



RESCINDED

Comptroller of the Currency
US Department of the Treasury

OCC 1999-28

Subject: Interpretive Rulings, Investment Securities, Corporate Activities
Date: July 6, 1999

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

Description: Proposed Rule

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changes, judicial rulings, OCC decisions, and other developments. Two of the proposed amendments to Part 7, relating to the acquisition by a bank of its shares and to its ability to engage in reverse stock splits, would facilitate the election of Subchapter S status. Community banks in particular may benefit from these provisions. Several other provisions make clear that automated teller machines, automated loan machines, and deposit production offices are not "branches," whether a bank establishes them alone or in combination with each other. The proposal also would clarify the scope of the OCC's "visitorial" powers over national banks to reflect long-standing judicial precedents defining visitorial powers.

The remaining proposed changes would remove an ambiguous provision in Part 1 and make technical amendments to Part 5 to update references to the Comptroller's Corporate Manual and to reflect that the "CAMELS" rating system has been amended to include "sensitivity to market risk" in the Uniform Financial Institutions Rating System.

For further information, contact Jacqueline Lussier, senior attorney, or Mark Tenhundfeld, assistant director, Legislative and Regulatory Activities Division, at (202) 874-5090.

Julie L. Williams
Chief Counsel

Related Links

- [64 FR 31749](#)

June 14, 1999

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency (OCC)

12 CFR Parts 1, 5, and 7

[Docket No. 99-08]

RIN 1557-AB61

Investment Securities; Rules, Policies, and Procedures for Corporate Activities; and Interpretive Rulings

ACTION: Notice of proposed rulemaking

SUMMARY: The Office of the Comptroller of the Currency (OCC) is proposing to update and clarify its rules regarding Investment Securities, Corporate Activities, and Interpretive Rulings. Most of the proposed changes amend the OCC's regulation codifying interpretive rulings. These proposed amendments clarify certain existing interpretive rulings and add new interpretive rulings based on recent statutory changes, judicial rulings, OCC decisions, and other developments. The remaining proposed changes would clarify in the OCC's regulation on investment securities its long-standing treatment of instruments secured by Type I securities, and make technical amendments to the OCC's regulation on corporate activities to update the names of offices within the OCC, to clarify certain definitions, and to amend references to the CAMEL rating system to reflect the addition of the sixth element for sensitivity to market risk. This proposal reflects the OCC's continuing commitment to assess the effectiveness of our rules and to make further changes where necessary.

DATES: You should submit written comments by August 13, 1999.

ADDRESSES: You should direct written comments to the Communications Division, Attention: Docket No. 99-08, Third Floor, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219. In addition, you may send comments by facsimile transmission to (202) 874-5274, or by electronic mail to regs.comments@occ.treas.gov.

FOR FURTHER INFORMATION CONTACT: You can request additional information on this proposal by calling Jacqueline Lussier, Senior Attorney, or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities Division, (202) 874-5090. You can inspect and photocopy the comments at the OCC's Public Disclosure Room, First Floor, 250 E Street, SW, Washington, DC 20019, between 9:00 am and 5:00 pm on business days. You can make an appointment to inspect the comments by calling (202) 874-5043.

SUPPLEMENTARY INFORMATION:

Section-by-Section Analysis of Proposed Changes

As previously noted, most of the changes proposed amend part 7. The OCC proposes to amend part 7 to clarify and supplement its provisions where necessary. In addition, the OCC proposes to add new interpretive rulings, based on recent statutory changes, judicial rulings, OCC decisions, and other developments. These changes are described below, followed by a discussion of the proposed changes to parts 1 and 5.

Part 7--Interpretive Rulings

Messenger Service (Sec. 7.1012)

Under 12 U.S.C. 36(j), a ``branch" of a bank is defined to include any branch bank where deposits are received, or checks paid, or money lent. Current Sec. 7.1012(c) sets forth circumstances under which a national bank and its customers may use a messenger service for various purposes without the messenger service being deemed a ``branch" under section 36. These criteria are derived from caselaw. However, the criteria do not reflect two recent federal court decisions.¹ This proposal amends Sec. 7.1012(c) to reflect these recent cases.

[1] See *Cades v. H & R Block*, 43 F.3d 869 (4th Cir. 1994), cert. denied, 515 U.S. 1103 (1995); *Christiansen v. Beneficial Nat'l Bank*, 972 F. Supp. 681 (S.D. Ga. 1997). These cases addressed the issue of whether a third party should be considered to be a branch of a national bank where a tax preparation company originated tax refund anticipation loans between a national bank and taxpayers and conveyed the loan proceeds to the customers.

Under the current rule, in order to avoid being treated as a bank branch, a messenger service, including both a messenger service affiliated with a bank and a service that is independent of a bank, generally must both make its services available to the public, including other depository institutions, and retain the ultimate discretion to determine which customers and geographic areas it will

serve. 12 CFR 7.1012(c)(2)(ii)(A) and (B). The recent cases indicate that this test should apply differently depending on whether the service is affiliated with a bank. Pursuant to these cases, a nonaffiliated service need show only that it has the discretion to determine, in its own business judgment, which customers it will serve and where. In contrast, an affiliated service, because it may be more likely to favor its affiliates as a result of its common ownership or control, must show that it actually serves the public generally, including nonaffiliated depository institutions.

