period in the future, if deemed necessary. The committee wants to ensure that consistent accounting and administrative procedures can be implemented simultaneously in the future.

There is unanimous committee support to reduce the time periods specified for timely payment of assessments owed by handlers to 30 days of invoice for both types of inspections.

Currently, the time lapse between the date the fruit is shipped and the date assessments are due is between 60–90 days. Handlers normally receive payment for shipments within 30 days of shipment. Therefore, the impact of this action will not be significant as payments for shipments are normally received 30–60 days before assessments are due.

For the 1997–98 season, handlers will pay assessments of $.0225 per tray or tray equivalent and have 60 days from date of invoice for in-line inspected kiwifruit and have 45 days from date of invoice for block inspected kiwifruit to pay their assessments before their assessments are considered delinquent. If handlers pay their assessments in a timely manner, they are not charged the simple interest rate of 1.5 percent per month nor the 10 percent late charge.

Under this rule, handlers will have 30 days from the invoice date before their assessments will be considered delinquent. This 30-day reduction in the time period for handlers receiving in-line inspection and 15-day reduction in the time period for handlers receiving block inspection will have no impact on handlers who pay their assessments in a timely manner. Even for those who do not pay in a timely manner, the impact will not be significant. For example, if a handler is delinquent in paying assessments, a simple interest rate of 1.5 percent interest per month and an assessment of $.0225 per tray or tray equivalent will apply. During the peak month of March 1996, less than 1.6 million trays or tray equivalents were shipped. This equates to an approximate average of 26,667 trays for each of the 60 handlers, which when assessed at $.0225 per tray generates a $600 assessment per handler. If an account is 30 days delinquent, the handler is charged a 1.5 percent interest charge in the amount of $9.00 and a 10 percent late charge in the amount of $60.00 over the assessment. This action does not change the interest rate nor the late charge percentage, but reduces the time period specified for timely payment to 30 days. If amounts are paid in a timely manner, no additional charges are incurred. The majority of assessments owed by handlers are paid within the specified time periods.

This change will reduce the administrative and accounting burden for handlers and for the committee staff by making the committee's and the commission's time periods consistent. While no specific alternatives were suggested during the public meeting, the committee's recommendation and the rule finalized herein do provide for built-in alternatives and flexibility. Allowing the committee to further revise this time period to a later time period in the future, if deemed necessary, will ensure that consistent accounting and administrative procedures can be implemented simultaneously in the future. This rule will be applied uniformly to all handlers and was viewed by the committee as the best solution.

This action will not impose any additional reporting or recordkeeping requirements on either small or large kiwifruit handlers. As with all Federal marketing order programs, reports and forms are periodically reviewed to reduce information requirements and duplication by industry and public sector agencies.

The Department has not identified any relevant Federal rules that duplicate, overlap or conflict with this final rule.

In addition, the committee's meeting was widely publicized throughout the kiwifruit industry and all interested persons were invited to attend the meeting and participate in committee deliberations on all issues. Like all committee meetings, the April 16, 1997, meeting was a public meeting and all entities, both large and small, were able to express views on this issue.

A proposed rule concerning this action was issued by the Department on June 30, 1997, and published in the **Federal Register** on Monday, July 7, 1997 (62 FR 36231). Copies of the rule were mailed to all Committee members and kiwifruit handlers. The rule was also made available through the Internet by the Office of the Federal Register. No comments were received.

After consideration of all relevant matter presented, including the information and recommendations submitted by the committee and other available information, it is hereby found that this rule, as hereinafter set forth, will tend to effectuate the declared policy of the Act.

It is further found that good cause exists for not postponing the effective date of this rule until 30 days after publication in the **Federal Register** (5 U.S.C. 553) because this change should apply to all kiwifruit shipped during the season. Such shipments can begin as early as September. Further, handlers are aware of this rule, which was recommended at a public meeting. Also, a 30-day comment period was provided for in the proposed rule and no comments were received.

List of Subjects in 7 CFR Part 920

Kiwifruit, Marketing agreements.

For the reasons set forth in the preamble, 7 CFR part 920 is amended as follows:

PART 920—KIWIFRUIT GROWN IN CALIFORNIA

1. The authority citation for 7 CFR part 920 continues to read as follows:

Authority: 7 U.S.C. 601–674.

2. Section 920.112 is revised to read as follows:

§ 920.112 Late payments.

Pursuant to § 920.41(a), interest will be charged at a 1.5 percent monthly simple interest rate. Assessments for kiwifruit shall be deemed late if not received within 30 days of invoice, or such other later time period as specified by the committee. A 10 percent late charge will be assessed when payment becomes 30 days late. Interest and late payment charges shall be applied only to the overdue assessment.

Dated: August 21, 1997.

Robert C. Keeney,

Director, Fruit and Vegetable Division.

[FR Doc. 97–22710 Filed 8–26–97; 8:45 am]

BILLING CODE 3410–02–P

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R–0958]

Bank Holding Companies and Change in Bank Control (Regulation Y); Amendments to Restrictions in the Board's Section 20 Orders

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Conditions to Board Orders.

SUMMARY: The Board is modifying the prudential limitations established in its decisions under the Bank Holding Company Act and section 20 of the Glass-Steagall Act permitting a nonbank subsidiary of a bank holding company to underwrite and deal in securities. The Board is eliminating those restrictions that have proven to be unduly burdensome or unnecessary in light of other laws or regulations, and

consolidating the remaining restrictions in a series of eight operating standards. The Board has concluded that the narrower set of restrictions will be fully consistent with safety and soundness and should improve operating efficiencies at section 20 subsidiaries and increase options for their customers.

