This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 332

Powers Inconsistent With the Purposes of Federal Deposit Insurance Law

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

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC is proposing to amend Part 332 of its regulations to: (1) Prohibit any insured bank (including national banks, state banks that are members of the Federal Reserve System and Federally chartered savings banks insured by FDIC) from directly engaging in the following: Underwriting of insurance; underwriting or developing real estate; reinsurance; insuring, guaranteeing, or certifying title to real estate; guaranteeing or becoming surety upon the obligations of others; insuring the fidelity of others; or engaging in a surety business, (2) require any subsidiary of an insured bank that conducts any of these activities to meet the criteria for a bona fide subsidiary set out in the regulation, (3) require notice to the FDIC of intent to invest in any such subsidiary, (4) place certain restrictions on the affiliation of an insured bank with a company that engages in any of the subject activities, (5) place certain restrictions on extensions of credit and other transactions between insured banks and their subsidiaries or affiliates that engage in any of the subject activities, (6) require all insured banks that established or acquired a subsidiary or became affiliated with a company that engages in the subject activities prior to the effective date of the regulation to conform thereto within one year, (7) require any insured bank that as of the effective date of the regulation is directly engaging in any of the subject activities to conform to the regulation within two years, and (8) place certain restrictions on insured banks that provide electronic data processing ("EDP") services to persons or companies other than banks, or act as agent or broker for insurance, real estate, securities, or travel services.

DATE: Comments must be received by February 11, 1984.

ADDRESS: Send comments to Hoyle L. Robinson, Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, D.C. 20429. Comments may be hand delivered to Room 6108 between the hours of 8:30 am and 5:00 pm.

FOR FURTHER INFORMATION CONTACT: Pamela E.F. LeCren, Senior Attorney, Legal Division, (202–389–4171), Room 4126E, 550 17th Street NW., Washington, D.C. 20429, or Ken A. Quincy, Examination Specialist, Planning and Program Development Branch, Division of Bank Supervision, (202–389–4141) Room NY–760F, 550 17th Street NW., Washington, D.C. 20429.

SUPPLEMENTARY INFORMATION: On August 30, 1983 the Board of Directors of the FDIC adopted an Advance Notice of Proposed Rulemaking soliciting comment on the need for rulemaking to govern the direct or indirect involvement of insured banks in real estate brokerage and underwriting, insurance brokerage and underwriting, data processing for third parties, travel agency activities, and other financially related services. (48 FR 40900, September 12, 1983.) The notice set forth sixteen specific questions designed to solicit responses directed to whether or not such activities on the part of insured banks pose safety and soundness problems, present any conflicts of interest, or are inconsistent with the purposes of Federal deposit insurance. The notice was also designed to solicit information on how each of the subject industries functions and what regulatory requirements, if any, currently govern these industries. In addition, comment was also directed to whether or not limitations should be imposed on the ability of a company engaged in any of the above activities to acquire an insured bank.

As the FDIC stated in the supplementary information to the Advance Notice of Proposed Rulemaking, the clear separation which existed in the past between the product lines of banks, thrifts, and other types of financial companies and commercial firms is becoming blurred. The environment in which banks function today is rapidly changing, *i.e.* the traditional boundaries distinguishing "banking" from other "financial services" and from "commerce" are beginning to erode with the ever-increasing number of cross-industry acquisitions, expansion by banks into new product markets, and changes in state law authorizing banks to engage directly, or indirectly through subsidiaries, in activities heretofore open to banks only in limited instances. In addition, a wide array of commercial enterprises are affiliated with banks as a result of the so-called loophole in the Bank Holding Company Act that permits the phenomenon of the nonbank bank. As banking powers are expanded by state legislatures, or powers previously conferred but not exercised are activated, the FDIC has both the responsibility and authority to carefully weigh these developments in its capacity as a supervisor of insured nonmember banks and the insurer of much of the nation's banking system.

As the FDIC indicated in that notice, the FDIC is firmly committed to a dual banking system and is mindful of the issues raised by any effort by a federal agency to review the propriety of banks engaging in activities authorized by their state chartering authorities or their primary federal regulatory agencies. At the same time, the FDIC must fulfill its obligation to monitor market place developments and changes in state law in order to assess the potential impact of such changes on bank safety and soundness and on the nation's deposit insurance system. While the FDIC strongly supports expansion of bank powers that would allow banks to develop new sources of income to offset the costs of liability deregulation, the FDIC cannot ignore the possibility that such expansion may increase the risk to the deposit insurance system.

The Advance Notice of Proposed Rulemaking was published for a 60-day comment period which closed on November 14, 1983. A total of 155 comments (including comments received after November 14, 1983) were received and considered by the FDIC. The comments were distributed among the following: 86 comments from banks and/or banking trade associations; 6 comments from savings and loans and/or savings and loan trade associations; 24 comments from insurance agents

and/or insurance trade associations; 4 comments from travel agencies or travel agency trade associations; 1 comment from an EDP association; 12 comments from realtors or real estate trade associations; 10 comments from state officials and/or state bank supervisory agencies; 6 comments from "others", including the Antitrust Division of the United States Department of Justice. In addition to reviewing the above comments, FDIC considered the testimony of various individuals and organizations that was given in March, 1984 before the Senate Committee on Banking, Housing, and Urban Affairs on S. 2181, "The Financial Services Competitive Equity Act" and S. 2134, "The Depository Institutions Holding Company Act Amendments of 1983".

Overall Summary of Comments

The majority of the comments briefly responded to some or all of the sixteen specific questions posed in the Advance Notice of Proposed Rulemaking. Most, however, did not elaborate as to any one particular activity referenced in the notice. The following is a capsule summary of the comments which responded on a per question basis:

Question 1—If insured banks enter into expanded activities, existing safeguards against conflicts of interest that could arise are adequate (27); existing safeguards are not adequate (4).

Question 2—FDIC should impose a disclosure requirement as to conflicts of interest (29); should not do so (5).

Question 3—FDIC should permit dual employment relationships (20); should not permit dual employment relationships (7).

Question 4—There will be problems of overlapping regulation if banks enter into expanded activities (5); these problems would be aggravated if the activity is conducted in-house (3); regulatory differences will lead to competitive inequalities (2).

Question 5—The subject activities should be conducted in separate subsidiaries (11); the activities are not necessarily safer if conducted in a subsidiary (8); whether or not the activities should be placed in-house or in a subsidiary depends upon the activity in question (6); insurance underwriting activities should be conducted in a subsidiary (4); real estate underwriting should be conducted in a subsidiary (4); there is no necessity for the activities to be conducted in a subsidiary *i.e.*, banks should be able to conduct any of the activities in-house (6); banks should be able to do real estate brokerage in-house (9); banks should be able do real estate underwriting in-house (4); banks shold be able to do insurance brokerage in-house (11); banks should be able to do insurance underwriting in-house (3).

Question 6—There are fundamental differences between banks and companies that engage in the subject activities (4); there are no such fundamental diffferences that require the subject activities to be conducted in a subsidiary (13); there is no significant difference between banking and data processing and banking and travel agency services that would warrant precluding these activities to banks (11); there are significant differences between banking and insurance (4); no such differences exist (1); there are significant differences between banking and real estate (2); there are no such significant differences (1).

Question 7—Section 23A type restrictions should be imposed on bank subsidiaries (9); any such restriction should be left to the states and not be imposed by the FDIC (3); no such restrictions should be imposed (15); such restrictions are appropriate in some cases (3).

Question 8—A bank's investment in a subsidiary conducting such activities should be limited (14); should be limited in accordance with the activity (2); should not be limited (13); any such limitation should be left to the states (1).

Question 9—A bank's investment in a subsidiary that conducts such activities should be considered a part of the bank's regulatory capital (15); should not be included in the bank's regulatory capital (9); the decision to include or exclude the investment from the bank's capital should depend upon the activity involved (2).

Question 10—If the FDIC requires that an activity be conducted by a separate, adequately capitalized subsidiary, the FDIC should define what constitutes adequate capital (11); FDIC should not define adequate capital (16); should leave the definition to the states (1); should define adequate capital if the industry in question does not itself establish capital requirements (1).

Question 11—FDIC should impose a prior approval requirement before an insured bank can directly engage in any such activity or establish a subsidiary to do so (8); should not impose a prior approval requirement (22).

Question 12—Rather than an approval requirement, the FDIC should simply require notice (29); should not require prior notice (1).

Question 13—There should be no limitation on bank entry based upon bank size, camel rating, etc. (16); such a limitation is appropriate depending upon the bank's size and rating (5); depending upon size only (1); depending upon rating only (8).

Question 14—Entry into the activities in question should be considered a change in character of the bank (2); should not be considered a change in character of the bank (16).

Question 15—FDIC should consider the initiation of such activities as inconsistent with Federal deposit insurance (1); consistent with Federal deposit insurance (18).