The OCC concludes that this analysis is appropriate when determining if a messenger service is a bank branch. Accordingly, the proposal combines the criteria in Sec. 7.1012(c)(2)(ii)(A) and (c)(2)(ii)(B) into one new paragraph and applies the resulting criteria differently depending on whether or not the messenger service is affiliated with the bank. This means that a nonaffiliated messenger service need only demonstrate that it has the discretion to determine, in its own business judgment, whom it will serve and where. In contrast, since the operations of a messenger service that is affiliated

[[Page 31750]]

with a bank could be influenced by that bank, an affiliated messenger service must continue to demonstrate both that it actually provide services to the general public, including nonaffiliated depository institutions, and that it has the discretion to determine whom it will serve and where.

The proposal also makes a stylistic amendment to Sec. 7.1012(c)(2)(i) to state the rule more economically.

Independent Undertakings To Pay Against Documents (Sec. 7.1016)

Section 7.1016 codifies interpretations concerning the issuance by national banks of letters of credit and other independent undertakings. The proposal makes five technical amendments to update this section.

The first amendment changes footnote 1 by clarifying that the United Nations Convention on Independent Guarantees and Standby Letters of Credit was adopted by the U.N. General Assembly in 1995 and signed by the United States in 1997. The second amends footnote 1 by adding the recently finalized International Standby Practices (ISP-98) to the footnote as another important source of applicable laws or rules of practice recognized by law related to independent undertakings. The third amendment replaces the terms "account party" and "customer" in the text (which refer to the party for whose account an independent undertaking is issued) with the term "applicant" (which is the term used in the laws and rules of practice cited in the footnote) in

Sec. 7.1016(a), (b)(1)(iii)(C), and (b)(1)(iv). The fourth clarifies, in Sec. 7.1016(b)(2)(ii), that the precautions taken when an independent undertaking is renewed apply only to automatic renewals. Renewals that are within a bank's discretion necessarily allow the bank to make a credit assessment before renewing. Finally, the fifth amendment updates one of the telephone numbers in the footnote.

National Bank as Guarantor or Surety on Indemnity Bond (Sec. 7.1017)

In recent rulemakings ² that amended part 7 and part 28 (the OCC's rule on international banking activities), the provision on a national bank's guarantees of its foreign operations was relocated from former Sec. 7.7012 to Sec. 28.4(c) in order to consolidate the regulations governing international banking activities in one part of the OCC's regulations. No substantive change was made to the section relocated. However, because part 7 still has a section on national banks acting as guarantors (current Sec. 7.1017) and because this section no longer addresses guarantees abroad, several people have asked whether a national bank still may guarantee the liabilities of its foreign operations. The answer is yes, and, to alleviate this apparent confusion, the proposal adds a cross-reference in Sec. 7.1017 to Sec. 28.4(c).

2\ 61 FR 4862 (Feb. 9, 1996) (amending part 7); 61 FR 19524 (May 2, 1996) (amending 12 CFR part 28).

Ownership of Stock Necessary To Qualify as Director (Sec. 7.2005)

A national bank director must own a qualifying equity interest (qualifying shares) in a national bank or the company that controls that national bank. 12 U.S.C. 72; 12 CFR 7.2005. Current Sec. 7.2005 codifies the OCC's guidance about the various ways in which a director may comply with the requirement.

The proposed revisions to Sec. 7.2005(b)(4) codify guidance provided in OCC interpretive letters ³ approving buyback or repurchase agreements between shareholders and prospective directors. Generally, under a buyback agreement, the transferring shareholder sells shares of the bank or its holding company to a director subject to an agreement that the director will sell the shares back to the transferring shareholder when the director's service ends. This enables the director to own qualifying shares while permitting the transferring shareholder to prevent the transfer of the shares to unknown parties.

3\ See, e.g., Letter from Julie L. Williams, Chief Counsel (Mar. 31, 1997) (unpublished); Letter from Jonathan Rushdoony,

Attorney (Mar. 27, 1986) (unpublished); Letter from Leslie G. Linville, Senior Attorney (Jan. 9, 1986) (unpublished). You can inspect and photocopy the unpublished OCC staff interpretive letters cited in this preamble (in redacted form) at the OCC's Public Disclosure Room, First Floor, 250 E Street, SW, Washington, DC 20219. You can make an appointment to inspect the letters by calling (202) 874-5043.

Consistent with these interpretive letters, proposed new paragraphs (b)(4)(ii), (iii), and (iv) of Sec. 7.2005 state that a buyback agreement may give a director the option of transferring shares back to the transferring shareholder if the director no longer needs those shares to satisfy the ownership requirement. The transferring shareholder may retain a right of first refusal to reacquire the shares if the director seeks to transfer ownership to a third person. Further, a director may assign the right to receive dividends or distributions on the shares back to the original shareholder and execute an irrevocable proxy authorizing the original shareholder to vote the shares. This change will make it easier for banks, including community banks in particular, to attract qualified people to serve on bank boards.

Oath of Directors (Sec. 7.2008)

Current Sec. 7.2008 provides guidance on the methods by which the oath of directors may be administered. However, this section does not provide instructions for the filing or retention of executed oaths, prompting questions about what a national bank should do with the executed oaths once they are obtained.

To respond to these requests for guidance, the proposal amends paragraph (c) of Sec. 7.2008 so that it informs national banks to file the original executed oaths with the OCC and retain a copy in the bank's records in accordance with the instructions set forth in the Comptroller's Corporate Manual. This guidance is consistent with 12 U.S.C. 73, which states that each director's executed and subscribed oath must be transmitted to the Comptroller of the Currency and filed and preserved in the Comptroller's office for a period of 10 years.

The proposal also amends the last sentence in Sec. 7.2008(b) to reflect the name for the manual currently in use, namely, the "Comptroller's Corporate Manual."