EFFECTIVE DATE: October 27, 1997.

FOR FURTHER INFORMATION CONTACT: Gregory Baer, Managing Senior Counsel (202) 452–3236, Thomas Corsi, Senior Attorney (202) 452–3275, Legal Division; Michael J. Schoenfeld, Senior Supervisory Financial Analyst (202) 452–2781, Division of Banking Supervision and Regulation; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Diane Jenkins (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background

Section 20 of the Glass-Steagall Act prohibits a member bank of the Federal Reserve System from being affiliated with a company that is ''engaged principally'' in underwriting and dealing in securities not eligible for underwriting and dealing by a member bank.[1] Beginning in 1987, the Board has issued a series of orders authorizing bank holding companies to establish ''section 20 subsidiaries'' to engage in underwriting and dealing within the limits of the Act.[2]

In those orders, the Board has established a series of prudential restrictions as conditions for approval under the Bank Holding Company Act. Most of the firewalls were adopted in the Board's initial 1987 Order authorizing bank holding companies to underwrite and deal in commercial paper, municipal revenue bonds, mortgage-backed securities, and consumer-receivable-related securities. Others were added in 1989 when the Board authorized underwriting and dealing in all types of debt and equity securities. The restrictions are designed to prevent securities underwriting and dealing risks from being passed from a section 20 subsidiary to an affiliated insured depository institution, and thus to the federal safety net, and to mitigate the potential for conflicts of interest, unfair competition, and other adverse effects that may arise from the affiliation of commercial and investment banks.

On January 8, 1997, the Board proposed to rescind many of the firewalls and consolidate the remainder in a series of operating standards to be published in the Code of Federal Regulations. The proposal was developed through the Board's comprehensive review of its regulations and written policies that was required by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.[3] That statute directs the Board and other banking agencies to streamline their regulations to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. In the proposal, the Board stated that in its experience the risks of securities underwriting and dealing had proven to be manageable in a bank holding company framework, and that bank holding companies and banks had successfully undertaken and managed activities posing similar risks for which no firewalls were erected. The Board noted that the purposes of the firewalls are often duplicated by other statutes or regulations that are more narrowly tailored to addressing the perceived risk or conflict.

II. Summary of Comments

The Board received twenty-nine public comments on its proposal, and comments were overwhelmingly favorable. Only two commenters opposed the Board's proposed elimination of firewalls. The remaining commenters supported the Board's proposal, though almost all of those commenters urged the Board to go further to rescind all or at least more of the firewalls.

The comments generally expressed support for the proposal in a summary fashion, reserving specific comment for the four firewalls on which the Board sought comment and two others that proved controversial. Those comments are discussed below in the context of each relevant firewall.

One trade association representing community banks expressed concerns about the proposal.[4] The commenter stated that the Board may be acting too quickly in eliminating some of the firewalls and urged a careful approach. The commenter urged the Board to retain the requirement that a bank holding company deduct from its regulatory capital any investment in a section 20 subsidiary, arguing that elimination would allow a bank holding company to lodge all of its capital (other than bank capital) at its section 20 subsidiary, which would mean that no capital would be available at the holding company level if the holding company were called upon to serve as a source of strength to its insured depository institution subsidiaries. The commenter also urged the Board to maintain capital requirements for a section 20 subsidiary that mirror the net capital rule of the Securities and Exchange Commission (SEC), as the SEC could revise or eliminate its regulation.

The same commenter urged the Board to retain restrictions on a bank extending credit to customers of a section 20 affiliate or offering credit enhancements for securities underwritten by the section 20 affiliate. The commenter urged the Board to delay final action on the proposal because one bill pending in Congress would continue to impose such restrictions. The commenter also expressed concern that conflicts of interest would be present when a bank lent to customers of a section 20 affiliate, and that customers needed the firewall for protection.[5]

III. Final Notice

The Board is adopting the proposed operating standards, and the corresponding rescission of the existing firewalls, substantially as proposed. Based on its experience supervising section 20 subsidiaries and the comments received on the proposal, the Board has concluded that the great majority of risks of affiliation of commercial and investment banks are addressed by general bank and bank holding company regulations, and by the securities laws and regulations of the SEC, National Association of Securities Dealers (NASD) and securities exchanges that apply to a section 20 subsidiary just like any other broker-dealer. However, in certain areas—for example, the potential for a customer to confuse the financial products of a commercial and investment bank—the Board has determined that there are unique risks of affiliation not addressed by other

[1] 12 U.S.C. 377.

[2] See, *e.g., J.P. Morgan & Co. Inc., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 Federal Reserve Bulletin 192 (1989) (hereafter, *1989 Order*); *Citicorp, J.P. Morgan & Co., and Bankers Trust New York Corp.*, 73 Federal Reserve Bulletin 473 (1987) (hereafter, *1987 Order*); *see also Canadian Imperial Bank of Commerce, The Royal Bank of Canada, Barclays PLC and Barclays Bank PLC*, 76 Federal Reserve Bulletin 158 (1990) (applying earlier orders to section 20 subsidiaries of foreign banks) (hereafter, 1990 Order).

[3] 12 U.S.C. 4803.

[4] The other adverse commenter did not address the proposal but generally opposed the affiliation of commercial and investment banking.

[5] The commenter noted that five other restrictions were being rescinded because they were largely duplicated by sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1) or other statutes. The commenter stressed that it supported elimination so long as eliminating the firewalls did not change the substance of how transactions could occur.

laws. The operating standards being adopted by the Board address those risks.