Question 16—The existing antitrust laws are adequate to address any concerns arising from bank entry into such activities (17); are not adequate (2); bank entry into these areas should be limited to de novo entry (1); should not be limited to de novo entry (11).

In addition to the above, the FDIC received comments generally as follows: 20 comments against FDIC adopting any guidelines or regulations; 8 comments for action of FDIC's part; 7 comments indicating that the states rather than the FDIC should act; 9 comments urging the FDIC not to place any limitation on the ownership of an insured bank by a company engaged in any of the listed activities; 5 comments indicating that such a limitation should be imposed; 1 comment indicating that any such restriction should come from Congress and not FDIC. 25 comments urging FDIC to adopt a liberal stance that would permit banks to compete with nonbank firms and give banks added earning sources; and 10 comments totally opposed to bank entry into nonbanking activities. The Antitrust Division of the Department of Justice commented at length that there is little baisis for concern that bank entry into any of the areas under consideration will cause excessive concentration or increased anti-competitive tying. The comment further opined the existing antitrust laws are sufficient to prevent any particular entry from lessening competition.

Virtually none of the comments responded to the request for assistance in distinguishing between banking and commerce. Several comments urged, however, that FDIC act to maintain the separation between the two. Courier, leasing, and management consultant services were identified in the notice as examples of "other financially related services." No other services were identified by the comments as additional examples of financially related services. Courier services were favored by 3 comments; leasing by 2; management consulting by 3 comments, one of which indicated that guidelines might be advisable; and 1 comment opposed bank entry into management consulting. No comments were received

in response to the request for assistance in defining what constitutes the financial services industry, *i.e.*, "what standards should be used to differentiate between commercial banking, other financial services, and commerce in today's changing environment."

Comments Addressing Insurance Activities

The FDIC received a total of 29 comments that solely addressed whether insured banks should be permitted to directly or indirectly engage in insurance activities. The majority of those addressing this issue were insurance agents, insurance trade associations, or insurance companies. The comments in this group were overwhelmingly opposed to bank entry into insurance activities for the following reasons: Bank entry will lead to express and implicit tying arrangements, will give banks an unfair competitive advantage, will lead to economic concentration, will present regulatory conflicts, and will adversely affect banks as insurance activities are inherently risky. Although most of the comments in the overall group came from the insurance industry, some banks did express the same concerns. Other comments, however, supported bank participation in insurance activities. For example, several banks stated that they have engaged in insurance activities for a number of years and that these activities do not pose safety and soundness problems.

Comments Addressing Real Estate Activities

Relatively few comments were received that specifically addressed bank entry into real estate activities. The comments were for the most part opposed to bank entry into real estate underwriting or brokerage for the following reasons: Banks will have an unfair competitive advantage, bank entry will lead to economic concentration, banks will engage in unlawful tying arrangements, real estate activities can require sizable investments and profits are speculative, and bank entry into real estate underwriting or brokerage will necessarily lead to conflicts of interest that will harm consumers. Several comments indicated a concern that if banks are permitted to enter the real estate brokerage area they might use their mortgage portfolios as soliciting tools. The FDIC received several comments from banks indicating that they have engaged in real estate brokerage for a number of years without evidence of any tying abuse or safety and soundness problems.

Comments Addressing Electronic Data Processing Services

FDIC received one lengthy comment addressing banks providing electronic data processing service. The comment indicated that certain abuses might arise if a bank, its subsidiary, a bank holding company, or any of its subsidiaries offers EDP services. The following restrictions were suggested to address those potential abuses: (1) Prohibit banks from advising borrowers of the availability of EDP services from the bank or from an affiliate or subsidiary of the bank unless specific inquiry is made; (2) prohibit bank employees from receiving additional compensation if a customer utilizes the EDP services of the bank, its affiliate, or its subsidiary; (3) prohibit the bank from making its customer list available to the EDP subsidiary or affiliate; and (4) require the bank to price its EDP services on an explicit fee basis as well as structure the EDP department as an individual profit center.

Comments Addressing Travel Agency Activities

Very few comments were received that specifically addressed bank entry into the travel agency business. One comment did indicate that as of 1974, 24 states permitted banks to offer travel agency services. One comment opposed to bank entry into the travel agency business indicated that bank entry is not proper, will give banks an unfair competitive advantage, that existing antitrust laws are insufficient safeguards, and that regulatory conflicts could arise.

Discussion of Proposed Regulation

After fully considering the above, the FDIC has determined to propose a regulation that: (1) Prohibits any insured bank from directly engaging in the following: underwriting insurance (excluding credit life insurance); underwriting or developing real estate; engaging in reinsurance; insuring, guaranteeing or certifying title to real estate; guaranteeing or becoming surety upon the obligations of others; insuring the fidelity of others; or engaging in a surety business, (2) requires that any subsidiary of an insured bank that conducts any of the above activities be a bona fide subsidiary, (3) requires notice to FDIC of intent to invest in any such subsidiary, (4) places certain restrictions on the affiliation of an insured bank with a company that engages in any of the above activities, (5) places certain restrictions on extensions of credit and other transactions between insured banks and their subsidiaries or affiliates that engage in any of the above activities, (6) requires any insured bank that established or acquired a subsidiary or became affiliated with a company that engages in these activities prior to the effective date of the regulation to conform to the regulation within one year, (7) requires any insured bank that as of the effective date of the regulation is directly engaging in any of these activities to conform to the regulation within two years, (8) places certain restrictions on insured banks that provide EDP services to persons or companies other than banks, or act as agent or broker for insurance, real estate, securities, or travel services.

The requirements and restrictions of the proposed regulation are discussed more fully below. Specific comments are summarized where relevant to an explanation of the proposed regulation. In developing the proposal, the FDIC identified certain alternative approaches to several issues. Where this is the case, the alternatives are set forth along with a specific request for comment in regard thereto.

1. Activities Required To Be in Subsidiory

Section 332.3(a) of the proposed regulation prohibits an insured bank from conducting certain activities other than through a bona fide subsidiary. (The definition of bona fide subsidiary is discussed in paragraph #2 below.) The restricted activities are: (1) Underwriting casualty insurance, property insurance, life insurance (other than credit life insurance), annuity contracts, mortgage guarantee insurance, or any other type of insurance, (2) reinsurance, (3) real estate development, real estate syndication, real estate equity participation, or any other form of real estate underwriting, (4) insuring, guaranteeing, or certifying title to real estate, (5) with certain limited exceptions, guaranteeing or becoming surety upon the obligations of others, (6) insuring the fidelity of others, and (7) conducting a surety business. Insured banks are also specifically prohibited under § 332.3(b) of the proposed regulation from establishing or acquiring a subsidiary that engages in any of the above activities if to do so would contravene an outstanding order of the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Home Loan Bank Board or any agreement entered into between the insured bank and any such agency.

Insured nonmember banks are presently prohibited, with certain limited exceptions continued in the proposal, from directly exercising the last four powers listed above. See Part 332 of the FDIC's current regulations. The proposal would therefore extend to national and state member banks a regulatory provision to which insured nonmember banks are already subject. This aspect of the proposal would not substantively affect insured nonmember banks insofar as the restriction on directly engaging in such activities is concerned.

Section 332.3(b) of the proposal contains an exception from the bona fide subsidiary requirements of the regulation with respect to the conduct of any activity which has been specifically authorized for national banks under federal law. This exception would apply in situations where Congress has specifically authorized national banks to engage in certain activities by statute, as well as in situations where the Comptroller of the Currency, acting by regulation or interpretation under federal law, has specifically authorized national banks to conduct those activities.

For example, if Congress specifically authorizes national banks to conduct insurance underwriting (or any other activity described in §332.3(a) of the proposed regulation) either directly or in an operating subsidiary, an insured bank would not be prohibited under the regulation from conducting insurance underwriting in-house or in a subsidiary. Furthermore, any insurance underwriting subsidiary of an insured bank would not need to meet the criteria for a bona fide subsidiary. Additionally, as provided by § 332.9 of the proposal, an insured bank could acquire or establish an insurance underwriting subsidiary without giving the FDIC prior notice and the subsidiary would not be subject to the lending and other restrictions found in § 332.7. Finally, the insured bank's investment in the insurance underwriting subsidiary would not be excluded from the bank's capital.

State chartered insured banks and federal savings banks insured by the FDIC would still of course need to be authorized by their chartering authority to engage in the activity in order to take advantage of the exceptions in § 332.3(b) and §332.9. The FDIC has tentatively determined that these exceptions are appropriate inasmuch as Congress, or the Comptroller of the Currency acting by means of a lawful regulation or interpretation of federal law, must determine that the conduct of the activity in question is appropriate for national banks.

