, or registered investment company;

(ii) An investment adviser registered under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3); or

(iii) Any entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.

(c) *Business conduct.* A bank that is a government securities broker or dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business as a government securities broker or dealer.

(d) *Recommendations to customers.* In recommending to a customer the purchase, sale or exchange of a government security, a bank that is a government securities broker or dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to the customer's other security holdings and as to the customer's financial situation and needs.

(e) *Customer information.* Prior to the execution of a transaction recommended to a non-institutional customer, a bank that is a government securities broker or dealer shall make reasonable efforts to obtain information concerning:

- (1) The customer's financial status;
- (2) The customer's tax status;
- (3) The customer's investment objectives; and
- (4) Such other information used or considered to be reasonable by the bank in making recommendations to the customer.

#### **Subpart D—Prompt Corrective Action**

##### **§ 208.40 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.**

(a) *Authority.* Subpart D of Regulation H (12 CFR part 208, Subpart D) is issued by the Board of Governors of the Federal Reserve System (Board) under section 38 (section 38) of the FDI Act as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose and scope.* This subpart D defines the capital measures and capital levels that are used for determining the supervisory actions authorized under section 38 of the FDI Act. (Section 38 of the FDI Act establishes a framework of supervisory actions for insured

depository institutions that are not adequately capitalized.) This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38. Certain of the provisions of this subpart apply to officers, directors, and employees of state member banks. Other provisions apply to any company that controls a member bank and to the affiliates of the member bank.

(c) *Other supervisory authority.*

Neither section 38 nor this subpart in any way limits the authority of the Board under any other provision of law to take supervisory actions to address unsafe or unsound practices or conditions, deficient capital levels, violations of law, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the Board, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(d) *Disclosure of capital categories.*

The assignment of a bank under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the Board or otherwise required by law, no bank may state in any advertisement or promotional material its capital category under this subpart or that the Board or any other Federal banking agency has assigned the bank to a particular capital category.

##### **§ 208.41 Definitions for purposes of this subpart.**

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used have the same meanings as set forth in section 38 and section 3 of the FDI Act.

(a) *Control*—(1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term *controlled* shall be construed consistently with the term *control*.

(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary

authority to exercise voting rights with respect to the shares.

(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate Federal banking agency for up to three one-year periods.

(b) *Controlling person* means any person having control of an insured depository institution and any company controlled by that person.

(c) *Leverage ratio* means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure (Appendix B to this part).

(d) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(e) *Risk-weighted assets* means total weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(f) *Tangible equity* means the amount of core capital elements in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage servicing rights to the extent that the Board determines that mortgage servicing rights may be included in calculating the bank's Tier 1 capital.

(g) *Tier 1 capital* means the amount of Tier 1 capital as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(h) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(i) *Total assets* means quarterly average total assets as reported in a bank's Report of Condition and Income (Call Report), minus intangible assets as provided in the definition of tangible equity. At its discretion the Federal Reserve may calculate total assets using a bank's period-end assets rather than quarterly average assets.

(j) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

#### § 208.42 Notice of capital category.

(a) *Effective date of determination of capital category.* A member bank shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) *Notice of capital category.* A member bank shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Report of Condition and Income (Call Report) is required to be filed with the Board;

(2) A final report of examination is delivered to the bank; or

(3) Written notice is provided by the Board to the bank of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's capital category has changed as provided in paragraph (c) of this section or § 208.43(c).

(c) *Adjustments to reported capital levels and capital category—*(1) *Notice of adjustment by bank.* A member bank shall provide the Board with written notice that an adjustment to the bank's capital category may have occurred no later than 15 calendar days following the date that any material event occurred that would cause the bank to be placed in a lower capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent Call Report or report of examination.

(2) *Determination by Board to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the Board shall determine whether to change the capital category of the bank and shall notify the bank of the Board's determination.

#### § 208.43 Capital measures and capital category definitions.

(a) Capital measures. For purposes of section 38 and this subpart, the relevant capital measures are:

(1) The total risk-based capital ratio;

(2) The Tier 1 risk-based capital ratio;

and

(3) The leverage ratio.