Compliance with the operating standards will be a condition of the continued operation of any existing section 20 subsidiary and, unless modified in the authorizing order, a condition of the operation of any section 20 subsidiary approved in the future. For purposes of existing section 20 subsidiaries, the operating standards replace the Board's existing section 20 firewalls.[6]

Set forth below are: (1) A summary of each of the firewalls established in the Board's orders;[7] (2) the Board's proposal with respect to the firewall; and (3) the Board's final action and the reasons for that action, including a discussion of any comments received. Each of the proposed operating standards is discussed in the context of the firewall from the 1989 Order on which it is based:

Operating standard	Firewall
1. Capital requirement for bank holding company and section 20 subsidiary.	1, 3 and 4.
2. Internal controls	11.
3. Interlocks restriction	13.
4. Customer disclosure	14.
5. Credit for clearing purposes	21(a) & (b).
6. Funding of securities purchases from a section 20 affiliate.	6.
7. Reporting requirement	24.
8. Application of sections 23A and 23B to foreign banks.	21(a).

Those wishing a more detailed description of the firewalls should refer to the request for comment on the Board's proposal, where each of the firewalls was set forth verbatim.[8]

[6] The only exception is Firewall #1 of the Board's 1987 Order, which set forth the types of securities to which companies operating under that order must limit their underwriting and dealing. 1987 Order at 502–03. That restriction will continue to apply.

[7] Footnotes to the orders are omitted. Description of the firewalls conforms to the 1989 Order. The Board's request for comment describes the differences among the firewalls in the 1989 Order (allowing debt and equity underwriting), the 1987 Order (allowing underwriting and dealing in only four types of debt securities), and the 1990 Order (applicable to foreign banks).

[8] 62 FR 2622 (Jan. 17, 1997). As with the earlier notice, references to banks include thrifts. In addition, to the extent that the operating standards apply to banks and thrifts, they also apply to the U.S. branches and agencies of foreign banks.

IV. Analysis of Each Firewall

A. Capital Adequacy Conditions

Firewall 1(a) (Deduction of Investment in Subsidiary From Bank Holding Company Capital)

Firewall 1(b) (Deduction of Extensions of Credit From Bank Holding Company Capital)

Existing firewalls. Requires a bank holding company to maintain adequate capital after deducting (1) any investment in a section 20 subsidiary that is treated as capital in the subsidiary (Firewall 1(a)), and (2) any credit that it or a nonbank subsidiary extends to a section 20 subsidiary, unless the credit is fully secured by U.S. Treasury securities or other marketable securities and is collateralized in the same manner and to the same extent as would be required under section 23A(c) of the Federal Reserve Act (Firewall 1(b)).

Proposal. The Board proposed to rescind the capital deduction required by this firewall, but retain the requirement that a bank holding company maintain adequate capital on a fully consolidated basis as a condition for operating a section 20 subsidiary.

Final action. The Board is retaining the requirement that any bank holding company operating a section 20 subsidiary be adequately capitalized. Although bank holding companies are also subject to the Board's risk-based capital guidelines, Operating Standard #1 will condition the operation of a section 20 subsidiary on a bank holding company's maintaining adequate capital.

The Board is eliminating the required capital deductions. The capital deductions (and resulting deconsolidation for regulatory capital purposes) are inconsistent with generally accepted accounting principles (GAAP) and have therefore created confusion and imposed costs by requiring bank holding companies to prepare financial statements on two bases.

However, as one commenter noted, elimination of the capital deductions would allow a bank holding company to lodge its capital (other than bank capital) at the section 20 subsidiary, leaving less capital available at the holding company level if the holding company were called upon to serve as a source of strength to its insured depository institution subsidiaries.[9] Reflecting this concern, the Board in its section 20 orders has consistently required bank holding companies to maintain their ability to serve as a source of strength to their subsidiary banks, and has satisfied itself that the subsidiary banks of applicants, and any foreign bank applicants, were strongly capitalized before granting approval. Moreover, with the elimination of many of the firewalls, particularly the funding and credit enhancement firewalls, a bank's potential exposure to its section 20 affiliate will increase, thereby increasing the importance of maintaining strong bank capital levels.

[9] 12 CFR 225.4(a)(1).

As a protection for the bank, the Board proposed to retain the discretion to restrict funding and credit enhancements by a bank in the event the bank failed to qualify as well capitalized, as defined in section 38 of the Federal Deposit Insurance Act.[10] Thus, if a bank's capital ratios fell to the adequately capitalized level (where prompt corrective action did not yet engage), and the drop in capital ratios were attributable to poor credit decisions relating to its section 20 affiliate, the Board could act immediately to limit the damage.[11] The Board is adopting this proposal but also conditioning its approval of relief from the existing firewalls on a requirement that a bank holding company maintain the capital of its subsidiary banks at the well-capitalized level. Thus, in the event that a subsidiary bank fell below the well-capitalized level and the bank holding company failed to recapitalize it, the Board could order the bank holding company to divest its section 20 subsidiary. The Board would expect to do so only if the subsidiary were causing harm to the bank (and other steps such as restricting bank funding of the section 20 affiliate were ineffective), or if the divestiture of the section 20 affiliate was the only available source of funds within the organization to recapitalize the bank. The Board notes that Glass-Steagall reform legislation pending in the Congress also requires a bank holding company to maintain its subsidiary banks at the well-capitalized level as a condition of conducting securities activities.

In applying this condition to foreign banks, the Board has decided that a foreign bank should maintain capital at a level that is comparable to that of a

[10] 12 U.S.C. 1831o.

[11] Two commenters opposed this change because it could lead to a substantial disruption of the business of a section 20 subsidiary when affiliated banks experience capital difficulty. However, the Board would expect to reimpose these restrictions only if they addressed problems in the organization or diminished resulting risks to its insured depository institutions.