The proposed regulation does not prohibit an insured bank from guaranteeing or becoming surety upon the obligations of others as provided for in §347.3(c)(1) of FDIC's regulations pertaining to foreign banks nor does the prohibition extend to acceptances, endorsements, or letters of credit made or issued in the usual course of the banking business. Also exempted from the prohibition is guaranteeing or becoming surety as permitted by §§ 7.7010, 7.7012, 7.7015, and 7.7016 of the Comptroller of the Currency's regulations (12 CFR 7.7010, 7.7012, 7.7015, 7.7016). (On August 24, 1984 the FDIC proposed for comment an amendment to Part 332 of FDIC's regulations that would exempt check guaranty card programs from the prohibition on guaranteeing or becoming surety on the obligations of others (49 *FR* 33690). It is FDIC's intent to incorporate that exception in Part 332 as revised by this rulemaking should FDIC determine to go forward with that exception.)

Placement of insurance underwriting, real estate development, and reinsurance activities in a subsidiary or affiliate will: (1) Help to avoid regulatory overlap with existing law governing the insurance and real estate industries, (2) help insulate the insured bank from any potential risk, and (3) make examination of these activities easier inasmuch as the activities will be operationally separate from the insured bank (FDIC has the authority under section 10 of the Federal Deposit Insurance Act, 12 U.S.C. 1820(b), to examine the affairs of any affiliate or subsidiary of an insured bank to disclose fully the relations between the bank and its affiliate and subsidiary and the effect on such relations upon the insured bank).

In regard to protecting insured banks from risk, FDIC received comments from representatives of the insurance and real estate industries that, among other things, argued that insurance and real estate underwriting pose inherent risks to which banks should not be exposed. The FDIC also received comments, however, opining that the activities under review by the FDIC are not more risky than any traditional banking activity nor beyond the expertise of bankers, *i.e.*, banks that do commercial lending possess most of the skills necessary to engage in real estate equity investment and the risk assessment one undertakes in doing commercial lending is much the same as the risk assessment undertaken in the property and casualty insurance industries. In particular, the comment of the Antitrust Division of the United States Department of Justice stated that the activities are not substantially riskier than traditional banking activities. The comment went on to point out, however, that real estate and insurance underwriting are probably the riskiest of the activities dealt with by the notice. Nonetheless, indicated the Justice Department, bank safety and soundness could be protected by two methods: (1) Structural restrictions, and (2) limiting a bank's investment.

The FDIC is preliminarily of the opinion, after studying the available information, that insurance underwriting is not inherently unsafe and unsound in all instances. If the operation is properly managed by experienced personnel, underwriting can round out a bank's income producing services. The FDIC acknowledges that insurance underwriting is a capital and skill intensive industry that could pose substantive risks to safety and soundness and that certain types of insurance may require skills less likely to be currently possessed by bankers. The FDIC does not feel, however, that the presence of some risk warrants precluding insured banks from indirectly entering this area and taking advantage of expanded income sources. In sum, the agency believes that the risks can be adequately addressed by proper regulation and supervision.

The FDIC has preliminarily reached the same conclusion with respect to real estate underwriting and real estate development (the two terms are intended to be interchangeable). Real estate underwriting and development do present certain risks (real estate is not a liquid asset and the market is cyclical in nature). The activity would seem, however, to involve many of the same skills needed by banks for the successful conduct of real estate development financing. What is more, real estate activities can provide banks the opportunity for added income. Again, the risks can be adequately controlled or offset.

The FDIC invites comments on whether or not the terms real estate underwriting, real estate development, real estate equity participation, and real estate syndication should be defined and if so how. The FDIC is also interested in receiving comments addressing whether or not the list of activities required to be in a bona fide subsidiary should be expanded or, in the alternative, whether certain enumerated activities should be deleted entirely or deleted under certain circumstances.

2. Bona Fide Subsidiary

The proposed regulation defines the term "bona fide subsidiary" to mean a subsidiary of an insured bank that at a minimum: (1) Is adequately capitalized; (2) is physically separate and distinct in its operation from the operation of the bank, such physical separation being achieved at a minimum by separate offices clearly demarcated as belonging to the subsidiary, access to which is through a separate entrance from that used for the insured bank except that the bank's and subsidiary's offices may be accessed through a common outer lobby or common corridor; (3) does not share a common name or logo with the bank; (4) maintains separate accounting and other corporate records; (5) observes separate formalities such as separate board of directors' meetings; (6) maintains separate employees who are compensated by the subsidiary; (7) shares no common officers with the bank; (8) a majority of its board of directors is composed of persons who are neither directors nor officers of the bank; and (9) conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the bank and that investments recommended, offered or sold by the subsidiary are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are any undertakings on the part of the subsidiary otherwise undertakings or obligations of the bank.

It is FDIC's intent by so defining bona fide subsidiary to assure that any subsidiary of an insured bank that engages in underwriting, or other activities subject to the restrictions of § 332.3(a), is an independent, well-managed, financially viable corporate entity whose operation will not pose a threat to the bank and whose obligations and liabilities, as well as whose products or services offered to the public, will be perceived by the public to be its own and not those of the bank. The criteria necessary for a bona fide subsidiary are discussed more fully below.

(a) Adequate Capital

The presence of adequate capital is typically viewed as a central issue by a court when assessing whether or not a parent will be held liable for the obligations and acts of its subsidiary. Adequate capital is also very important from a safety and soundness point of view in the FDIC's perspective, as a parent bank is less likely to be harmed if the subsidiary has adequate capital. Adequate capital will enable the subsidiary to itself absorb losses as well as liabilities arising from its operation without having to look to its parent.

The FDIC has not proposed a definition of adequate capital but will look rather to industry standards. The insurance industry, for example, is highly regulated and has established capital requirements usually set by state statute. Although the real estate industry is for the most part unregulated in comparison with the insurance industry, industry standards should be identifiable. The FDIC still intends, however, to reserve the option of requiring that the subsidiary have capital over and above any such industry standard if the FDIC at any time finds such requirement to be warranted. It is the FDIC's intention to make this determination during the "notice" period (see § 332.5 of the proposal) and to inform the bank whether, in FDIC's opinion, the capital position of the subsidiary is adequate. It is the FDIC's belief that such a flexible approach will better serve the FDIC's supervisory interest of ensuring the safety and soundness of insured banks and that it will also avoid undue conflict with existing regulatory and supervisory systems governing the insurance and real estate industries. The adequacy of a subsidiary's capital will thereafter be reviewed on an ongoing basis as a part of the regulatory process.

(b) Physical Separation

The proposed regulation would permit an underwriting subsidiary of an insured bank to operate out of an office within a branch of an insured bank so long as the office is clearly demarcated as belonging to the subsidiary, and the subsidiary's office has a separate entrance from that used by the insured bank. The bank's and subsidiary's offices may be accessed, however, through a common outer lobby or common corridor. The FDIC will require that insured banks, when formulating plans to establish or acquire underwriting subsidiaries, to plan to locate their offices so as to allow for separate entrances. Any insured bank that presently has an underwriting subsidiary located within a branch of the bank would be required to establish a separate, clearly identified office for the subsidiary and make whatever changes are necessary to allow for a separate entrance from the bank except for a common outer lobby of common corridor.

(c) Common Name or Logo

The regulation as proposed would prohibit an insured bank and its underwriting or other subsidiary subject to the restrictions of the regulation from using a common name or logo. The FDIC is proposing this restriction as name identification is a factor used by the courts in deciding whether to pierce the corporate veil, is a factor in public identification of the subsidiary's operation with the parent bank, plays a role in any public misconception as to the insured status of investments made through the subsidiary, and plays a role in engendering an expectation that the bank is liable for the obligations of the subsidiary. Additionally, an insured bank may be reluctant to allow its subsidiary to fail if that subsidiary carries the bank's name.

The proposed regulation specifically indicates that the above restriction does not preclude a bank from advertising and/or otherwise disclosing the relationship between its subsidiary and itself. For example, bank X may advertise the real estate services of its real estate development subsidiary, Y company, and denote Y company as a subsidiary of bank X. In this way, a bank may still obtain some benefits of name recognition but the public confusion that may arise if the subsidiary uses a common name (especially if that subsidiary operates out of the bank's branch) is lessened.

(d) Separate Employee Requirement

The proposed regulation requires that the subsidiary maintain separate employees who are compensated by the subsidiary. The restriction does not, however, extend to the use by the subsidiary of bank employees to perform functions which do not directly involve customer contact such as accounting, data processing, and recordkeeping, so long as the bank and the subsidiary contract for such services on an arms-length basis. Although the FDIC acknowledges that a separate employee requirement can produce some additional costs to insured banks, the FDIC anticipates that the exception contained in the proposed regulation allowing bank employees to perform administrative, noncustomer contact type activities will reduce any inefficiency and added cost that might otherwise be produced by such a requirement. FDIC is proposing the separate employee requirement as it is felt that the use of separate employees in customer contact positions is an extremely important factor in maintaining the separate corporate identity of the subsidiary and the bank. The requirement is also expected to have the added benefit of encouraging

banks to hire experienced personnel to operate the subsidiary.