(b) *Capital categories.* For purposes of section 38 and this subpart, a member bank is deemed to be:

(1) "Well capitalized" if the bank:

(i) Has a total risk-based capital ratio of 10.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and

(iii) Has a leverage ratio of 5.0 percent or greater; and

(iv) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if the bank:

(i) Has a total risk-based capital ratio of 8.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 4.0 percent or greater; and

(iii) Has:

(A) A leverage ratio of 4.0 percent or greater; or

(B) A leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth; and

(iv) Does not meet the definition of a "well capitalized" bank.

(3) "Undercapitalized" if the bank has:

(i) A total risk-based capital ratio that is less than 8.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(iii) Except as provided in paragraph (b)(2)(iii)(B) of this section, has a leverage ratio that is less than 4.0 percent; or

(iv) A leverage ratio that is less than 3.0 percent, if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth.

(4) "Significantly undercapitalized" if the bank has:

(i) A total risk-based capital ratio that is less than 6.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 3.0 percent; or

(iii) A leverage ratio that is less than 3.0 percent.

(5) "Critically undercapitalized" if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Reclassification based on supervisory criteria other than capital.* The Board may reclassify a well capitalized member bank as adequately capitalized and may require an adequately-capitalized or an undercapitalized member bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower capital category (except that the Board may not reclassify a significantly undercapitalized bank as critically undercapitalized) (each of these actions are hereinafter referred to generally as "reclassifications") in the following circumstances:

(1) *Unsafe or unsound condition.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that the bank is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that, in the most recent examination of the bank, the bank received and has not corrected, a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, liquidity, or sensitivity to market risk.

#### § 208.44 Capital restoration plans.

(a) *Schedule for filing plan.* (1) *In general.* A member bank shall file a written capital restoration plan with the appropriate Reserve Bank within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the Board notifies the bank in writing that the plan is to be filed within a different period. An adequately capitalized bank that has been required, pursuant to § 208.43(c), to comply with supervisory actions as if the bank were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 208.43(c), unless the Board notifies the bank that it must submit a new or revised capital plan. A bank that is

notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate Reserve Bank within 45 days of receiving such notice, unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the Board instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A bank that is required to submit a capital restoration plan as the result of a reclassification of the bank pursuant to § 208.43(c) shall include a description of the steps the bank will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that Act by each company that controls the bank.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the Board shall provide written notice to the bank of whether the plan has been approved. The Board may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If the Board does not approve a capital restoration plan, the bank shall submit a revised capital restoration plan within the time specified by the Board. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized member bank (as defined in § 208.43(b)(3)) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as the Board approves a new or revised capital restoration plan submitted by the bank.

(e) *Failure to submit capital restoration plan.* A member bank that is undercapitalized (as defined in § 208.43(b)(3)) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement capital restoration plan.* Any undercapitalized member bank that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this

subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital plan.* A bank that has filed an approved capital restoration plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* Within 45 days of the effective date of Board approval of a capital restoration plan, or any amendment to a capital restoration plan, the Board shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank.* (1) *Limitation on Liability.* (i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific member bank that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank's total assets at the time the bank was notified or deemed to have notice that the bank was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank to the levels required for the bank to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the Board notifies the bank that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a bank shall be jointly and severally liable for the guarantee for such bank as required under section 38 and this subpart, and the Board may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank that is controlled by a company submits a capital

restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks that have not submitted an acceptable capital restoration plan.

(3) *Failure to perform guarantee.*

Failure by any company that controls a bank to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank shall be subject to the provisions of section 38 and this subpart that are applicable to banks that have failed in a material respect to implement a capital restoration plan.

**§ 208.45 Mandatory and discretionary supervisory actions under section 38.**

(a) *Mandatory supervisory actions.* (1) *Provisions applicable to all banks.* All member banks are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks.* Immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

- (i) Restricting payment of capital distributions and management fees (section 38(d));
- (ii) Requiring that the Board monitor the condition of the bank (section 38(e)(1));
- (iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));
- (iv) Restricting the growth of the bank's assets (section 38(e)(3)); and
- (v) Requiring prior approval of certain expansion proposals (section 3(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is significantly undercapitalized, or critically undercapitalized, or that the bank is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank

failed to submit or implement in any material respect an acceptable capital restoration plan, the bank shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (a)(3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.32, that the bank is critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

- (i) Restricting the activities of the bank (section 38(h)(1)); and
- (ii) Restricting payments on subordinated debt of the bank (section 38(h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the Board's discretion to take in connection with: A member bank that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; an officer or director of such bank; or a company that controls such bank, the Board shall follow the procedures for issuing directives under 12 CFR 263.202 and 263.204, unless otherwise provided in section 38 or this subpart.