Acquisition and Holding of Shares as Treasury Stock (Sec. 7.2020)

Current Sec. 7.2020 provides that a national bank has authority under 12 U.S.C. 24(Seventh) to acquire its outstanding shares and hold them as treasury stock to fulfill a legitimate corporate purpose, as

long as the bank complies with the restrictions and procedures specified in 12 U.S.C. 59. The only guidance contained in current Sec. 7.2020 on what qualifies as a legitimate corporate purpose is the statement that it is impermissible to acquire or hold treasury stock for speculation.

Several OCC interpretive letters ⁴ explain the term further, providing that "legitimate corporate purpose" includes: (a) holding shares in connection with an officer or employee stock option, bonus or repurchase plan; (b) holding shares for sale to a potential director to meet "qualifying share" requirements; (c) purchasing a director's qualifying shares upon his or her resignation or death if there is no ready

[[Page 31751]]

market for the shares; (d) reducing the number of shareholders in order to qualify the bank for reorganization as a Subchapter S corporation; and (e) reducing the number of shareholders to lower the bank's costs associated with shareholder communications and meetings.

⁴ See, e.g., Interpretive Letter No. 825 (Mar. 16, 1998), reprinted in [1997-98 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-274; Interpretive Letter No. 786 (June 9, 1997), reprinted in [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-213 (IL 786); Interpretive Letter No. 660 (Dec. 19, 1994), reprinted in [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 83,608 (IL 660).

The proposal revises Sec. 7.2020 to include these examples of legitimate corporate purposes. The examples listed are not exclusive. There may be additional circumstances under which a national bank's acquisition and holding of its shares as treasury stock will serve a legitimate corporate purpose. While the OCC expects that this guidance on what is a legitimate corporate purpose will benefit all national banks, certain of the examples listed as legitimate purposes (namely, the purchasing of shares upon a director's resignation or death if there is no ready market for the shares and qualifying the bank for treatment under the tax laws as a Subchapter S corporation) are expected to provide a particular benefit to community banks.

Reverse Stock Splits (Proposed New Sec. 7.2023)

In IL 786, the OCC considered the appropriateness of a reverse stock split, a restructuring of ownership interests in which a national bank reduces the number of its outstanding shares of stock by, for instance, replacing outstanding shares with fewer shares of a new

issuance and paying cash to the minority shareholders for their interests. That opinion determined that the national banking laws permit a reverse stock split, as long as the bank provides adequate protection for dissenting shareholders' rights and the transaction serves a legitimate corporate purpose.

Because the reverse stock split is a device that post-dates most corporate governance provisions in the national banking laws, those laws do not explicitly address the authority of a national bank to effect a reverse stock split. Several provisions of the banking laws--including 12 U.S.C. 59, 83, 214a, 215, and 215a--authorize components of a reverse stock split that, when read together, permit the transaction. One provision (12 U.S.C. 59) permits a national bank to reduce its capital upon the vote of shareholders holding two-thirds of its capital stock and OCC approval. Other provisions (12 U.S.C. 214a, 215, and 215a) authorize a national bank to engage in corporate combinations, including mergers and consolidations, although the bank must provide rights to shareholders dissenting to these transactions. Another provision (12 U.S.C. 83) allows national banks to hold treasury stock for legitimate corporate purposes after obtaining OCC approval pursuant to section 59.⁵ The OCC also recognizes that a bank may acquire its outstanding shares and hold them as treasury stock in connection with a reverse stock split.

⁵ See IL 660.

In light of this statutory authority, IL 786 concluded that a reverse stock split is permissible if the action serves a legitimate corporate purpose (in the case discussed in IL 786, a desire to reduce the number of shareholders to qualify for Subchapter S status) and dissenters' rights are adequately protected.⁶ The proposal codifies this conclusion in new Sec. 7.2023. This conclusion is expected to benefit all national banks by clarifying the extent of their flexibility in restructuring their ownership interests, but it is expected to provide particular benefit to community banks that desire, for instance, to restructure in order to qualify as a Subchapter S corporation.

⁶ This conclusion is consistent with the most recent applicable court decision, *NoDak Bancorp. v. Clarke*, 998 F.2d 1416 (8th Cir. 1993), in which the court upheld the OCC's approval of a cash-out merger in which the OCC found that there was a valid corporate purpose for the transaction and that minority shareholders were entitled to dissenters' rights. In an earlier decision, the Eleventh Circuit found in *Lewis v. Clark*, 911 F.2d 1558 (11th Cir. 1990), reh'g denied, 972 F.2d 1351 (1991), that the OCC lacked the

authority to approve a bank merger that required minority shareholders to accept cash for their shares while the majority shareholders were eligible to receive stock in the resulting bank, even where the minority shareholders had appraisal rights. The NoDak court distinguished *Lewis v. Clark*, finding that a national bank could cash out minority shareholders under the National Bank Act, as long as there is a valid business purpose and the minority shareholders are entitled to dissenters' rights.

In *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990), the court reversed the OCC's approval of a reverse stock split. The court held that the reverse stock split plan violated 12 U.S.C. 83 and 214a-215a, after concluding that the transaction had no legitimate business purpose and failed to provide for dissenters' right. The court expressly declined to answer whether section 83 prohibits all reverse stock split transactions, noting that its opinion was limited to the facts of the case. *Id.* at 1308 n.4, 1309. To clarify how the OCC applies the governing law in light of these decisions, the proposal reflects the OCC's position that the better reasoned view in the federal courts is that reverse stock splits will be approved if there is a legitimate corporate purpose and if shareholders are provided adequate dissenters' rights.