U.S. banking organization, for which different capital requirements apply to the bank and the bank holding company. As noted in the 1990 Order, foreign banks operate in the United States as both banks and bank holding companies, and the capital requirement for a foreign bank should take account of this fact. As noted above, in acting on applications by foreign banks to establish section 20 subsidiaries, the Board relied on the fact that each foreign bank was capitalized at levels well above the applicable minimums. Consequently, and in the interests of national treatment, the Board has decided that foreign banks should maintain a strong capital position, above the minimum levels of the Basle Capital Accord. The Board believes that this standard will provide substantial equivalence in the maintenance of capital by both domestic and foreign banking organizations that operate section 20 subsidiaries.

Firewall 2 (Prior Approval Requirement for Investments in Subsidiary)

This firewall was repealed by the Board at the time it published its request for comment. The firewall had required Board approval for any bank holding company investments in a section 20 subsidiary subsequent to its formation.

Firewall 3 (Requirement of Capital Plan)

Existing firewall. Requires that, before establishing a section 20 subsidiary, a bank holding company submit to the Board a plan to raise additional capital or demonstrate that it is strongly capitalized and will remain so after making authorized capital adjustments.

Proposal. The Board proposed to rescind this firewall, which was applied in the *1989 Order* granting authority to engage in underwriting and dealing in all types of debt and equity securities, but not in the 1987 Order.

Final action. The Board is retaining this firewall in modified form. The Board analyzes the capital adequacy, financial condition, and business plan of each applicant before approving its application to engage in underwriting and dealing pursuant to section 20. The Board expects that any bank holding company filing a notice with the Board to acquire and/or operate a section 20 subsidiary should have a strong capital position. Therefore, the Board has concluded that an operating standard setting forth the contents of a capital plan is unnecessary. The firewall also provides, however, that applicants seeking authority to engage in underwriting and dealing in all types of debt and equity securities shall also remain strongly capitalized, and the Board has not permitted applicants to commence underwriting and dealing in all types of debt and equity securities until they have demonstrated that they can meet this standard. Accordingly, the Board is retaining this requirement in Operating Standard # 1. Consistent with the discussion above, the Board will require that the bank holding company be strongly capitalized on a fully consolidated basis, and thus will not deduct from its capital the bank holding company's investment in, or extensions of credit to, its section 20 subsidiary.

Firewall 4 (Capital Adequacy Requirement)

Existing firewall. Requires a section 20 subsidiary to maintain capital adequate to support its activities and cover reasonably expected expenses and losses in accordance with industry norms.

Proposal. The Board sought comment on whether to retain this firewall.

Final action. The Board is rescinding this firewall, but modifying the operating standards to require the section 20 subsidiary to notify the Board as well as the SEC of any failure to maintain capital above ''early warning'' levels contained in SEC capital rules.

The purpose of this capital requirement was to prevent a section 20 subsidiary from operating below industry capital standards by trading on the reputation and resources of its affiliated bank, thereby gaining a competitive advantage over other broker-dealers. The Board has concluded, however, that the firewall is not an effective tool for addressing this concern, primarily because there is no defined ''industry norm.''

Although the SEC imposes ''haircut'' and capital requirements on all broker-dealers (including section 20 subsidiaries), these minimum capital levels cannot be considered ''industry norms.'' Because broker-dealers that fail to meet SEC minimum capital requirements are liquidated, and broker-dealers that fall below somewhat higher ''early warning'' levels are required to notify the SEC, broker-dealers ordinarily do not operate near these minimums. One commenter also explained that significant underwriters must maintain capital greatly in excess of SEC minimums so that they can draw down on their excess capital when a significant underwriting arises.

Commenters also stated that any attempt to determine the ''average'' capital actually held by the industry (as opposed to the minimum capital required by the SEC) and specify it as the industry norm would be unwise. Capital varies significantly depending on the activities and risk profile of the individual firm. Furthermore, commenters noted that whereas SEC capital requirements allow all capital to be concentrated in the broker-dealer and dedicated to meeting capital requirements, a bank holding company must meet capital requirements at the bank and holding company levels as well.

Finally, the Board already measures bank holding company capital on a consolidated basis, including the capital and assets of the section 20 subsidiary. Therefore, even in the absence of a special capital requirement for section 20 subsidiaries, their ability to leverage themselves will be constrained.

The Board has decided to require a section 20 subsidiary to notify the Board as well as the SEC of any failure to maintain capital above ''early warning'' levels contained in SEC capital rules.[12] If a section 20 subsidiary is required to file a warning notice advising the SEC that the section 20 subsidiary is experiencing financial distress, a copy of the notice will be required to be filed concurrently with the relevant Federal Reserve Bank. The Board would then have the authority to take appropriate action to maintain safety and soundness.

B. Credit Extensions to Customers of the Underwriting Subsidiary

Firewall 5 (Restriction on Credit Enhancement)

Existing firewall. Prohibits a section 20 affiliate from extending credit or issuing or entering into a stand-by letter of credit, asset purchase agreement, indemnity, guarantee, insurance or other facility that might be viewed as enhancing the creditworthiness or marketability of a bank-ineligible securities issue underwritten or distributed by the underwriting subsidiary.[13]

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall because other protections adequately serve its purposes, and its burden on section 20 subsidiaries and their customers therefore is not warranted. Commenters stressed that by prohibiting banks from providing routine credit enhancements in tandem with a section 20 affiliate, the firewall hampers the ability of bank holding companies to serve as full-service

[12] See 17 CFR 240.17a–11.