**Subpart E—Real Estate Lending and Appraisal Standards**

**§ 208.50 Authority, purpose, and scope.**

(a) *Authority.* Subpart E of Regulation H (12 CFR part 208, subpart E) is issued by the Board of Governors of the Federal Reserve System under section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o) and Title 11 of the Financial Institutions Reform, Recovery, and Enforcement Act (12 U.S.C. 3331–3351).

(b) *Purpose and scope.* This subpart E prescribes standards for real estate lending to be used by member banks in adopting internal real estate lending policies. The standards applicable to appraisals rendered in connection with federally related transactions entered into by member banks are set forth in 12 CFR part 225, subpart G (Regulation Y).

**§ 208.51 Real estate lending standards.**

(a) *Adoption of written policies.* Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for

extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) *Requirements of lending policies.*

(1) Real estate lending policies adopted pursuant to this section shall be:

- (i) Consistent with safe and sound banking practices;
- (ii) Appropriate to the size of the institution and the nature and scope of its operations; and
- (iii) Reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies shall establish:

- (i) Loan portfolio diversification standards;
- (ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;
- (iii) Loan administration procedures for the bank's real estate portfolio; and
- (iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) *Monitoring conditions.* Each member bank shall monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) *Interagency guidelines.* The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies (contained in appendix C of this part) established by the Federal bank and thrift supervisory agencies.

**Subpart F—Miscellaneous Requirements**

**§ 208.60 Authority, purpose, and scope.**

(a) *Authority.* Subpart F of Regulation H (12 CFR part 208, subpart F) is issued by the Board of Governors of the Federal Reserve System under sections 9, 11, 21, 25 and 25A of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), 481–486, 601 and 611), section 7 of the International Banking Act (12 U.S.C. 3105), section 3 of the Bank Protection Act of 1968 (12 U.S.C. 1882), sections 1814, 1816, 1818, 1831o, 1831p–1 and 1831r–1 of the FDI Act (12 U.S.C. 1814, 1816, 1818, 1831o, 1831p–1 and 1831r–1), and the Bank Secrecy Act (31 U.S.C. 5318).

(b) *Purpose and scope.* This subpart F describes a member bank's obligation to implement security procedures to discourage certain crimes, to file suspicious activity reports, and to comply with the Bank Secrecy Act's

requirements for reporting and recordkeeping of currency and foreign transactions. It also describes the examination schedule for certain small insured member banks.

#### § 208.61 Bank security procedures.

(a) *Authority, purpose, and scope.* Pursuant to section 3 of the Bank Protection Act of 1968 (12 U.S.C. 1882), member banks are required to adopt appropriate security procedures to discourage robberies, burglaries, and larcenies, and to assist in the identification and prosecution of persons who commit such acts. It is the responsibility of the member bank's board of directors to comply with the provisions of this section and ensure that a written security program for the bank's main office and branches is developed and implemented.

(b) *Designation of security officer.* Upon becoming a member of the Federal Reserve System, a member bank's board of directors shall designate a security officer who shall have the authority, subject to the approval of the board of directors, to develop, within a reasonable time, but no later than 180 days, and to administer a written security program for each banking office.

(c) *Security program.* (1) The security program shall:

(i) Establish procedures for opening and closing for business and for the safekeeping of all currency, negotiable securities, and similar valuables at all times;

(ii) Establish procedures that will assist in identifying persons committing crimes against the institution and that will preserve evidence that may aid in their identification and prosecution. Such procedures may include, but are not limited to: maintaining a camera that records activity in the banking office; using identification devices, such as prerecorded serial-numbered bills, or chemical and electronic devices; and retaining a record of any robbery, burglary, or larceny committed against the bank;

(iii) Provide for initial and periodic training of officers and employees in their responsibilities under the security program and in proper employee conduct during and after a burglary, robbery, or larceny; and

(iv) Provide for selecting, testing, operating, and maintaining appropriate security devices, as specified in paragraph (c)(2) of this section.