Visitorial Powers (Sec. 7.4000)

The proposal revises Sec. 7.4000, ``Books and records of national banks," to clarify the extent of the OCC's visitorial powers under 12 U.S.C. 484 and other federal statutes. Section 484 provides, in relevant part, that no national bank is subject to any visitorial powers except as authorized by federal law. 12 U.S.C. 484(a).⁷ Congress vested the OCC with exclusive visitorial powers to ensure the cohesive, uniform supervision of national banks.

\7\ The term ``visitorial," as used in section 484, derives from English common law, which used the term ``visitation" to refer to the act of a superintending officer who visits a corporation to examine its manner of conducting business and enforce observance of the laws and regulations. *Guthrie v. Harkness*, 199 U.S. 148, 158 (1905) (quoting *First National Bank of Youngstown v. Hughes*, 6 F. 737 (6th Cir. 1881)). The *Guthrie* court noted that visitors ``have power to keep [corporations] within the legitimate sphere of their operations, and to correct all abuses of authority, and to nullify all irregular proceedings." *Id.* For purposes of section 484, the term has been construed broadly, as discussed in the text following this footnote.

Courts have defined ``visitation" expansively to include the

inspection, regulation, or control of the operations of a bank to enforce the bank's observance of the law. See *First National Bank of Youngstown v. Hughes*, 6 F. 737, 740 (6th Cir. 1881), appeal dismissed, 106 U.S. 523 (1883). See also *Peoples Bank v. Williams*, 449 F. Supp. 254 (W.D. Va. 1978) (visitorial powers involve the exercise of the right of inspection, superintendence, direction, or regulation over a bank's affairs).⁸

\8\ Recently, a federal district court upheld the OCC's right to exercise exclusive regulatory authority to enforce applicable state law against national banks when it enjoined a state banking authority's administrative enforcement proceeding against two national banks. Ruling on Motion for Preliminary Injunction, *First Union Nat'l Bank v. Burke*, No. 3:98cv2171 (D. Ct. Apr. 7, 1999) (appeal pending).

Proposed Sec. 7.4000 codifies the definition of visitorial powers and illustrates what visitorial powers include by providing a non-exclusive list of these powers. They include: (a) examination of a bank; (b) inspection of a bank's books and records; (c) regulation and supervision of activities authorized or permitted under federal banking law; and (d) enforcing compliance with any applicable federal or state laws concerning those activities. The proposal also retitles Sec. 7.4000 as ``Visitorial powers" to reflect the rule's intended focus.

The proposal also reorganizes Sec. 7.4000 by grouping together, in proposed paragraph (b), the exceptions noted in several different places in the current rule that are explicitly provided by federal law to the OCC's exclusive visitorial powers. These exceptions do not preclude the OCC from exercising its concurrent authority to inspect a national bank's books and records in the instances listed. This reorganization of the exceptions in the current rule is done solely for ease of reference. None of the exceptions listed is new, and the list is not exclusive.⁹

\9\ The exceptions listed in the rule are those where federal statutory law explicitly provides for another agency to inspect a national bank's books and records. In addition, the OCC does not object to state insurance regulators inspecting the records of national banks related to their insurance activities that are regulated under applicable state law.

Establishment and Operation of Remote Service Units (Proposed New Sec. 7.4003)

The authority of national banks to establish "branches" in a state is linked to the extent that state law authorizes state banks to establish branches. See 12 U.S.C. 36(c)-(g). Branches are the only national bank facilities that are subject to state geographic restrictions or related approval requirements under 12 U.S.C. 36. The national bank branching statute, at 12 U.S.C. 36(j), defines a "branch" to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any state at which deposits are received, checks paid, or money lent. Section 36(j) explicitly excludes, however, an automated teller machine (ATM) or remote service unit (RSU) from the definition of "branch."

¹¹ In light of the exclusion of ATMs and RSUs from 12 U.S.C. 36(j), the OCC has concluded in recent interpretive letters ¹² that ATMs and RSUs established and operated by national banks are not subject to any state-imposed geographic or operational restrictions or licensing laws.

¹⁰ An RSU is an automated facility, operated by a customer of a bank, that engages in one or more of the core banking functions of receiving deposits, paying withdrawals, or lending money. An RSU includes ATMs, automated loan machines, and automated devices for receiving deposits, and may be equipped with a telephone or televideo device that allows contact with bank personnel.

¹¹ This exclusion was added to section 36(j) by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), Pub. L. 104-208, sec. 2205, enacted Sept. 30, 1996 (110 Stat. 3009).

¹² See, e.g., Interpretive Letter No. 789 (June 27, 1997), reprinted in [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-216 (IL 789); Interpretive Letter No. 772 (Mar. 6, 1997), reprinted in [1996-97 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-136 (IL 772).

Proposed new Sec. 7.4003 codifies the principle, reflected in those interpretive letters and other OCC interpretations ¹³ that automated loan machines (ALMs) and automated devices for receiving deposits are appropriately considered to be RSUs and, accordingly, are not subject to any state-imposed geographic or operational restrictions or licensing laws. As previously noted, RSUs are automated facilities, operated by customers of a bank, that receive deposits, pay withdrawals, or lend money. Similarly, ALMs and automated deposit-receiving devices are automated facilities, operated by bank customers, that permit a customer, in the case of an ALM, to apply for a loan and receive the loan proceeds or have them deposited into the customer's existing account or, in the case of the deposit-receiving device, make

deposits. ALMs and automated deposit-receiving devices qualify under this standard as RSUs and, therefore, are regulated in the same way as other RSUs.