(e) Common Officer/Director Restriction

The proposed regulation requires that the subsidiary and insured bank share no common officers and that a majority of the board of directors of the subsidiary be composed of persons who are neither directors nor officers of the bank. These restrictions are being proposed in order to: (1) Ensure that the subsidiary operates independently from the parent bank, and (2) reduce the likelihood that the parent bank may be held accountable for the obligations and actions of its subsidiary. The FDIC anticipates that these restrictions will help to ensure that the subsidiary employs experienced managers, something essential to a well-managed insurance and/or real estate underwriting operation.

3. Investment in Subsidiary

The proposed regulation provides that no insured bank may establish or acquire a subsidiary that underwrites insurance (excluding credit life insurance), insures, guarantees, or certifies title to real estate, or engages in any form of real estate underwriting or development unless the bank's capital (exclusive of its direct investment in such subsidiary or subsidiaries) is adequate as defined by the FDIC for capital adequacy purposes and, furthermore, that an insured bank's direct investment in any such subsidiary will not be counted toward the bank's regulatory capital. The exclusion does not apply, however, in the case of a subsidiary that exclusively conducts activities specifically authorized to national banks by statute, regulation or interpretation either directly or in an operating subsidiary.

This provision also provides the FDIC with an enforcement tool to help safeguard the safety and soundness of the insured banks that enter into these activities through their subsidiaries. If, for example, the FDIC should determine after receiving notice under § 332.5 that an insured bank's capital is not adequate after making the necessary adjustments entailed by this paragraph, the bank could be subject to enforcement action if it were to proceed with the acquisition or establishment of the subsidiary. This restriction will serve to prevent institutions with marginal capital from taking on activities that could pose risks. It is FDIC's opinion that the automatic exclusion of the bank's investment in its subsidiary from the bank's capital will provide greater assurance that the bank and the subsidiary are independent, financially viable entities.

4. Filing of Notice

The proposal requires that an insured bank that intends to acquire or establish a subsidiary that engages in insurance underwriting (excluding credit life insurance), real estate underwriting, reinsurance, or insures, guarantees, or certifies title to real estate file notice of intent with the appropriate FDIC regional office at least 60 days prior to the consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The bank must also notify the FDIC regional office in writing within 10 days after the consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The 60-day notice requirement may be waived in FDIC's discretion where such notice is impracticable, for example, in the case of a purchase and assumption transaction or an emergency merger. The notice requirement does not apply in the case of a subsidiary that exclusively conducts activities specifically authorized to national banks by statute, regulation, or interpretation either directly or in an operating subsidiary.

The proposal does not specify the content of the written notice of intent. By not specifying the content of the notice, the FDIC is permitting a bank to satisfy the notice requirement in any way it finds most convenient. It is the FDIC's intent to use the notice as a point of reference and for the regional office to contact the insured bank seeking further information if the bank's condition or other facts warrant a closer review. The proposal thus requires that the notice be received in the regional office at least 60 days prior to the acquisition or commencement of operation, whichever is earlier. Although the notice requirement is not an approval process, the FDIC would not be precluded from intervening in the intended acquisition or establishment of the subsidiary if such intervention was warranted, for example, if the subsidiary would not appear to meet the requirements for a bona fide subsidiary or any details of the planned transaction (such as the source of funding for the establishment or acquisition of the subsidiary) present any supervisory concerns.

The proposed regulation does not require a written notice when a bank becomes affiliated with a company that engages in any of the activities identified in § 332.3(a). (Insured bank affiliation with such companies is covered by § 332.6 of the proposal and is discussed in paragraph #5 below.) For the most part, affiliation with a company engaging in the activities here under consideration will arise out of a change in bank control or come to FDIC's attention when a bank seeks deposit insurance. As the FDIC will become aware of the affiliation prior to consummation in both instances, there is no need to create an additional notice requirement.

5. Affiliation With Insurance Underwriter, Real Estate Underwriter, or Title Company

The proposed regulation prohibits an insured bank from becoming affiliated with any company that: (1) Underwrites casualty insurance, property insurance, life insurance (excluding credit life insurance), annuity contracts, mortgage guarantee insurance, or any other type of insurance, (2) engages in reinsurance, (3) engages in real estate development, real estate syndication, real estate equity participation, or any other form of real estate underwriting, or (4) insures, guarantees, or certifies title to real estate unless: (A) The affiliate is physically separate and distinct in its operation from the operation of the bank, such physical separation being achieved at a minimum by separate offices clearly demarcated as belonging to the affiliate, access to which is through a separate entrance from that used for the insured bank except that the bank's and affiliate's offices may be accessed through a common outer lobby or common corridor; (B) the bank and affiliate share no common officers; (C) a majority of the board of directors of the bank is composed of persons who are neither officers nor directors of the affiliate; (D) any employee of the affiliate who is also an employee of the bank does not conduct activities on behalf of the affiliate on the premises of the bank that involve customer contract; (E) the bank and affiliate do not share a common name or logo; and (F) the affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank and that investments recommended, offered, or sold by the affiliate are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are any undertakings on the part of the affiliate otherwise undertakings or obligations of the bank.

The restrictions of this provision of the proposal are substantially the same as those that pertain to the qualifications for a bona fide subsidiary.

Again, the purpose of the FDIC in proposing these restrictions is: (1) To protect the safety and soundness of insured banks by requiring that the bank be operated independently and in a manner consistent with safe and sound banking practice, and (2) to protect the deposit insurance fund by avoiding claims against the bank arising out of the public's misconception as to the entity with which it is dealing. In view of the FDIC's overall goal to protect the deposit insurance system, the FDIC does not feel that the proposed restrictions are overly burdensome. The FDIC also does not feel that the restrictions will: (1) Interfere with the internal operations of bank affiliates, (2) disadvantage insured banks affiliated with insurance and real estate companies, or (3) deprive such banks of the good will of their affiliate's name. In the latter regard, the proposed regulation specifically indicates that the insured bank is not prohibited from advertising or otherwise disclosing its relationship to the affiliate. (For a detailed discussion of these restrictions see paragraph No. 2 above discussing the definition of bona fide subsidiary.)

6. Lending Restrictions

Section 332.7 of the proposed regulation sets forth several restrictions on the extent to which, and the manner in which, an insured bank may deal with its subsidiary or affiliate that engages in insurance underwriting (excluding credit life insurance), real estate underwriting, reinsurance, or insures, guarantees, or certifies title to real estate. If the subsidiary exclusively conducts activities that are specifically authorized to national banks by statute, regulation, or interpretation either directly or in an operating subsidiary, the restrictions of § 332.7 are inapplicable. Those restrictions are: (1) Any extension of credit by an insured bank to such subsidiary or affiliate may not exceed the amount limitations, and must be in accordance with the restrictions as to collateral, etc., imposed on "covered transactions" by section 23A of the Federal Reserve Act (12 U.S.C. 371c), (2) any extention of credit by an insured bank where the purpose of the extension of credit is to acquire any interest in any real estate underwritten by the bank's subsidiary or affiliate must be on terms and conditions consistent with safe and sound banking practice, (3) the aggregate of any such purpose loans shall not exceed 10 percent of the insured bank's capital, and (4) any extension of credit by an insured bank to any real estate development in which the bank's subsidiary or affiliate has an equity interest shall not exceed the limits to any one borrower established by 12 U.S.C. 84.

The above proposed restrictions are designed to address concerns that the FDIC has with respect to abuse of an insured bank's credit facilities. The requirement that an insured bank may not make loans for the purpose of acquiring any interest in real estate underwritten by the bank's subsidiary or affiliate unless the loans are on terms and conditions consistent with safe and sound banking practice is designed to prevent a bank from making imprudent loans so as to enable the bank's subsidiary or affiliate to sell real estate it has been unable to market. This prudential restriction on purpose lending is supplemented under the proposal with a companion restriction that the bank's aggregate extensions of credit for the purpose of acquiring an interest in real estate underwritten by the bank's subsidiary or affiliate may not exceed 10 percent of the bank's capital. Lastly, the requirement that extensions of credit by the bank to any real estate development in which the bank's subsidiary or affiliate has an equity interest may not exceed the limit on loans to any one borrower established by 12 U.S.C. 84 (basically, with certain exceptions, 15 percent of a bank's unimpaired capital and surplus) is designed to prevent a bank from making excessive and/or imprudent loans to a real estate venture in which its subsidiary or affiliate has an equity interest in an effort to protect the subsidiary's or affiliate's investment position. Taken together, these restrictions are designed to prevent abuses while at the same time allowing purpose lending and other direct and indirect financing of real estate activities.

The FDIC considered entirely prohibiting purpose lending on the part of insured banks that have real estate underwriting subsidiaries or affiliates. That approach was preliminarily rejected, however, out of concern that a flat prohibition on such lending could unduly restrict mortgage and other real estate financing. While the Federal regulatory authorities have the ability to correct unsafe and unsound banking practices through use of administrative actions and insured banks are expected to observe safe and sound lending practices, the proposed restrictions will make supervision of lending practices and enforcement of safe and sound banking practices easier from FDIC's standpoint.