(2) *Security devices.* Each member bank shall have, at a minimum, the following security devices:

(i) A means of protecting cash and other liquid assets, such as a vault, safe, or other secure space;

(ii) A lighting system for illuminating, during the hours of darkness, the area around the vault, if the vault is visible from outside the banking office;

(iii) Tamper-resistant locks on exterior doors and exterior windows that may be opened;

(iv) An alarm system or other appropriate device for promptly notifying the nearest responsible law enforcement officers of an attempted or perpetrated robbery or burglary; and

(v) Such other devices as the security officer determines to be appropriate, taking into consideration: the incidence of crimes against financial institutions in the area; the amount of currency and other valuables exposed to robbery, burglary, or larceny; the distance of the banking office from the nearest responsible law enforcement officers; the cost of the security devices; other security measures in effect at the banking office; and the physical characteristics of the structure of the banking office and its surroundings.

(d) *Annual reports.* The security officer for each member bank shall report at least annually to the bank's board of directors on the implementation, administration, and effectiveness of the security program.

(e) *Reserve Banks.* Each Reserve Bank shall develop and maintain a written security program for its main office and branches subject to review and approval of the Board.

#### § 208.62 Suspicious activity reports.

(a) *Purpose.* This section ensures that a member bank files a Suspicious Activity Report when it detects a known or suspected violation of Federal law, or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act. This section applies to all member banks.

(b) *Definitions.* For the purposes of this section:

(1) *FinCEN* means the Financial Crimes Enforcement Network of the Department of the Treasury.

(2) *Institution-affiliated party* means any institution-affiliated party as that term is defined in 12 U.S.C. 1786(r), or 1813(u) and 1818(b) (3), (4) or (5).

(3) *SAR* means a Suspicious Activity Report on the form prescribed by the Board.

(c) *SARs required.* A member bank shall file a SAR with the appropriate Federal law enforcement agencies and the Department of the Treasury in accordance with the form's instructions by sending a completed SAR to FinCEN in the following circumstances:

(1) *Insider abuse involving any amount.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, and the bank has a substantial basis for identifying one of its directors, officers, employees, agents or other institution-affiliated parties as having committed or aided in the commission of a criminal act regardless of the amount involved in the violation.

(2) *Violations aggregating \$5,000 or more where a suspect can be identified.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank and involving or aggregating \$5,000 or more in funds or other assets, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, and the bank has a substantial basis for identifying a possible suspect or group of suspects. If it is determined prior to filing this report that the identified suspect or group of suspects has used an "alias," then information regarding the true identity of the suspect or group of suspects, as well as alias identifiers, such as drivers' licenses or social security numbers, addresses and telephone numbers, must be reported.

(3) *Violations aggregating \$25,000 or more regardless of a potential suspect.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank and involving or aggregating \$25,000 or more in funds or other assets, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, even though there is no substantial basis for identifying a possible suspect or group of suspects.

(4) *Transactions aggregating \$5,000 or more that involve potential money laundering or violations of the Bank Secrecy Act.* Any transaction (which for purposes of this paragraph (c)(4) means

a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument or investment security, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected) conducted or attempted by, at or through the member bank and involving or aggregating \$5,000 or more in funds or other assets, if the bank knows, suspects, or has reason to suspect that:

(i) The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any law or regulation or to avoid any transaction reporting requirement under federal law;

(ii) The transaction is designed to evade any regulations promulgated under the Bank Secrecy Act; or

(iii) The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

(d) *Time for reporting.* A member bank is required to file a SAR no later than 30 calendar days after the date of initial detection of facts that may constitute a basis for filing a SAR. If no suspect was identified on the date of detection of the incident requiring the filing, a member bank may delay filing a SAR for an additional 30 calendar days to identify a suspect. In no case shall reporting be delayed more than 60 calendar days after the date of initial detection of a reportable transaction. In situations involving violations requiring immediate attention, such as when a reportable violation is on-going, the financial institution shall immediately notify, by telephone, an appropriate law enforcement authority and the Board in addition to filing a timely SAR.

(e) *Reports to state and local authorities.* Member banks are encouraged to file a copy of the SAR with state and local law enforcement agencies where appropriate.

(f) *Exceptions.* (1) A member bank need not file a SAR for a robbery or burglary committed or attempted that is reported to appropriate law enforcement authorities.