\13\ Interpretive Letter No. 838 (April 15, 1998), reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-293; Interpretive Letter No. 821 (Feb. 17, 1998), reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-271; IL 789; IL 772. Despite the plain language of section 36(j), one federal district court case, *Bank One, Utah v. Gutttau*, Civil No. 4-98-CV-10247 (D. Iowa July 24, 1998), has held that Iowa ATM law is not preempted by the National Bank Act. This holding is on appeal to the Eighth Circuit.

Deposit Production Offices (Proposed New Sec. 7.4004)

A national bank facility that does not receive deposits, pay checks, or lend money is not a branch for purposes of 12 U.S.C. 36(j). The OCC has determined that a national bank deposit production office (DPO), which merely assists bank customers in making deposits, is not a branch because it does not engage in any of the core banking functions that would cause it to be a branch under 12 U.S.C. 36.\14\

\14\ Interpretive Letter No. 691 (Sept. 25, 1995), reprinted in [1995-96 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-006 (deposit production offices are not branches as long as deposits are not accepted at the DPO but rather are mailed by the customer to the bank after filling out preliminary forms at the DPO); Interpretive Letter No. 638 (Jan. 6, 1994), reprinted in [1993-94 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 83,525 (a non-branch facility may perform deposit origination functions such as providing information on deposit products or handling application forms, as long as the activity stops short of actually receiving deposits).

Proposed new Sec. 7.4004 codifies this interpretation. Paragraph (a) states that a DPO must not receive deposits in order for it to be excluded from 12 U.S.C. 36(j)'s definition of "branch," and that all deposit and withdrawal transactions by customers using a DPO must be performed by the customer, either in person at the main office or a branch office of the bank, or by mail, electronic transfer, or a similar method of transfer. Paragraph (b) states that a national bank may use the services of, and compensate, persons not employed by the bank for its deposit production activities. This flexibility to operate a DPO with people other than bank employees is consistent with the approach taken with respect to national bank loan production offices

(LPOs). See 12 CFR 7.1004.

Combination of LPO, DPO, and RSU (Proposed New Sec. 7.4005)

When a facility combines the non-branch functions of an LPO, DPO, and RSU, the OCC has concluded that the facility is not a branch by virtue of that combination.^{\15\} Since an LPO, DPO, or RSU is not, individually, a branch under 12 U.S.C. 36(j), it follows that any combination of these facilities at one location also would not be a branch. The proposal adds this interpretation in new Sec. 7.4005.

^{\15\} Interpretive Letter No. 843 (Sept. 29, 1998), reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81-298 (IL 843). The proposal also reflects the position the OCC has taken as amicus curiae in litigation pending in the Federal District Court of Colorado in a case with substantially similar facts as those in IL 843. See OCC's Brief Amicus Curiae filed in First Nat'l Bank of McCook v. Fulkerson, Civil Action No. 98- D-1024 (filed Jan. 4, 1999).

Part 1--Investment Securities

The OCC proposes to amend 12 CFR 1.3(e)(1) to clarify a provision that has led to some confusion. Current Sec. 1.3(e)(1) sets forth the regulatory treatment of Type IV securities that are fully secured by Type I securities. The OCC proposes to eliminate the statement in Sec. 1.3(e)(1) that a national bank may deal in Type IV securities that are fully secured by Type I securities. This language has led to confusion about the treatment of Type V securities and about the relationship of the current provision with Sec. 1.3(g) regarding securitization. Consistent with previous judicial rulings and OCC decisions,^{\16\} the OCC will continue to apply its long-standing regulatory treatment of asset-backed instruments that are fully secured by Type I securities and treat those instruments as Type I securities.

^{\16\} See *Security Pacific v. Clarke*, 885 F.2d 1034 (2d Cir. 1989), cert. denied, 493 U.S. 1070 (1990) (national bank authority to securitize assets); Interpretive Letter No. 514 (May 5, 1990), reprinted in [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 83,218 (bonds collateralized by Gov't Nat'l Mortgage Ass'n (GNMA), Fed. Nat'l Mortgage Ass'n (FNMA) and Fed. Home Loan Mortgage Ass'n (FHLMC) pass-through certificates); Interpretive Letter No. 362 (May 22, 1986), reprinted in [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,532 (issuing, underwriting and dealing in evidences of indebtedness collateralized by GNMA, FNMA or FHLMC certificates); Interpretive Letter No. 378 (April 24, 1987),

reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,602 (issuance and sale of collateralized mortgage obligations--bonds representing interests in pools of mortgages or mortgage-related obligations); Interpretive Letter No. 257 (April 12, 1983), reprinted in [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,421 (underwriting and dealing in mortgage-backed pass-through certificates evidencing undivided interests in Fed. Housing Admin. insured mortgage pools purchased by the bank from GNMA); Investment Securities Letter No. 29 (Aug. 3, 1988), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,899 (investment limits for asset-backed securities consisting of General Motors Acceptance Corp. receivables).

Part 5--Rules, Policies, and Procedures for Corporate Activities

In 1996, the interagency Uniform Financial Institutions Rating System--

[[Page 31753]]

then commonly referred to as the CAMEL rating system \17\--was updated to add a sixth component, addressing sensitivity to market risk. \18\ To reflect the addition of that sixth component, the acronym CAMEL was changed to CAMELS. In a recent rulemaking \19\ that amended 12 CFR part 3 (the OCC's rule on minimum capital ratios), the OCC made the conforming amendment by changing ``CAMEL" to ``CAMELS" in Sec. 3.6(c). However, the other OCC regulation in which the term CAMEL is used, part 5, was not updated concurrently.

\17\ The rating system was referred to as the CAMEL rating system because it assessed five components of a bank's performance: capital adequacy, asset quality, management administration, earnings, and liquidity.