[13] A bank-ineligible security is one that a member bank is prohibited from underwriting or dealing in by section 16 of the Glass-Steagall Act. 12 U.S.C. 24(Seventh); 12 U.S.C. 335.

financial services providers and reduces options for their customers. For example, existing corporate customers of a bank may wish to issue commercial paper or issue debt in some other form. Although the bank may refer the customer to its section 20 affiliate, the bank is prohibited from providing credit enhancements even though it is the institution best suited to perform a credit analysis—and, with smaller customers, perhaps the only institution willing to perform a credit analysis. The bank is precluded from providing a credit enhancement even if it reached an independent credit decision prior to referring the customer to its section 20 affiliate.

Moreover, significant safety and soundness protections will remain in the absence of the firewall. First, a bank will be required to hold capital against all credit enhancements extended to customers of its section 20 affiliate—something that was not the case at the time the firewall was adopted. Second, the amount of credit that a bank may extend to an issuer of securities underwritten by an affiliated section 20 will be limited by loan-to-one borrower rules.[14] Third, section 23B of the Federal Reserve Act will require that all credit enhancements of securities being underwritten by a section 20 affiliate be on market terms—that is, the same terms that would be offered to a third party of equal creditworthiness.[15] Thus, for example, a bank could not offer such credit enhancements at less than market terms, or to customers who were poor credit risks, in order to generate underwriting business for a section 20 affiliate. Similarly, section 106 of the Bank Holding Company Act Amendments of 1970 would prohibit a bank from offering discounted credit enhancements on the condition that an issuer obtain investment banking services from a section 20 affiliate.[16]

Finally, Operating Standard #2, discussed below, will require that the bank conduct an independent and thorough credit evaluation before offering any credit enhancement in tandem with a section 20 affiliate, and maintain documentation of that evaluation sufficient to allow examiners to assess compliance with its credit policies.

Firewall 6 (Restriction on Funding Purchases of Securities)

Existing firewall. This firewall prohibits a bank holding company or its subsidiary from knowingly extending credit to a customer to fund the purchase of a bank-ineligible security that is being underwritten by a section 20 subsidiary during the period of the underwriting or for 30 days thereafter, or to purchase from the underwriting subsidiary any bank-ineligible security in which the underwriting subsidiary makes a market. The limitation does not include lending to a broker-dealer for the purchase of securities where an affiliated bank is the clearing bank for such broker-dealer.

Proposal. The Board sought comment on whether existing protections were sufficient to address the primary concern of Firewall 6: the possibility that a bank would extend credit below market rates in order to induce customers to purchase securities underwritten by its section 20 affiliate or to facilitate its market making activities. The primary risks of such action are threefold: that such extensions of credit may not be repaid, thereby harming the bank; that customers will be induced by easy credit into purchasing risky securities, thereby harming the customer; and that a section 20 affiliate could reap a competitive advantage over competitors that do not have a federally subsidized affiliate to provide credit to their customers.

Final action. The Board is retaining this firewall as Operating Standard #6 with respect to any extension of credit during the underwriting period or for 30 days thereafter, subject to an exception for preexisting lines of credit.[17] The Board is removing the restriction on lending for purchases of securities in which a section 20 affiliate makes a market.

Commenters supported elimination of the firewall. Commenters stressed that it would make little sense for a bank to expose itself to the losses associated with unsound loans so that its section 20 affiliate could earn a fraction of those potential losses on the sale of securities. One commenter explained that a bank may have a pre-existing line of credit for a customer for the purchase of securities on margin. Such a line would have been entered into based on the customer's creditworthiness and the value of the security, not the identity of the underwriter of any potential securities purchases, and could also be subject to the margin requirements imposed by the Board's Regulation U. Commenters also stressed that a section 20 subsidiary, as a registered broker-dealer, is responsible under NASD, NYSE, and SEC ''know your customer'' and suitability rules for ensuring that the securities purchased by a customer are suitable investments for that particular customer.[18]

Commenters noted that section 11(d) of the Securities Exchange Act of 1934 addresses some of the same concerns as Firewall 6. Section 11(d) prohibits a broker-dealer (including a section 20 subsidiary) that is acting as an underwriter from extending or arranging for credit to customers purchasing the newly issued securities during the underwriting period and for 30 days after the underwriting period. Thus, a section 20 subsidiary acting as underwriter would be prohibited from arranging for an affiliated bank to make loans to customers for purchases during an underwriting period.

Commenters also noted that section 23B of the Federal Reserve Act would apply to loans to fund purchases by customers of securities from a section 20 affiliate during the existence of the underwriting or selling syndicate, and to any loan to purchase a security from the inventory of the section 20 affiliate, including securities in which the section 20 affiliate makes a market.[19] Section 23B would require the loan to be on market terms.

The Board has concluded, however, that these protections do not address all the concerns behind the firewall. Section 11(d) does not apply to a bank loan unless the loan is arranged by an affiliated broker-dealer, and although section 23B requires the loan to be on market terms, the Board has some concern that during an underwriting period, when the market value of the securities is uncertain, section 23B may not be an adequate protection. In sum, the Board has concluded that existing law is not a complete protection against the conflicts of interest that arise when a bank lends during the underwriting period or for 30 days thereafter.

However, the Board will revise the restriction to allow an extension of credit to be made pursuant to a preexisting line of credit, provided that (1) the line of credit was not entered into in contemplation of the purchase of

[14] 12 U.S.C. 84; 12 CFR 32.2.

[15] 12 U.S.C. 371c–1(a)(2)(E)(ii).

[16] 12 U.S.C. 1972(1).

[17] This operating standard does not apply when a section 20 subsidiary is acting only as a selling group member. Although a selling group member may be engaged in the public sale or distribution of securities for purposes of the Glass-Steagall Act, a selling group member is not considered an underwriter.