The proposal makes extensions of credit from insured banks to their subsidiaries and affiliates that underwrite insurance or real estate, engage in reinsurance, or insure, guarantee, or certify title to real estate subject to the same amount limitations and other restrictions applicable to "covered transactions" under section 23A of the Federal Reserve Act, *e.g.*, extensions of credit to any one subsidiary may not exceed 10 percent of the bank's capital stock and surplus. As section 23A of the Federal Reserve Act does not treat subsidiaries of banks as affiliates, transactions between banks and their subsidiaries are not subject to the restrictions contained therein. The FDIC is proposing to extend those restrictions to such transactions where the subsidiary engages in the listed activities inasmuch as the FDIC feels that the potential risk to bank safety and soundness warrants such action. As section 23A of the Federal Reserve Act already covers extensions of credit to affiliates, the reference to affiliates in § 332.7(a) will not create any additional requirements with reference to affiliates.

Inasmuch as section 23A of the Federal Reserve Act treats extensions of credit by a bank's subsidiary to an affiliate of the bank (*e.g.*, an extension of credit by an insurance underwriting subsidiary of a bank to a real estate development subsidiary of the bank's parent) as covered transactions, the FDIC has not proposed any prudential restrictions on transactions between a bank's subsidiary and its sister affiliates. Section 23A does not appear, however, to cover transactions between two or more subsidiaries of an insured bank. FDIC is therefore specifically requesting comment on the need, if any, to impose restrictions on transactions between insurance and real estate and perhaps other types of subsidiaries of insured banks in order to protect bank safety and soundness, prevent conflicts of interest, and/or address other concerns. The FDIC is also specifically requesting comment on whether or not, in view of any state and/or federal statutes on loans to any one borrower, there is a need to limit extensions of credit, as proposed, to any real estate development in which the bank's subsidiary or affiliate has an equity interest.

The FDIC received several comments describing the mortgage insurance industry and the title insurance industry which set forth concerns regarding potential adverse consequences that can result from bank entry into these areas through subsidiaries or affiliates. With regard to the mortgage insurance industry it was stated that there is a risk that (1) a bank may purchase or refinance problem loans insured by its mortgage insurance subsidiary or

affiliate in order to help its subsidiary or affiliate over financial difficulties, and (2) if the subsidiary or affiliate is the principal insurer of the bank's mortgage portfolio and that of the bank's correspondents, the failure of the subsidiary or affiliate could have an extremely adverse affect on the bank. (The losses against which a mortgage insurer insures typically occur when lenders are incurring their greatest losses on loans.) A comment addressing title insurance raised the same issues characterizing the concerns as follows. If a bank places its title insurance business with a "captive" insurer, the financial risk of title related problems has not been shifted to a third party outside of the financial family. If the insurer fails, the bank could suffer extremely adverse affects.

In view of the above comments, the FDIC is requesting comment on whether or not it should entertain adopting one or more of the following restrictions: (1) A prohibition on a bank purchasing or refinancing loans insured by its mortgage insurance subsidiary or affiliate, (2) allow such transactions but only if the transactions are consistent with safe and sound banking practices, (3) place a limit on the amount of a bank's mortgage portfolio that may be insured by the bank's mortgage insurance or title insurance subsidiary or affiliate, and/or (4) prohibit a bank from insuring *any* of its mortgage portfolio with its mortgage insurance subsidiary or affiliate.

In the same vein, FDIC invites comments on whether or not the agency should adopt a prohibition on a bank utilizing the insurance coverage of its subsidiary or affiliate to assure repayment of an outstanding balance on an extension of credit in the event of loss or damage to any property used as collateral. In the alternative, should FDIC limit the percentage of the bank's overall extensions of credit that may have collateral insured by the bank's subsidiary or affiliate? Lastly, FDIC is interested in receiving comments on to what extent, if any, certain potential lending abuses of the sort discussed above may arise when an insured bank has an insurance underwriting subsidiary.

7. Trust Department Restrictions

Proposed § 332.7(e) prohibits an insured bank that has a subsidiary or affiliate that underwrites any type of insurance (excluding credit life insurance), engages in reinsurance, engages in real estate underwriting or development, or insures, guarantees, or certifies title to real estate from purchasing as fiduciary co-fiduciary, or managing agent on behalf of any account for which the bank has investment discretion any product, service, or property underwritten, sold, marketed, or provided by the bank's subsidiary or affiliate unless one of three conditions is satisfied. Those conditions are: (1) The purchase is expressly authorized by the managing agency agreement, the trust instrument, court order or local law, or specific authority for the purchase is obtained from all interested parties after full disclosure; (2) the purchase, although not expressly authorized under item (1), is otherwise consistent with the bank's common law fiduciary obligation; or (3) the purchase is permissible under applicable state and federal law or regulation. Again, these restrictions do not apply in the case of a subsidiary conducting activities specifically authorized to national banks.

The FDIC intends by this provision to ensure against abuses that can arise in the administration of trust and other accounts over which the bank has investment discretion. The provision is for the most part simply a restatement of a bank's common law fiduciary obligation to refrain from dealing with itself in the administration of a trust. The provision has been styled as proposed (in the alternative) in order to take into account, for example, federal law governing employee benefit and pension plans that would permit, in certain instances, transactions involving such funds and affiliates of their trustees. An insured bank would still be subject to any applicable stricter federal or state statutory or regulatory requirement. For example, if a particular transaction is specifically prohibited under state law, a bank could not rely on § 332.7(e) as authority to enter into the transaction.

8. Tying

A common thread to many of the comments addressing bank entry into real estate and insurance is that such entry will lead to implicit and explicit tie-ins. In response to that concern, the proposal prohibits a bank that has a subsidiary or affiliate that engages in insurance underwriting (excluding credit life insurance), real estate underwriting, reinsurance, or insures guarantees, or certifies title to real estate from directly or indirectly conditioning any extension of credit on the requirement that the borrower purchase any property, product, or service underwritten, sold, marketed, or provided by the bank's subsidiary or affiliate. A bank that is part of a holding company system is currently subject to antitying prohibitions under the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972). As to these banks, the prohibition found in § 332.7(d) of the proposal does not represent a substantive change. Banks that are not in holding company systems and nonbank banks are not covered by 12 U.S.C. 1972. Subsection 332.7(d) will, therefore, make such a provision applicable as to these banks. This restriction does not apply in the case of a subsidiary conducting activities authorized to national banks.

In addition to soliciting comment on the above antitying provision, FDIC is seeking comment on whether or not it should adopt a specific disclosure requirement that affirmatively requires that banks provide written disclosures to their customers indicating that (1) bank customers are not obligated to utilize the services of, or purchase any product or real estate sold by, the bank's susidiary or affiliate in order to obtain credit, and (2) that whether or not the customer does or does not deal with the bank's subsidiary or affiliate will not affect the bank's decision to extend credit.

9. Insured Bank, Bank Subsidiary or Affiliate—Provider of EDP Services, Agent or Broker for Insurance, Real Estate, Securities, or Travel Services

Section §332.8 focuses on instances in which a bank is authorized by state or federal statute or regulation to directly or indirectly: (1) Provide EDP services to persons or companies other than banks, (2) provide travel agency services, or (3) act as agent or broker in connection with the purchase or sale of securities, insurance (including credit life insurance) or real estate. Paragraph (a) of § 332.8 indicates that where a bank, or any of its directors, officers, or employees, is so authorized to provide any of these services, the bank shall not exercise such authority unless certain restrictions are observed. Those restrictions are as follows: (1) Any bank director, officer, or employee who acts as agent or broker in connection with the purchase or sale of securities, insurance (including credit life insurance) or real estate, or who acts as agent to provide travel services, is licensed in accordance with applicable state or federal law or regulation and has met any applicable state or federal training, education, or other requirement; (2) the bank, its directors, officers, and employees, when providing any of these services, conduct business so as to make bank customers fully aware (i) of the capacity in which the bank, its directors, officers and emplyees are acting and (ii) that the

customers are not required, or otherwise obligated, to purchase any product, policy, property, security, or service provided by the bank in order to obtain credit; and (3) and director, officer, or emplyee who acts as agent or broker in connection with the purchase or sale of insurance, real estate, or securities, who acts as agent to provide travel services, or who solicits EDP customers and who is compensated on a commission basis remits the commission to the bank. A fourth restriction requires that any loans made by the bank for the purpose of acquiring real estate or securities where the bank or any of its directors, officers, or employees acted as agent or broker in connection with the purchase or sale be on terms and conditions that are consistent with safe and sound banking practice.