(2) A member bank need not file a SAR for lost, missing, counterfeit, or

stolen securities if it files a report pursuant to the reporting requirements of 17 CFR 240.17f-1.

(g) *Retention of records.* A member bank shall maintain a copy of any SAR filed and the original or business record equivalent of any supporting documentation for a period of five years from the date of the filing of the SAR. Supporting documentation shall be identified and maintained by the bank as such, and shall be deemed to have been filed with the SAR. A member bank must make all supporting documentation available to appropriate law enforcement agencies upon request.

(h) *Notification to board of directors.* The management of a member bank shall promptly notify its board of directors, or a committee thereof, of any report filed pursuant to this section.

(i) *Compliance.* Failure to file a SAR in accordance with this section and the instructions may subject the member bank, its directors, officers, employees, agents, or other institution affiliated parties to supervisory action.

(j) *Confidentiality of SARs.* SARs are confidential. Any member bank subpoenaed or otherwise requested to disclose a SAR or the information contained in a SAR shall decline to produce the SAR or to provide any information that would disclose that a SAR has been prepared or filed citing this section, applicable law (e.g., 31 U.S.C. 5318(g)), or both, and notify the Board.

(k) *Safe harbor.* The safe harbor provisions of 31 U.S.C. 5318(g), which exempts any member bank that makes a disclosure of any possible violation of law or regulation from liability under any law or regulation of the United States, or any constitution, law or regulation of any state or political subdivision, covers all reports of suspected or known criminal violations and suspicious activities to law enforcement and financial institution supervisory authorities, including supporting documentation, regardless of whether such reports are filed pursuant to this section or are filed on a voluntary basis.

#### **§ 208.63 Procedures for monitoring Bank Secrecy Act compliance.**

(a) *Purpose.* This section is issued to assure that all state member banks establish and maintain procedures reasonably designed to assure and monitor their compliance with the provisions of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*) and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103, requiring

recordkeeping and reporting of currency transactions.

(b) *Establishment of compliance program.* On or before April 27, 1987, each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*) and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103. The compliance program shall be reduced to writing, approved by the board of directors, and noted in the minutes.

(c) *Contents of compliance program.* The compliance program shall, at a minimum:

(1) Provide for a system of internal controls to assure ongoing compliance;

(2) Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;

(3) Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide training for appropriate personnel.

#### **§ 208.64 Frequency of examination.**

(a) *General.* The Federal Reserve examines insured member banks pursuant to authority conferred by 12 U.S.C. 325 and the requirements of 12 U.S.C. 1820(d). The Federal Reserve is required to conduct a full-scope, on-site examination of every insured member bank at least once during each 12-month period.

(b) *18-month rule for certain small institutions.* The Federal Reserve may conduct a full-scope, on-site examination of an insured member bank at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The bank has total assets of \$250 million or less;

(2) The bank is well capitalized as defined in subpart D of this part (§ 208.43);

(3) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve found the bank to be well managed;

(4) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve assigned the bank a CAMELS rating of 1 or 2;

(5) The bank currently is not subject to a formal enforcement proceeding or

order by the FDIC, OCC, or Federal Reserve System; and

(6) No person acquired control of the bank during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(c) *Authority to conduct more frequent examinations.* This section does not limit the authority of the Federal Reserve to examine any member bank as frequently as the agency deems necessary.

### Subpart G—Interpretations

#### § 208.100 Sale of bank's money orders off premises as establishment of branch office.

(a) The Board of Governors has been asked to consider whether the appointment by a member bank of an agent to sell the bank's money orders, at a location other than the premises of the bank, constitutes the establishment of a branch office.

(b) Section 5155 of the Revised Statutes (12 U.S.C. 36), which is also applicable to member banks, defines the term branch as including "any branch bank, branch office, branch agency, additional office, or any branch place of business \* \* \* at which deposits are received, or checks paid, or money lent." The basic question is whether the sale of a bank's money orders by an agent amounts to the receipt of deposits at a branch place of business within the meaning of this statute.

(c) Money orders are classified as deposits for certain purposes. However, they bear a strong resemblance to traveler's checks that are issued by banks and sold off premises. In both cases, the purchaser does not intend to establish a deposit account in the bank, although a liability on the bank's part is created. Even though they result in a deposit liability, the Board is of the opinion that the issuance of a bank's money orders by an authorized agent does not involve the receipt of deposits at a "branch place of business" and accordingly does not require the Board's permission to establish a branch.