\18\ 61 FR 67021 (Dec. 19, 1996).

\19\ 64 FR 10194 (Mar. 2, 1999).

This proposal changes the references to CAMEL in several sections of part 5 to CAMELS, reflecting, as discussed in the preceding paragraph, the recent addition of ``sensitivity to market risk" to the Uniform Financial Institutions Rating System. The proposal also contains technical amendments to several sections in part 5 to conform them to provisions in the Comptroller's Corporate Manual that have been revised since part 5 last was amended. Finally, the proposal makes a technical amendment to Sec. 5.35(g)(3) to correct an error in a reference to another paragraph of Sec. 5.35.

Request for Comments

The OCC invites comment on any of the proposed changes.

The OCC also seeks comments on the impact of each proposal on community banks. The OCC recognizes that community banks operate with more limited resources than larger institutions and may present a different risk profile. Thus, the OCC specifically requests comments on the impact of each proposal on community banks' current resources and available personnel with the requisite expertise, and whether the goals of the proposed regulation could be achieved, for community banks, through an alternative approach.

Executive Order 12866 and the President's memorandum of June 1, 1998, require each agency to write all rules in plain language. We invite your comments on how to make this proposed rule easier to understand. For example:

Have we organized the material to suit your needs?

Are the requirements in the rule clearly stated?

Does the rule contain technical language or jargon that isn't clear?

Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand?

Would more (but shorter) sections be better?

What else could we do to make the rule easier to understand?

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the OCC hereby certifies that this proposal will not have a significant economic impact on a substantial number of small entities. As is discussed more fully in the preamble to this proposal, the proposal clarifies and updates 12 CFR parts 1, 5, and 7. The proposal imposes no new requirements on national banks. Accordingly, a regulatory flexibility analysis for the proposal is not required.

Executive Order 12866

The OCC has determined that this proposal is not a significant regulatory action under Executive Order 12866.

Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1532 (Unfunded Mandates Act), requires that the agency prepare a budgetary impact statement before promulgating any rule likely to result in a federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the

private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires the agency to identify and consider a reasonable number of regulatory alternatives before promulgating the rule.

The OCC has determined that this proposal will not result in expenditures by state, local, and tribal governments, or by the private sector, of \$100 million or more in any one year. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed any regulatory alternatives. The proposal is clarifying in nature and imposes no new requirements on national banks.

List of Subjects

12 CFR Part 1

Banks, banking, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 5

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 7

Credit, Insurance, Investments, National banks, Reporting and recordkeeping requirements, Securities, Surety bonds.

Authority and Issuance

For the reasons set out in the preamble, chapter I of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 1--INVESTMENT SECURITIES

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

Authority: 12 U.S.C. 1 et seq., 24 (Seventh), and 93a.

2. In Sec. 1.3, paragraph (e)(1) is revised to read as follows:

Sec. 1.3 Limitations on dealing in, underwriting, and purchase and sale of securities.

* * * * *

(e) Type IV securities--(1) General. A national bank may purchase and sell Type IV securities for its own account. Except as described in paragraph (e)(2) of this section, the amount of the Type IV securities

that a bank may purchase and sell is not limited to a specified percentage of the bank's capital and surplus.

* * * * *

PART 5--RULES, POLICIES, AND PROCEDURES FOR CORPORATE ACTIVITIES

3. The authority citation for part 5 continues to read as follows:

Authority: 12 U.S.C. 1 et seq., 93a.

4. In Sec. 5.3, paragraph (c) is revised and paragraph (g)(2) is amended by revising the term "(CAMEL)" to read "(CAMELS)", to read as follows:

Sec. 5.3 Definitions.

* * * * *

(c) Appropriate district office means:

(1) Bank Organization and Structure for all national bank subsidiaries of certain holding companies assigned to the Washington, D.C., licensing unit;

(2) The appropriate OCC district office for all national bank subsidiaries of certain holding companies assigned to a district office licensing unit;

(3) The OCC's district office where the national bank's supervisory office is located for all other banks; or

[[Page 31754]]

(4) The OCC's International Banking and Finance Department for federal branches and agencies of foreign banks.

* * * * *

Sec. 5.11 [Amended]

5. In Sec. 5.11, paragraph (i)(1) is amended by revising the phrase "a representative of the OCC" to read "presiding officer".

6. In Sec. 5.33, paragraph (d)(2)(i) is revised to read as follows:

Sec. 5.33 Business combinations.

* * * * *

(d) * * *

(2) * * *

(i) A business combination between eligible banks, or between an eligible bank and an eligible depository institution, that are controlled by the same holding company or that will be controlled by the same holding company prior to the combination; or

* * * * *

Sec. 5.35 [Amended]

7. In Sec. 5.35, paragraph (g)(3) is amended by revising the term ``paragraph (h)'' to read ``paragraph (i)''.

Sec. 5.37 [Amended]

8. In Sec. 5.37, paragraphs (d)(1)(i) and (d)(3) are amended by revising the term ``district'' to read ``supervisory'', and paragraph (d)(3) is amended further by revising the term ``(CAMEL)'' to read ``(CAMELS)''.

Sec. 5.51 [Amended]

9. In Sec. 5.51, paragraph (c)(6)(i) is amended by revising the term ``(CAMEL)'' to read ``(CAMELS)''.

Sec. 5.64 [Amended]

10. In Sec. 5.64, paragraph (b) is amended by revising the term ``district'' to read ``supervisory''.

PART 7--INTERPRETIVE RULINGS

11. The authority citation for part 7 continues to read as follows:

Authority: 12 U.S.C. 1 et seq. and 93a.