The FDIC has not proposed a requirement that the above activities be placed in a subsidiary of the bank inasmuch as it is FDIC'a opinion that such selling activities do not pose safety and soundness problems of the types present with insurance underwriting and real estate development. The FDIC is, however, proposing the above restrictions in order to: (1) Address the antitying concerns which were raised by a number of comments, (2) prevent imprudent loans from being made in connection with a bank's real estate or securities brokerage operations, (3) ensure that bank directors, officers, or employees that conduct any of the referenced activities are properly trained and meet all applicable education requirements, and (4) protect against conflicts of interest and tying abuses that can arise when individuals who provide these services are compensated on a commission basis. The FDIC specifically invites comments on the appropriateness of the proposed restrictions and is also interested in receiving comment on whether or not additional requirements should be imposed. For example, should the regulation address leasing arrangements whereby insurance companies, etc. lease space in bank branches?

Paragraph (b) of § 332.8 pertains to instances where an affiliate or subsidiary of an insured bank provides travel services, EDP services, acts as agent in connection with the purchase or sale or real estate or securities, or acts as agent for the sale of insurance. The provision provides that an insured bank having such an affiliate or subsidiary shall not: (1) Directly or indirectly condition any extension of credit upon the requirement that the borrower utilize any service provided by, or purchase any policy, product, security, or real estate sold by, the bank's subsidiary or affiliate, and (2) make any extension of credit for the purpose of acquiring any interest in any real estate or for the purpose of acquiring any security where the bank's subsidiary or affiliate acted as agent or broker in connection with the transaction unless the terms and conditions of the extension of credit are consistent with safe and sound banking practice. As in the case of paragraph (a) of § 332.8, these restrictions are designed to prevent tying abuses and prevent imprudent loans from being made in connection with the subsidiary's or affiliate's real estate or securities brokerage operation.

10. Definition of "Affiliate", "Subsidiary", "Extension of Credit" and "Company"

The proposed regulation defines the term "affiliate" to mean a company that directly or indirectly controls an insured bank or is under common control with an insured bank. "Control" is defined as the power to directly or indirectly vote 25% of a bank's or company's stock, the ability to control the election of a majority of a bank's or company's directors or trustees, or the ability to exercise a controlling influence over the management and policies of a bank or company. At a minimum, the proposed regulation treats as affiliates of an insured bank the bank's parent company, a company that control 25% or more of the bank's stock, and companies controlled by either of the above.

The term "subsidiary" is defined in the proposed regulation to mean a company directly or indirectly controlled by a bank. As "company" is defined in the proposed regulation to include corporations other than banks, partnerships, business trusts, associations, joint ventures, pool syndicates or other similar business organizations, a business entity operated by several insured banks in a co-operative effort may be considered a subsidiary of each of the banks.

The term "extension of credit" as defined in the proposed regulation has generally the same meaning as found in Federal Reserve Board Regulation O (12 CFR 215.3) which concerns insider transactions. The term as defined herein, however, covers purchases "whether or not under repurchase agreement" of securities, other assets, or operations. The "whether or not" language is included in the proposed regulation in an attempt to control the extent to which a bank may indirectly direct funds into a subsidiary by means of purchasing securities and other assets from the subsidiary. The term also differs from that used in Regulation O in that a "draw" upon a line of credit is an extension of credit whereas a "grant" of a line of credit is not.

11. Scope of Regulation

If adopted, the proposed regulation would apply to all insured banks including national banks, state banks that are members of the Federal Reserve System, insured branches of foreign banks, and federal savings banks that are insured by the FDIC. FDIC is specifically interested in receiving comment from all insured banks regarding the extent to which, if any, the proposed regulation will conflict with, or duplicate, statutory or regulatory restrictions to which insured banks are already subject.

12. Compliance

The proposed regulation establishes a one-year time period in which insured banks that, prior to the effective date of the regulation, established or acquired a subsidiary or became affiliated with a company that engages in insurance underwriting (excluding credit life insurance), real estate underwriting, reinsurance, or insuring, guaranteeing, or certifying title to real estate must bring themselves into compliance with Part 332. Such banks must, however, comply with § 332.6 with respect to affiliations within 180 days of the effective date of the regulation and § 332.7 with respect to lending and other restrictions within 90 days. In addition, any such subsidiary must conform to the requirements for a bona fide subsidiary as set out in § 332.2(b) with 180 days from the effective date of the regulation.

Any insured bank that as of the effective date of the regulation is directly engaging in any of the activities required by § 332.3 to be placed in a subsidiary is given a two-year period in which to comply with Part 332 (*i.e.*, move the restricted operation into a bona fide subsidiary). Such banks, however, must comply with the lending and other restrictions of § 332.7 within 90 days.

Any insured bank (including its officers, directors, or employees) that as of the effective date of the regulation was (1) providing EDP services, (2) acting, or whose officers, directors, or employees were acting, as agent to provide travel services, real estate brokerage services, or insurance brokerage services, or (3) affiliated with, or had a subsidiary that, provided such services, shall have 90 days from the effective date of the regulation to come into compliance with the regulation.

The proposed regulation also establishes a requirement that insured

banks that, prior to the effective date of the regulation, established or acquired or became affiliated with any company that underwrites insurance or real estate, engages in reinsurance, or insures, guarantees, or certifies title to real estate, notify the regional director of the appropriate FDIC regional office not later than 30 days from the effective date of the regulation that the bank is so affiliated or has a subsidiary that engages in the referenced activities. The FDIC has not proposed a similar requirement that insured banks which as of the effective date of the regulation are directly engaging in any of the restricted activities notify the FDIC within 30 days that the bank is so engaging and that it will comply with the regulation within the directed time period. The FDIC invites comments on whether or not such a notice requirement should be adopted.

The FDIC also specifically directs comment to the propriety of the phase-out provision as proposed. Is immediate compliance more appropriate than a phase-out provision in view of the FDIC's stance that the restricted activities may pose a safety or soundness problem? If a phase-out provision is adopted, should the time periods as proposed be longer or shorter? Is it proper to draw a distinction in the phase-out period between banks that were directly engaging in an activity as of the effective date of the regulation and banks which established or acquired subsidiaries or became affiliated with companies that engaged in the relevant activities prior to the effective date of the regulation?

Lastly, the proposed regulation indicates that any insured bank that as of the effective date of the regulation was acting as, or whose directors, officers, or employees were acting as, broker or agent in connection with the purchase or sale of securities, insurance (including credit line insurance), or real estate, or as of that date had a subsidiary or affiliate that was acting as agent or broker in connection with the sale or purchase of securities, insurance (including credit life insurance), or real estate, shall comply with Part 332 within 90 days. Additionally, insured banks that as of the effective date of the regulation were providing EDP services to persons or companies other than banks or that had a subsidiary or affiliate that was so providing EDP services, and any insured bank that as of that date was acting, or whose directors, officers, or employees were acting, as agent to provide travel services, shall comply with Part 332 within 90 days. FDIC is interested in receiving comments on what burdens, if any, would be associated with these requirements.

13. Paperwork Reduction Act

The notice requirements contained in the proposed regulation do not constitute "collections of information" for purposes of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) and therefore are not subject to the Office of Management and Budget ("OMB") clearance provisions of that Act. This is because the notice requirements fall within the exception to the definition of "information" set out in § 1320.7(k)(1) of OMB regulations implementing the "collection of information clearance" provisions of the Act (5 CFR 1320). It is recognized, however, that the notice requirements do place an affirmative obligation on an insured bank to notify the FDIC of its intended action, to confirm whether or not the subsidiary was acquired or established, and to notify FDIC if the bank has a subsidiary that engages in restricted activities or is affiliated with a company that engages in restricted activities. Any costs associated with these notices would appear, however, to be minimal. The proposed regulation does not specify the content of the written notices nor does it require insured banks to provide FDIC with any specific information.

14. Regulatory Flexibility Act Analysis

In accordance with the FDIC's policy statement entitled "Development and Review of FDIC Rules and Regulations" and the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the FDIC conducted an analysis of the proposed regulation. The results of that analysis follow.

The proposed regulation would prohibit, with certain exceptions, an insured bank from conducting insurance or real estate underwriting activities unless such activities were conducted in a bona fide subsidiary of the bank. There are several benefits to such a restriction. By separating these activities from the bank, there will be less regulatory overlap and it will be easier for the various regulatory agencies to monitor the conditions of the institutions for which they are responsible. Moreover, by providing some insulation between the bank and its real estate and insurance underwriting activities, the safety of the bank is less likely to be threatened should its real estate or insurance subsidiaries encounter financial difficulty.

The provisions which require independent capitalization, limit intercompany dealing, and prohibit insured banks from becoming affiliated with companies engaging in insurance or real estate underwriting activities unless the affiliate is physically separate from the bank and has a separate name and logo are consistent with the desire to limit the overall exposure of the banking organization by maintaining some separation between an insured institution's banking and nonbanking activities. These restrictions will not impose substantial costs on insured banks and will make it less likely that financial problems encountered by an affiliate will result in problems for the bank itself. The absence of an investment cap in the insured bank's subsidaries will enable even relatively small insured banks to compete in these markets. The exclusion of the bank's investment in its subsidiary does not eliminate any of the potential benefits that will result from increased competition in these markets. It does, however, encourage asset diversification by ensuring that insured banks do not become overexposed to cyclical declines in any of these types of activities. Based on the above, the Board of Directors hereby certifies that the proposed rule, if promulgated, will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 332

Banks, Banking, Federal Deposit Insurance Corporation, Foreign banks, Banking, State nonmember bank.