#### § 208.101 Obligations concerning institutional customers.

(a) As a result of broadened authority provided by the Government Securities Act Amendments of 1993 (15 U.S.C. 78o-3 and 78o-5), the Board is adopting sales practice rules for the government securities market, a market with a particularly broad institutional component. Accordingly, the Board believes it is appropriate to provide further guidance to banks on their suitability obligations when making recommendations to institutional customers.

(b) The Board's Suitability Rule, § 208.37(d), is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Banks' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Banks are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer.

(c) In recommending to a customer the purchase, sale, or exchange of any government security, the bank shall have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to the customer's other security holdings and financial situation and needs.

(d) The interpretation in this section concerns only the manner in which a bank determines that a recommendation is suitable for a particular institutional customer. The manner in which a bank fulfills this suitability obligation will vary, depending on the nature of the customer and the specific transaction. Accordingly, the interpretation in this section deals only with guidance regarding how a bank may fulfill customer-specific suitability obligations under § 208.37(d).<sup>7</sup>

(e) While it is difficult to define in advance the scope of a bank's suitability obligation with respect to a specific institutional customer transaction recommended by a bank, the Board has identified certain factors that may be relevant when considering compliance with § 208.37(d). These factors are not intended to be requirements or the only factors to be considered but are offered merely as guidance in determining the scope of a bank's suitability obligations.

(f) The two most important considerations in determining the scope of a bank's suitability obligations in making recommendations to an institutional customer are the customer's capability to evaluate investment risk independently and the extent to which the customer is exercising independent judgement in evaluating a bank's recommendation. A bank must determine, based on the

information available to it, the customer's capability to evaluate investment risk. In some cases, the bank may conclude that the customer is not capable of making independent investment decisions in general. In other cases, the institutional customer may have general capability, but may not be able to understand a particular type of instrument or its risk. This is more likely to arise with relatively new types of instruments, or those with significantly different risk or volatility characteristics than other investments generally made by the institution. If a customer is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular product, the scope of a bank's customer-specific obligations under § 208.37(d) would not be diminished by the fact that the bank was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

(g) A bank may conclude that a customer is exercising independent judgement if the customer's investment decision will be based on its own independent assessment of the opportunities and risks presented by a potential investment, market factors and other investment considerations. Where the bank has reasonable grounds for concluding that the institutional customer is making independent investment decisions and is capable of independently evaluating investment risk, then a bank's obligations under § 208.25(d) for a particular customer are fulfilled.<sup>8</sup> Where a customer has delegated decision-making authority to an agent, such as an investment advisor or a bank trust department, the interpretation in this section shall be applied to the agent.

(h) A determination of capability to evaluate investment risk independently will depend on an examination of the customer's capability to make its own investment decisions, including the resources available to the customer to make informed decisions. Relevant considerations could include:

- (1) The use of one or more consultants, investment advisers, or bank trust departments;
- (2) The general level of experience of the institutional customer in financial markets and specific experience with the type of instruments under consideration;

<sup>7</sup> The interpretation in this section does not address the obligation related to suitability that requires that a bank have "a 'reasonable basis' to believe that the recommendation could be suitable for at least some customers." In the Matter of the Application of F.J. Kaufman and Company of Virginia and Frederick J. Kaufman, Jr., 50 SEC 164 (1989).

<sup>8</sup> See footnote 7 in paragraph (d) of this section.



(3) The customer's ability to understand the economic features of the security involved;

(4) The customer's ability to independently evaluate how market developments would affect the security; and

(5) The complexity of the security or securities involved.

(i) A determination that a customer is making independent investment decisions will depend on the nature of the relationship that exists between the bank and the customer. Relevant considerations could include:

(1) Any written or oral understanding that exists between the bank and the customer regarding the nature of the relationship between the bank and the customer and the services to be rendered by the bank;

(2) The presence or absence of a pattern of acceptance of the bank's recommendations;

(3) The use by the customer of ideas, suggestions, market views and information obtained from other government securities brokers or dealers or market professionals, particularly those relating to the same type of securities; and

(4) The extent to which the bank has received from the customer current comprehensive portfolio information in connection with discussing recommended transactions or has not been provided important information regarding its portfolio or investment objectives.