[18] Rule 2110 of the NASD's Conduct Rules (Standards of Commercial Honor and Principles of Trade); Rule 2310 of the NASD's Conduct Rules (Recommendations to Customers (suitability)); NYSE Rule 405 (''know your customer''); SEC Rule 15g–9 (sales practice rules for certain low-price securities).

[19] Section 23B applies to ''any transaction or series of transactions with a third party * * * if an affiliate is a participant in such transaction or series of transactions.'' 12 U.S.C. 371c–1(a)(2)(E).

affiliate-underwritten securities,[20] and (2) either the line of credit is unrestricted or the extension of credit is clearly consistent with any restrictions imposed. (For example, if a customer had a preexisting line of credit limited to purchases of rated securities, then the bank would continue to be prohibited from lending to purchase unrated securities underwritten by an affiliate.)

The Board has concluded that these transactions do not present the same risks as other loans made during an underwriting. Such lines of credit are routinely used by institutional and other sophisticated customers, and are based on the customer's overall creditworthiness as well as margin required for any purchase; although any security purchased using the line of credit is taken as collateral, there are other assurances of repayment. In such cases, the customer is not being induced by an offer of bank credit to purchase an affiliate-underwritten security, as the customer is free to use the line of credit to purchase other securities of the same type. Finally, for purposes of section 23B, the pricing of the line of credit can be compared to other, similar lines that are not used to purchase affiliate-underwritten securities.

The Board has also concluded that the potential conflicts of interest associated with extending securities credit are lessened, and the protections more effective, when the section 20 affiliate is making a secondary market in the securities. First, the section 20 affiliate's potential exposure as market maker should be substantially less and more manageable than its exposure as underwriter. Second, especially because there is generally more than one firm making a market in a given security, compliance with the market terms requirement of section 23B should be easier to determine than in the underwriting context, where there may be no secondary market. Third, because section 11(d) does not apply to loans for the purpose of purchasing securities in which a broker-dealer makes a market, broker-dealers (including section 20 subsidiaries) are already permitted to lend in this context, and lending by banks does not appear to present any greater conflict of interest that would justify excluding them from this credit market. Fourth, as described more fully below, existing ''Chinese Wall'' procedures should help to ensure that a bank lending officer is unaware of the section 20 affiliate's market making role.

The Board recognizes that section 23A of the Federal Reserve Act would apply to both types of transactions being exempted from the firewall to the extent that the proceeds of the transaction would be ''used for the benefit of, or transferred to'' the affiliate.[21] Section 23A limits transactions with any one affiliate to 10 percent of the bank's capital, and transactions with all affiliates to 20 percent of capital, and also requires that collateral be pledged to a bank for any extension of credit. As several commenters noted, application of section 23A could not only restrict the amount of such credit but raise interpretive and compliance questions concerning how a bank should monitor compliance with the statute. However, for the same reasons that the Board has decided to exempt these transactions from the firewall, the Board is considering whether an exemption from section 23A may also be appropriate. The Board expects to seek comment on this and other issues arising under sections 23A and 23B in the near future.

Firewall 7 (Restriction on Extensions of Credit for Repayment of Underwritten Securities)

Existing firewall. Prohibits a bank holding company or any of its subsidiaries from extending credit to an issuer of bank-ineligible securities previously underwritten by a section 20 affiliate for the purpose of the payment of principal, interest or dividends on such securities.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall. The Board stated in 1987 that it was adopting this firewall in order to prevent a bank from making unwise loans to improve the financial condition of companies whose securities were underwritten by the section 20 affiliate, either to assist in the marketing of the securities or to prevent the customers of the section 20 affiliate from incurring losses on securities sold by the subsidiary. However, this conflict of interest is more attenuated than those present when credit is extended during the underwriting period, as the financial and reputational risks to the section 20 affiliate are lessened once the underwriting is successfully completed.

The firewall also has proven burdensome and has had unintended effects. For example, banks face compliance problems renewing a company's revolving line of credit if a section 20 subsidiary has underwritten an offering by that company since the credit was first extended; the bank must either recruit other lenders to participate in the renewal or amend the line of credit in order to specify its purpose.

Finally, in the absence of this firewall, section 23B of the Federal Reserve Act will require that extensions of credit for the purpose of payment of principal, interest or dividends be made on market terms if the section 20 affiliate is a participant in the transaction.[22]

Firewall 8 (Procedures for Extensions of Credit)

Existing firewall. Requires a bank holding company to adopt procedures, including maintenance of necessary documentary records, to ensure that any extension of credit by it or any of its subsidiaries to issuers of bank-ineligible securities underwritten or dealt in by a section 20 subsidiary are on an arm's-length basis for purposes other than payment of principal, interest, or dividends on the issuer's bank-ineligible securities being underwritten or dealt in by the underwriting subsidiary.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall as superfluous. Section 23B, enacted since this firewall was initially adopted, requires extensions of credit by a bank in conjunction with an issuance of securities underwritten by a section 20 affiliate to be on market terms. Although the firewall also includes extensions of credit by *nonbank* subsidiaries, those extensions of credit do not directly implicate the federal safety net. In amending section 23A in 1982 and adopting section 23B in 1987, Congress chose not to apply them to the parent bank holding company or any other nonbank lender, and the Board sees no reason to reverse that judgment in this context.

Firewall 9 (Restriction on Thrifts)

Existing firewall. Requires thrifts to observe the limitations of sections 23A and 23B of the Federal Reserve Act in any dealings with a section 20 affiliate.

Proposal. The Board proposed to rescind this provision.