In consideration of the foregoing, the FDIC is proposing to revise Part 332 of title 12 *Code of Federal Regulations* as follows:

PART 332—POWERS INCONSISTENT WITH PURPOSES OF FEDERAL DEPOSIT INSURANCE LAW

Sec.

332.1 Purpose and scope.
332.2 Definitions.
332.3 Activities required to be in subsidiary.
332.4 Investment in subsidiary.
332.5 Filing notice of intent.
332.6 Affiliation with insurance underwriter, real estate underwriter, or title company.
332.7 Restrictions: Subsidiary or affiliate underwriters insurance, underwrites real estate, or insures guarantees or certifies title to real estate.
332.8 Restrictions: Insured bank, its subsidiary or affiliate-provider of EDP services, broker or agent for insurance, real estate, securities, or travel services.
332.9 Exemption for certain subsidiaries.
332.10 Compliance.

Authority: Sec. 6, 64 Stat. 876, 12 U.S.C. 1816; sec. 8(a), sec. 2[8(a)] of the Act of September 21, 1950 (Pub. L. 797; 64 Stat 879), effective September 21, 1950, as amended by sec. 204 of title II of the Act of October 16,

1966 (Pub. L. 89-695; 80 Stat. 1054), effective October 16, 1966; sec. 6(c)(14) of the Act of September 17, 1978 (Pub. L. 95-369; 92 Stat. 618), effective September 17, 1978; and sec. 113(g) of title I of the Act of October 15, 1982 (Pub. L. 97-320; Stat. 1473 and 1474), effective October 15, 1982; 12 U.S.C. 1818(a); sec. 8(b), sec. 2[8(b)] of the Act of September 21, 1950 (Pub. L. 797), as added by sec. 202 of title II of the Act of October 16, 1966 (Pub. L. 89-695; 80 Stat. 1046), as amended by sec. 110 of title I of the Act of October 28, 1974 (Pub. L. 93-395; 88 Stat. 1506); sec. 11 of the Act of September 17, 1978 (Pub. L. 95-369; 92 Stat. 624); secs. 107(a)(1) and 107(b) of title I of the Act of November 10, 1978 (Pub. L. 95-630; 92 Stat. 3649 and 3653); and secs. 404(c), 425(b), and 425(c) of title IV of the Act of October 15, 1982 (Pub. L. 97-320; 96 Stat. 1512 and 1524); 12 U.S.C. 1818(b); sec. 9, 64 Stat. 881-882, 12 U.S.C. 1819; sec. 11(a), sec. 2[11(a)] of the Act of September 21, 1950 (Pub. L. 797; 64 Stat. 884), effective September 21, 1950, as amended by sec. 301(c) of title III of the Act of October 16, 1966 (Pub. L. 89-695; 80 Stat. 1055), effective October 16, 1966; sec. 7(a)(3) of title I of the Act of December 23, 1969 (Pub. L. 91-151; 83 Stat. 375), effective December 23, 1969; secs. 101(a)(3) and 102(a)(3) of title I of the Act of October 28, 1974 (Pub. L. 93-495; 88 Stat. 1500 and 1502), effective November 27, 1974; sec. 1401(a) of title XIV of the Act of November 10, 1978 (Pub. L. 95-630; 92 Stat. 3712), effective March 10, 1979; sec. 323 of title III of the Act of December 21, 1979 (Pub. L. 96-153; 93 Stat. 1120); sec. 308 of title III of the Act of March 31, 1980 (Pub. L. 96-221; 94 Stat. 147), effective March 31, 1980; and sec. 103 of title I of the Act of December 26, 1981 (Pub. L. 97-110; 95 Stat. 1514), effective December 26, 1981; sec. 11(f), sec. 2[11(f)] of the Act of September 21, 1950 (Pub. L. 797; 64 Stat. 885), effective September 21, 1950, as amended by sec. 6(c)(20) of the Act of September 17, 1978 (Pub. L. 95-369; 92 Stat. 619), effective September 17, 1978, 12 U.S.C. 1821(f); sec. 18(j)(2); 92 Stat. 3664, 12 U.S.C. 1828(j)(2), sec. 422, 96 Stat. 1489, (Pub. L. 97-320).

§ 332.1 Purpose and scope.

The provisions of this part apply to all insured banks including state chartered banks that are members of the Federal Reserve System, national banks, insured branches of foreign banks, and Federal savings banks that are insured by FDIC. The purpose of this part is to assure the safe and sound operation of insured banks, prohibit activities that are inconsistent with the purposes of Federal deposit insurance, and prevent conflicts of interests.

§ 332.2 Definitions.

For the purposes of this part, the following definitions apply.

(a) "Affiliate" shall mean any company that directly or indirectly controls or is under common control with an insured bank.

(b) "Bona fide subsidiary" means a subsidiary of an insured bank that at a minimum: (1) Is adequately capitalized; (2) is physically separate and distinct in its operation from the operation of the bank such physical separation being achieved at a minimum by separate offices clearly demarcated as belonging to the subsidiary, access to which is through a separate entrance from that used for the insured bank, except that the bank's and subsidiary's offices may be accessed through a common outer lobby or common corridor; (3) does not share a common name or logo with the bank; [1] (4) maintains separate accounting and other corporate records; (5) observes separate formalities such as separate board of directors' meetings; (6) maintains separate employees who are compensated by the subsidiary; [2] (7) shares no common officers with the bank; (8) a majority of its board of directors is composed of persons who are neither directors nor officers of the bank; and (9) conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the bank and that investments recommended, offered or sold by the subsidiary are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are any undertakings on the part of the subsidiary otherwise undertakings or obligations of the bank.

(c) "Company" shall mean any corporation (other than a bank), any partnership, business trust, association, joint venture, pool syndicate, or other similar business organization.

(d) "Control" shall mean the power to directly or indirectly vote 25 per centum or more of the voting stock of a bank or company, the ability to control in any manner the election of a majority of a bank's or company's directors or trustees, or the ability to exercise a controlling influence over the management and policies of a bank or company.

(e) "Extension of credit" shall mean the making or renewal of any loan, a draw upon a line of credit, or an extending of credit in any manner whatsoever and includes, but is not limited to:

(1) A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;

(2) An advance by means of an overdraft, cash item or otherwise;

(3) Issuance of a standby letter of credit (or other similar arrangement regardless of same or description);

(4) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;

(5) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;

(6) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (A) accrued interest or (B) taxes, insurance, or other expenses incidental to the existing indebtedness; or

(7) Any other transaction as a result of which a natural person or company becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

(f) "Subsidiary" shall mean any company directly or indirectly controlled by an insured bank.

§ 332.3 Activities required to be in subsidiary.

(a) No insured bank may conduct any of the following activities other than through a bona fide subsidiary of the bank: (1) Underwriting casualty insurance, property insurance, life insurance (excluding credit life insurance), annuity contracts, mortgage guarantee insurance, or any other type of insurance; (2) reinsurance; (3) real estate development, real estate syndication, real estate equity participation, or any other form of real estate underwriting; (4) insuring, guaranteeing or certifying title to real estate; (5) guaranteeing or becoming surety upon the obligations of others,[3] or

[1] This requirement shall not prohibit the subsidiary from advertising or otherwise disclosing its relationship to the insured bank.

[2] This requirement shall not be construed to prohibit the use by the subsidiary of bank employees to perform functions which do not directly involve customer contact such as accounting, data processing and recordkeeping, so long as the bank and the subsidiary contract for such services on terms and conditions comparable to those agreed to by independent entities.

[3] An insured bank is not proscribed from guaranteeing or becoming surety upon the obligations of others as provided in § 347.3(c)(1) nor does this proscription extend to acceptances, endorsements, or letters of credit made or issued in the usual course of the banking business nor to guaranteeing or becoming surety as permitted by §§ 7.7010, 7.7012, 7.7015, 7.7016 of the Comptroller of the Currency's regulations (12 CFR 7.7010, 7.7012, 7.7015, 7.7016).

insuring the fidelity of others; or (6) a surety business.

(b) Notwithstanding the foregoing, (1) no insured bank may establish or acquire a subsidiary that engages to any extent in the above activities if to do so would contravene any outstanding order of the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Home Loan Bank Board or any agreement entered into by the insured bank and any such agency; and (2) § 332.3(a) shall not require any insured bank to establish or acquire a bona fide subsidiary in order to conduct any activity described therein that national banks are specifically authorized by statute, regulation, or interpretation to conduct either directly or in an operating subsidiary.