12. In Sec. 7.1012, paragraphs (c)(2)(i) and (c)(2)(ii) are revised and paragraphs (c)(2)(iii), (c)(2)(iv), (c)(2)(v), and (c)(2)(vi) are added to read as follows:

Sec. 7.1012 Messenger service.

* * * * *

(c) * * *

(2) * * *

(i) A party other than the national bank owns or rents the messenger service and its facilities and employs the persons who provide the service;

(ii)(A) The messenger service retains the discretion to determine in its own business judgment which customers and geographic areas it will serve; or

(B) If the messenger service and the bank are under common ownership or control, the messenger service actually provides its services to the general public, including other depository institutions, and retains the discretion to determine in its own business judgment which customers and geographic areas it will serve;

(iii) The messenger service maintains ultimate responsibility for scheduling, movement, and routing;

(iv) The messenger service does not operate under the name of the bank, and the bank and the messenger service do not advertise, or otherwise represent, that the bank itself is providing the service, although the bank may advertise that its customers may use one or more third party messenger services to transact business with the bank;

(v) The messenger service assumes responsibility for the items during transit and for maintaining adequate insurance covering thefts, employee fidelity, and other in-transit losses; and

(vi) The messenger service acts as the agent for the customer when the items are in transit. The bank deems items intended for deposit to be deposited when credited to the customer's account at the bank's main office, one of its branches, or another permissible facility, such as a back office facility that is not a branch. The bank deems items representing withdrawals to be paid when the items are given to the messenger service.

* * * * *

13. In Sec. 7.1016, paragraphs (a) including the footnote, (b)(1)(iii)(C), (b)(1)(iv), and (b)(2)(ii) are revised to read as follows:

Sec. 7.1016 Independent undertakings to pay against documents.

(a) General authority. A national bank may issue and commit to issue letters of credit and other independent undertakings within the scope of the applicable laws or rules of practice recognized by

law.¹ Under such letters of credit and other independent undertakings, the bank's obligation to honor depends upon the presentation of specified documents and not upon nondocumentary conditions or resolution of questions of fact or law at issue between the applicant and the beneficiary. A national bank may also confirm or otherwise undertake to honor or purchase specified documents upon their presentation under another person's independent undertaking within the scope of such laws or rules.

\1\ Samples of such laws or rules of practice include, but are not limited to: the applicable version of Article 5 of the Uniform Commercial Code (UCC) (1962, as amended 1990) or revised Article 5 of the UCC (as amended 1995) (available from West Publishing Co., 1/800/328-4880); the Uniform Customs and Practice for Documentary Credits (International Chamber of Commerce (ICC) Publication No. 500) (available from ICC Publishing, Inc., 212/206-1150); the International Standby Practices (ISP-98) (available from the Institute of International Banking Law & Practice, 301/869-9840); the United Nations Convention on Independent Guarantees and Standby Letters of Credit (adopted by the U.N. General Assembly in 1995 and signed by the U.S. in 1997) (available from the U.N. Commission on International Trade Law, 212/963-5353); and the Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits (ICC Publication No. 525) (available from ICC Publishing, Inc., 212/206-1150); as any of the foregoing may be amended from time to time.

(b) * * *

(1) * * *

(iii) * * *

(C) Entitle the bank to cash collateral from the applicant on demand (with a right to accelerate the applicant's obligations, as appropriate); and

(iv) The bank either should be fully collateralized or have a post-honor right of reimbursement from the applicant or from another issuer of an independent undertaking. Alternatively, if the bank's undertaking is to purchase documents of title, securities, or other valuable documents, the bank should obtain a first priority right to realize on the documents if the bank is not otherwise to be reimbursed.

(2) * * *

(ii) In the event that the undertaking provides for automatic renewal, the terms for renewal should be consistent with the bank's

ability to make any necessary credit assessments prior to renewal;

* * * * *

14. In Sec. 7.1017, the introductory text is revised to read as follows:

Sec. 7.1017 National bank as guarantor or surety on indemnity bond.

A national bank may lend its credit, bind itself as a surety to indemnify another, or otherwise become a guarantor (including, pursuant to 12 CFR 28.4, guaranteeing the deposits and other liabilities of its Edge corporations and Agreement corporations and of its corporate instrumentalities in foreign countries), if:

* * * * *

15. In Sec. 7.2005, paragraph (b)(4) is revised to read as follows:

Sec. 7.2005 Ownership of stock necessary to qualify as director.

* * * * *

(b) * * *

(4) Other arrangements--(i) Shares held through retirement plans and similar arrangements. A director may

[[Page 31755]]

hold his or her qualifying interest through a profit-sharing plan, individual retirement account, retirement plan, or similar arrangement, if the director retains beneficial ownership and legal control over the shares.

(ii) Shares held subject to buyback agreements. A director may acquire and hold his or her qualifying interest pursuant to a stock repurchase or buyback agreement with a transferring shareholder under which the director purchases the qualifying shares subject to an agreement that the transferring shareholder will repurchase the shares when, for any reason, the director ceases to serve in that capacity. The agreement may give the transferring shareholder a right of first refusal to repurchase the qualifying shares if the director seeks to transfer ownership of the shares to a third person.

(iii) Assignment of right to dividends or distributions. A director may assign the right to receive all dividends or distributions on his or her qualifying shares to another, including a transferring shareholder, if the director retains beneficial ownership and legal

control over the shares.

(iv) Execution of proxy. A director may execute a revocable or irrevocable proxy authorizing another, including a transferring shareholder, to vote his or her qualifying shares, provided the director retains beneficial ownership and legal control over the shares.