Final action. The Board is rescinding this firewall as superfluous, given that the Home Owners' Loan Act has since been amended to apply sections 23A and 23B of the Federal Reserve Act to a thrift as if it were a member bank.[23]

[20] In determining whether the line of credit is truly preexisting, examiners will consider the timing of the line of credit and the underwriting, the conditions imposed on the line of credit, and whether the line of credit has been used for purposes other than the purchase of affiliate-underwritten securities.

[21] 12 U.S.C. 371c(a)(2).

[22] 12 U.S.C. 371c–1(a)(3).

[23] 12 U.S.C. 1468(a)(1).

Firewall 10 (Restriction on Industrial Revenue Bonds)

Existing firewall. Applies the requirements relating to credit extensions to issuers noted in paragraphs 5–9 above to extensions of credit to parties that are major users of projects that are financed by industrial revenue bonds.

Proposal. As the Board proposed to rescind the incorporated restrictions, the Board proposed to rescind this restriction as well.

Final action. As the Board is rescinding all of the incorporated restrictions relating to credit extensions to issuers, the Board is rescinding this restriction as well.

Firewall 11 (Loan Documentation and Exposure Limits)

Existing firewall. Requires bank holding companies to cause their subsidiary banks to adopt policies and procedures, including appropriate limits on exposure, to govern their participation in financing transactions underwritten or arranged by a section 20 affiliate. They shall also ensure that loan documentation is available for review by the Reserve Banks to ensure that an independent and thorough credit evaluation has been undertaken in connection with bank or thrift participation in such financing packages and that such lending complies with the firewalls and section 23B of the Federal Reserve Act.

Proposal. The Board proposed to include this firewall in slightly amended form in its operating standards for all section 20 subsidiaries.

Final action. The Board is retaining this restriction as part of Operating Standard 2. The Board will thereby be imposing this restriction for the first time on section 20 subsidiaries operating under the *1987 Order.*

Several commenters objected to retention of this requirement as redundant in view of the current federal banking agency examination standards for risk management. These commenters noted that this restriction was initially adopted in the context of highly leveraged transactions, and that additional internal control restrictions are not placed on bank activities with respect to other nonbank subsidiaries. However, the Board has concluded that this operating standard remains important in light of the risks of affiliation between a section 20 subsidiary and a depository institution, particularly in view of the Board's removal of other restrictions on such affiliation.

Firewall 12 (Procedures for Limiting Exposure to One Customer)

Existing firewall. Mandates that bank holding companies establish appropriate policies, procedures, and limitations regarding exposure of the holding company on a consolidated basis to any single customer whose securities are underwritten or dealt in by the section 20 subsidiary.

Proposal. The Board sought comment on whether to include this restriction in its operating standards for section 20 subsidiaries.

Final action. The Board is rescinding this firewall. The firewall mandates consolidated exposure limits for a bank holding company with respect to any one issuer whose securities are underwritten or dealt in by a section 20 subsidiary. The Board has the authority to review bank holding company policies on exposure through the examination process and believes that an examination is adequate to ensure that a bank holding company is not exposed unduly to any single issuer. Bank holding companies have successfully operated section 20 subsidiaries under the Board's 1987 Order without being subject to this requirement. Finally, unlike the banks for whom exposure limits are required by Operating Standard #2, bank holding companies are not federally insured.

C. Limitations to Maintain Separateness of an Underwriting Affiliate's Activity

Firewall 13 (Interlocks Restriction)

Existing firewall. Prohibits directors, officers or employees of a bank from serving as a majority of the board of directors or the chief executive officer of an affiliated section 20 subsidiary, and directors, officers or employees of a section 20 subsidiary from serving as a majority of the board of directors or the chief executive officer of an affiliated bank.[24] Requires the underwriting subsidiary to have offices separate from any affiliated bank.

Proposal. The Board proposed no changes to the interlocks restrictions, which it recently amended. The Board proposed to rescind the separate office requirement.

Final action. The Board is rescinding the separate office requirement. First, in the Board's experience, maintaining separate offices for functions that do not involve retail customers—for example, back-office functions—serves no purpose and represents a needless expense. Second, for sales to retail customers, the Board intends to rely on the Interagency Statement on Retail Sales of Nondeposit Investment Products, which largely duplicates this restriction.[25] According to the Interagency Statement, sales or recommendations of non-deposit investment products on the premises of a depository institution—including sales by a section 20 affiliate—should be conducted in a physical location distinct from the area where retail deposits are taken.

Several commenters suggested elimination of or modifications to the interlocks restriction, on which the Board did not seek comment. The Board continues to view the interlocks restriction as helping to ensure the corporate separateness of a bank and a section 20 affiliate, and thereby as helping to prevent a piercing of the bank's corporate veil by creditors of the section 20 affiliate.

D. Disclosure by the Underwriting Subsidiary

Firewall 14 (Customer Disclosures)

Existing firewall. Requires a section 20 affiliate to provide each of its customers with a special disclosure statement describing the difference between itself and its bank affiliates, pointing out that an affiliated bank could be a lender to an issuer, and referring the customer to the disclosure documents for details. The statement must also state that securities sold, offered, or recommended by the underwriting subsidiary are not deposits, are not insured by the Federal Deposit Insurance Corporation, are not guaranteed by an affiliated bank or thrift, and are not otherwise an obligation or responsibility of such a bank or thrift (unless such is the case). The section 20 affiliate should also disclose any material lending relationship between the issuer and a bank or lending affiliate of the section 20 affiliate as required under the securities laws and in every case where the proceeds of the issue will be used to repay outstanding indebtedness to affiliates.

Proposal. The Board proposed to amend this firewall to follow the Interagency Statement on Retail Sales of Nondeposit Investment Products that applies to sales by bank employees or on bank premises.