§ 332.4 Investment in subsidiary.

(a) No insured bank may establish or acquire a subsidiary that underwrites insurance (excluding credit life insurance), insures, guarantees, or certifies title to real estate, engages in any form of real estate underwriting, or engages in reinsurance unless the bank's capital (exclusive of its direct investment in such subsidiary) is adequate as defined by FDIC for capital adequacy purposes.

(b) An insured bank's direct investment in such subsidiary will not be counted toward the bank's capital.

§ 332.5 Filing notice of intent.

Any insured bank that intends to acquire or establish a subsidiary that (a) underwrites casualty insurance, life insurance (excluding credit life insurance), annuity contracts, mortgage guarantee insurance, or any other type of insurance; (b) engages in reinsurance; (c) engages in real estate development, real estate syndication, real estate equity participation, or any other form of real estate underwriting; or (d) insures, guarantees, or certifies title to real estate, shall notify the regional director of the FDIC region in which the bank is located of such intent. Notice shall be in writing and must be received in the regional office at least 60 days prior to the consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The bank shall also notify the FDIC regional office in writing within 10 days after the consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The 60-day notice requirement may be waived in FDIC's discretion where such notice is impracticable, *e.g.*, in the case of a purchase and assumption transaction or an emergency merger.

§ 332.6 Affiliation with insurance underwriter, real estate underwriter, or title company.

An insured bank is prohibited from becoming affiliated with any company that (a) underwrites casualty insurance, property insurance, life insurance (excluding credit life insurance), annuity contracts, mortgage guarantee insurance, or any other type of insurance, (b) engages in reinsurance, (c) engages in real estate development, real estate syndication, real estate equity participation, or any other form of real estate underwriting, or (d) insures, guarantees, or certifies title to real estate, unless: (1) The affiliate is physically separate and distinct in its operation from the operation of the bank, such physical separation being achieved at a minimum by separate officials clearly demarcated as belonging to the affiliate, access to which is through a separate entrance from that used for the insured bank, except that the bank's and affiliate's offices may be accessed through a common outer lobby or a common corridor; (2) the bank and affiliate share no common officers; (3) a majority of the board of directors of the bank is composed of persons who are neither officers nor directors of the affiliate; (4) any employee of the affiliate who is also an employee of the bank does not conduct activities on behalf of the affiliate on the premises of the bank that involve customer contact; (5) the bank and affiliate do not share a common name or logo;[4] and (6) the affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank and that investments recommended, offered, or sold by the affiliate are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are any undertakings on the part of the affiliate otherwise undertakings or obligations of the bank.

§ 332.7 Restrictions: Subsidiary or affiliate underwrites insurance, underwrites real estate, or insures, guarantees or certifies title to real estate.

An insured bank that has a subsidiary or affiliate that underwrites any type of insurance (excluding credit life insurance), engages in reinsurance, engages in real estate development or any other type of real estate underwriting, or insures, guarantees, or certifies title to real estate shall not:

(a) Make any extension of credit to such subsidiary or affiliate that would be in excess of the limits as to amount, and not in accordance with the restrictions imposed on "covered transactions" by section 23A of the Federal Reserve Act (12 U.S.C. 371c) and that are not within any exemption established thereby.

(b) Make any extension of credit where the purpose of the extension of credit is to acquire any interest in any real estate underwritten by the bank's subsidiary or affiliate unless the terms and conditions of the extension of credit are consistent with safe and sound banking practice.

(c) Extend credit in the aggregate in excess of 10 per centum of the bank's capital where the purpose of the extensions of credit is to acquire any interest in any real estate underwritten by the bank's subsidiary or affiliate.

(d) Directly or indirectly condition any extension of credit on the requirement that the borrower purchase any property, product, or service underwritten, sold, marketed, or provided by the bank's subsidiary or affiliate.

(e) Purchase as fiduciary, co-fiduciary, or managing agent on behalf of any account for which the bank has investment discretion any product, service, or property underwritten, sold, marketed, or provided by the bank's subsidiary or affiliate unless (1) the purchase is expressly authorized by the managing agency agreement, trust instrument, court order, or local law, or specific authority for the purchase is obtained from all interested parties after full disclosure, (2) the purchase, although not expressly authorized under (1), is otherwise consistent with the bank's common law fiduciary obligation, or (3) the purchase is permissible under applicable state and federal law or regulation.

(f) Exceed the limits on loans to any one borrower established by 12 U.S.C. 84 when making extensions of credit to any real estate development in which the bank's subsidiary or affiliate has an equity interest.

§ 332.8 Restrictions: Insured bank, its subsidiary, or affiliate—provider of EDP services, broker or agent for insurance, real estate, securities, or travel services.

(a) Where an insured bank (including any of its directors, officers, or employees) is authorized by state or federal statute or regulation to provide electronic data processing services to

[4] This requirement shall not be construed to prohibit the bank from advertising or otherwise disclosing its relationship to the affiliate.

persons or companies other than banks, to provide travel agency services, or to act as agent or broker in connection with the purchase or sale of securities, insurance (*including* credit life insurance), or real estate, the bank shall not exercise such authority unless:

(1) Any bank director, officer, or employee who is acting as agent or broker to provide any such service is licensed in accordance with any applicable state or federal statute or regulation and has met any applicable state or federal training, education, or other requirement.

(2) The bank (including its directors, officers, and employees) when providing any such service conducts business pursuant to policies and procedures designed to make bank customers fully aware: (i) Of the capacity in which the bank (including its directors, officers, and employees) is acting, and (ii) that the customer is not required, or otherwise obligated, to purchase any insurance product or policy sold by the bank, its directors, officers, or employees or utilize any such service of the bank, its directors, officers, or employees in order to obtain any extension of credit or other financial service from the bank.

(3) Any bank director, officer, or employee who is acting as agent or broker in connection with the provision of any such service and who is compensated on a commission basis remits the commission to the bank.

(4) The terms and conditions of any extension of credit made by the bank for the purpose of acquiring any interest in any real estate or for the purpose of acquiring securities where the bank (including its directors, officers, and employees) acted as agent or broker in connection with the transaction are consistent with safe and sound banking practice.

(b) An insured bank that has a subsidiary or affiliate that provides travel services, electronic data processing services, acts as agent or broker in connection with the purchase or sale of real estate or securities, or acts as agent in the sale of insurance (including credit life insurance) shall not:

(1) Directly or indirectly condition any extension of credit union the requirement that the borrower utilize any service provided by, or purchase any policy, product, real estate, or security sold by, the bank's subsidiary or affiliate.

(2) Make any extension of credit for the purpose of acquiring any interest in any real estate or securities where the bank's subsidiary or affiliate acted as agent or broker in connection with the transaction unless the terms and conditions of the extension of credit are consistent with safe and sound banking practice.

§ 332.9 Exemption for certain subsidiaries.

Nothing in §§ 332.4, 332.5, or 332.7 shall apply in the case of a subsidiary of an insured bank that exclusively conducts any activity described in § 332.3(a) that national banks are specifically authorized by statute, regulation, or interpretation to conduct either directly or in an operating subsidiary.

§ 332.10 Compliance.

(a) Any insured bank that, prior to the effective date of this regulation, established or acquired a subsidiary that underwrites insurance (excluding credit life insurance), underwrites real estate, engages in reinsurance, or insures, guarantees, or certifies title to real estate or which prior to that date became affiliated with a company that engages in the above activities shall have one year from the effective date of this regulation to bring itself into compliance with this part, *provided*, however, that such bank must comply with § 332.8 within 180 days of the effective date of the regulation, § 332.7 within 90 days of the effective date of the regulation, and any such subsidiary must meet the definition of "bona fide subsidiary" within 180 days of the effective date of the regulation. Any insured bank subject to this paragraph shall inform the regional director of the FDIC region in which the bank is located not later than 30 days from the effective date of the regulation that the bank has a subsidiary that underwrites insurance or real estate, engages in reinsurance, or insures, guarantees, or certifies title to real estate, or that it is affiliated with a company that underwrites insurance or real estate, engages in reinsurance, or insures, guarantees or certifies title to real estate.

(b) Any insured bank that as of the effective date of this regulation was directly engaging in any activity required by § 332.3 to be in a bona fide subsidiary shall have two years from the effective date of this regulation to comply with this part, *provided*, however, that such bank must comply with § 332.7 within 90 days from the effective date of the regulation.

(c) Any insured bank that as of the effective date of the regulation was providing electronic data processing services to persons or companies other than banks or was acting as, or whose directors, officers, or employees were acting as, agent to provide travel services or broker or agent in connection with the purchase or sale of securities, insurance (including credit life insurance), or real estate, or that as of that date had a subsidiary or affiliate that was acting in such a capacity shall have 90 days from the effective date of the regulation to comply with this part.

By Order of the Board of Directors this 26th day of November 1984.

Federal Deposit Insurance Corporation,

Hoyle L. Robinson,

Executive Secretary.

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