* * * * *

16. In Sec. 7.2008, the last sentence of paragraph (b) is revised and a new paragraph (c) is added to read as follows:

Sec. 7.2008 Oath of directors.

* * * * *

(b) Execution of the oath. * * *

Appropriate sample oaths are located in the ``Comptroller's Corporate Manual."''

(c) Filing and recordkeeping. A national bank must file the original executed oaths of directors with the OCC and retain a copy in the bank's records in accordance with the Comptroller's Corporate Manual filing and recordkeeping instructions for executed oaths of directors.

17. Section 7.2020 is revised to read as follows:

Sec. 7.2020 Acquisition and holding of shares as treasury stock.

(a) Acquisition of outstanding shares. Under 12 U.S.C. 59, a national bank may acquire its outstanding shares and hold them as treasury stock, if the acquisition and retention of the shares is, and continues to be, for a legitimate corporate purpose.

(b) Legitimate corporate purpose. Examples of legitimate corporate purposes include the acquisition and holding of treasury stock to:

(1) Have shares available for use in connection with employee stock option, bonus, purchase, or similar plans;

(2) Sell to a director for the purpose of acquiring qualifying shares;

(3) Purchase a director's qualifying shares upon the cessation of the director's service in that capacity if there is no ready market for the shares;

(4) Reduce the number of shareholders in order to qualify as a Subchapter S corporation; or

(5) Reduce costs associated with shareholder communications and meetings.

(c) Other purposes. Purposes other than those enumerated in paragraph (b) of this section may satisfy the legitimate corporate purpose test.

(d) Prohibition. It is not a legitimate corporate purpose to acquire or hold treasury stock on speculation about changes in its value.

18. A new Sec. 7.2023 is added to subpart B to read as follows:

Sec. 7.2023 Reverse stock splits.

(a) Authority to engage in reverse stock splits. A national bank may engage in a reverse stock split if the transaction serves a legitimate corporate purpose and provides adequate dissenting shareholders' rights.

(b) Legitimate corporate purpose. Examples of legitimate corporate purposes include a reverse stock split to:

(1) Reduce the number of shareholders in order to qualify as a Subchapter S corporation; or

(2) Reduce costs associated with shareholder communications and meetings.

19. In Sec. 7.4000, the section heading and paragraphs (a) and (b) are revised to read as follows:

Sec. 7.4000 Visitorial powers.

(a) General rule. (1) Only the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks, except as otherwise expressly provided by federal law. State officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances authorized by federal law. Production of records may, however, be required under normal judicial procedures.

(2) For purposes of this section, visitorial powers include:

- (i) Examination of a bank;
- (ii) Inspection of a bank's books and records;
- (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; or
- (iv) Enforcing compliance with any applicable federal or state laws concerning those activities.

(b) Exceptions to the general rule. Federal law expressly provides special authority for state or other federal officials to:

- (1) Inspect the list of shareholders, provided the official is authorized to assess taxes under state authority (12 U.S.C. 62; this section also authorizes inspection of the shareholder list by shareholders and creditors of a national bank);
- (2) Review, at reasonable times and upon reasonable notice to a bank, the bank's records solely to ensure compliance with applicable state unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with those laws (12 U.S.C. 484(b));
- (3) Verify payroll records for unemployment compensation purposes (26 U.S.C. 3305(c));
- (4) Ascertain the correctness of federal tax returns (26 U.S.C. 7602); or
- (5) Enforce the Fair Labor Standards Act (29 U.S.C. 211).

* * * * *

20. A new Sec. 7.4003 is added to read as follows:

Sec. 7.4003 Establishment and operation of a remote service unit by a national bank.

A remote service unit (RSU) is an automated facility, operated by a customer of a bank, that conducts banking functions, such as receiving deposits, paying withdrawals, or lending money. A national bank may establish and operate an RSU pursuant to 12 U.S.C. 24 (Seventh). An RSU includes an automated teller machine, automated loan machine, and automated device for receiving deposits. An RSU may be equipped with a telephone or televideo device that allows contact with bank personnel. An RSU is not considered a "branch" within the meaning of 12 U.S.C. 36(j), and is not subject to state geographic or operational restrictions or licensing laws.

21. A new Sec. 7.4004 is added to read as follows:

Sec. 7.4004 Establishment and operation of a deposit production office by a national bank.

(a) General rule. A national bank or its operating subsidiary may engage in deposit production activities at a site

[[Page 31756]]

other than the main office or a branch of the bank. A deposit production office (DPO) may solicit deposits, provide information about deposit products, and assist persons in completing application forms and related documents to open a deposit account. A DPO is not a branch within the meaning of 12 U.S.C. 36(j) and 12 CFR 5.30(d)(1) so long as it does not receive deposits, pay withdrawals, or make loans. All deposit and withdrawal transactions of a bank customer using a DPO must be performed by the customer, either in person at the main office or a branch office of the bank, or by mail, electronic transfer, or a similar method of transfer.

(b) Services of other persons. A national bank may use the services of, and compensate, persons not employed by the bank in its deposit production activities.

22. A new Sec. 7.4005 is added to read as follows:

Sec. 7.4005 Combination of loan production office, deposit production office, and remote service unit.

A location at which a national bank operates a loan production office (LPO), a deposit production office (DPO), and a remote service unit (RSU) is not a "branch" within the meaning of 12 U.S.C. 36(j) by virtue of that combination. Since an LPO, DPO, or RSU is not, individually, a branch under 12 U.S.C. 36(j), any combination of these facilities at one location does not create a branch.

Dated: May 11, 1999.

John D. Hawke, Jr.,
Comptroller of the Currency.

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