(j) Banks are reminded that these factors are merely guidelines that will be utilized to determine whether a bank has fulfilled its suitability obligation with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination of suitability. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular bank/customer relationship, assessed in the context of a particular transaction.

(k) For purposes of the interpretation in this section, an institutional customer shall be any entity other than a natural person. In determining the applicability of the interpretation in this section to an institutional customer, the Board will consider the dollar value of the securities that the institutional customer has in its portfolio and/or under management. While the interpretation in this section is potentially applicable to any institutional customer, the guidance contained in this section is more appropriately applied to an institutional customer with at least \$10

million invested in securities in the aggregate in its portfolio and/or under management.

## **PART 250—MISCELLANEOUS INTERPRETATIONS**

1. The authority citation for part 250 continues to read as follows:

**Authority:** 12 U.S.C. 78, 248(i) and 371c(e).

**§§ 250.120 through 250.123, 250.140, 250.161, 250.162 [Removed]**

2. Sections 250.120, 250.121, 250.122, 250.123, 250.140, 250.161, 250.162 are removed.

**§§ 250.300 through 250.302 [Removed]**

3. The undesignated center heading preceding § 250.300 and §§ 250.300 through 250.302 are removed.

By order of the Board of Governors of the Federal Reserve System, July 6, 1998

**Jennifer J. Johnson,**  
*Secretary of the Board.*

[FR Doc. 98-18274 Filed 7-10-98; 8:45 am]

**BILLING CODE 6210-01-P**

## **FEDERAL RESERVE SYSTEM**

### **12 CFR Part 209**

**[Regulation I; Docket No. R-0966]**

### **Issue and Cancellation of Federal Reserve Bank Capital Stock**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** The Board of Governors of the Federal Reserve System is amending its Regulation I regarding the issue and cancellation of Federal Reserve Bank Capital Stock in order to reduce regulatory burden and simplify and update requirements. The amendments modernize Regulation I in accordance with the Board's policy of regular review of its regulations and the Board's review of its regulations pursuant to section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.

**EFFECTIVE DATE:** October 1, 1998.

**FOR FURTHER INFORMATION CONTACT:** Rick Heyke, Staff Attorney (202/452-3688), Legal Division, Board of Governors; Bill Pullen, Accountant (202/736-1947, Division of Reserve Bank Operations and Payment Systems, Board of Governors; or Anthony Scafide, Manager (215/574-6546), Wholesale Payments Division, Federal Reserve Bank of Philadelphia. For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Diane Jenkins Thompson (202/452-3544).

## **SUPPLEMENTARY INFORMATION:**

### **Background**

As part of its policy of regular review of its regulations, and consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act), the Board of Governors of the Federal Reserve System (Board) is amending its Regulation I regarding issue and cancellation of Federal Reserve Bank capital stock (12 CFR part 209). Section 303 of the Riegle Act requires each federal banking agency to review and streamline its regulations and written policies to improve efficiency, reduce unnecessary costs, and remove inconsistencies and outmoded and duplicative requirements. The amendments are designed to reduce regulatory burden and simplify and update the Regulation.

The Board published a notice of proposed rulemaking in the **Federal Register** on March 31, 1997 (62 FR 15297) that solicited comments on the proposed amendments described below. In general, the amendments simplified, modernized, and condensed the Regulation, and reflected the replacement of share certificates by a book-entry system. The amendments also codified Board and staff interpretations. In addition, the amendments deleted the many references to specific forms. Many of these references are incorrect because the forms no longer exist or no longer have the same identification numbers. Finally, the proposal sought comment on the method of computing accrued dividends on Reserve Bank capital stock and on deferring changes in Reserve Bank capital stock positions to reflect small changes in member bank capital stock and surplus.

The Board received nine comments on its proposal, five from Federal Reserve Banks, three from banking organizations, and one from a trade association. The comments were generally supportive of the proposal overall, and especially of the shift to book entry electronic recordkeeping.

### **Final Rule**

The Board is adopting the revised Regulation I substantially as proposed. In addition, in response to comments, the final Regulation makes clear that Reserve Bank stock is issued to member banks in organization as of their opening for business and not before, incorporates the Board's final rule on relocation of member banks and makes appropriate adjustments to the section on Cancellation of Reserve Bank Stock, carries over adjustments in Reserve