Final action. The Board has decided to adopt this operating standard as proposed. A section 20 subsidiary will be required to provide each of its retail

[24] As the Board noted in a recent order, this limitation does not apply to interlocks between a section 20 subsidiary and a subsidiary of an affiliated bank. *See Bankers Trust New York*, 83 Federal Reserve Bulletin ____ (July 21, 1997).

[25] Federal Reserve Regulatory Service 3–1579.51.

customers the same disclosures that the Interagency Statement mandates for retail customers of banks, even when it is operating off bank premises.[26] The disclosures of the Interagency Statement are only slightly different from those required by the existing firewall, however, and the amendment will allow the same form to be used for both. The operating standard is narrower than the firewall it replaces because it no longer requires disclosures to institutional customers (who should be aware of whether a product is federally insured or bank guaranteed) but broader than the existing firewall because it requires an acknowledgment of the disclosure by retail customers.

While commenters favored limiting customer disclosure requirements to retail customers, they objected to extending the reach of the Interagency Statement to activities conducted off bank premises, and thereby to requiring retail customers to sign and return an acknowledgment in those circumstances. Commenters contended that requiring the disclosures to be made off bank premises does not further the purpose of the requirement, which is to prevent customer confusion regarding whether products offered by a section 20 subsidiary are federally insured or guaranteed by an affiliated bank. One commenter noted that the NASD has sought SEC approval of a new rule that is designed to require disclosures consistent with those required by the Interagency Statement.[27]

The Board continues to believe that it is appropriate for a section 20 subsidiary to provide the disclosures required by the Interagency Statement to all of its retail customers. As set forth in the Interagency Statement, customer acknowledgment of these disclosures will be required only at the time that a customer opens an account with the section 20 subsidiary, and therefore should not be unduly burdensome to obtain. Thus, this disclosure provides some benefit at minimal cost. The Board notes that when it rejected a suggestion that a section 20 subsidiary be required to have a different name or logo from a banking affiliate, it relied in part on the disclosures that would be given to customers.[28]

E. Marketing Activities on Behalf of an Underwriting Subsidiary

Firewall 15 (Restriction on Advertising Bank Connection)

Existing firewall. Prohibits a section 20 affiliate and any affiliated bank from engaging in advertising or entering into an agreement stating or suggesting that the bank is responsible for the section 20 affiliate's obligations.

Proposal. The Board proposed to rescind this firewall as superfluous.

Final action. This firewall is now duplicated by section 23B(c) of the Federal Reserve Act,[29] and therefore the Board is rescinding it.

Firewall 16 (Cross-Marketing and Agency Activities by Banks)

This firewall was rescinded in 1996.[30]

F. Investment Advice by Bank/Thrift Affiliates

Firewall 17 (Expressing an Opinion on Securities)

Existing firewall. Prohibits a bank from expressing an opinion on the value or the advisability of the purchase or the sale of bank-ineligible securities underwritten or dealt in by a section 20 affiliate unless the bank notifies the customer that the section 20 affiliate is underwriting, making a market, distributing or dealing in the security.

Proposal. The Board proposed to retain this restriction but sought comment on whether it should only prohibit expressing an opinion when the employee has knowledge of the affiliate's role.

Final action. The Board is retaining this restriction, with a knowledge requirement added, as Operating Standard # 4. SEC Rule 10b–10 and NASD Rule 2250 already require a *broker-dealer* to provide written disclosure to a customer that it is a market maker in a security at or before completion of a transaction in the security. These restrictions are based on the conflict of interest between the broker-dealer's duty to advise its customers and its financial interest in selling its security. The operating standard extends these restrictions to an affiliated bank because it would have a similar financial incentive to give advice that would benefit its affiliate.

Commenters argued for either elimination of the firewall or addition of a knowledge standard. Several commenters stressed that the existing firewall essentially requires routine, widespread disclosure of securities-related information throughout a bank holding company system in order to ensure that employees provide the required disclosure whenever a section 20 affiliate has a role in the transaction. This approach is fundamentally inconsistent with the "Chinese Wall" procedures prevalent throughout the investment banking industry, which address the same conflict-of-interest problem by narrowly restricting the flow of information to those whose possession of such information could not create a conflict of interest. One commenter also noted that the existing firewall is difficult to enforce for large, diversified bank holding companies because it requires that information on all securities "dealt in" by the company be disseminated to every area in the holding company system where "an opinion on the value or the advisability" of a securities transaction might be expressed.

The Board has concluded that these concerns can be abated, and the potential conflict of interest raised by such advice still addressed, by retaining the requirement with a knowledge standard added. Thus, when the bank employee providing the investment advice knows of a section 20 affiliate's role in an underwriting—as might be the case with a dual employee—the employee must give the required disclosure. Regardless of the employee's knowledge, the Board notes that any potential for a conflict of interest is diminished because any dual employee is generally prohibited from receiving compensation for recommending an affiliate's securities.[31]

One commenter asked the Board to clarify that an opinion on the value of a security provided by the custodial department of the bank is not covered. Rather, the operating standard should be limited to expressing an opinion on the advisability of purchasing or selling a security. The Board agrees.

Firewall 18 (Restriction on Fiduciary Purchases During Underwriting Period or From Market Maker)

Existing firewall. Prohibits a bank holding company and any of its bank, thrift, trust or investment advisory

[26] For purposes of this operating standard, a retail customer is any customer that is not an "accredited investor" as defined in 17 CFR 230.501(a).

[27] NASD Notice to Members 96–3, *NASD Files with the SEC Proposed Rule Governing Members Operating on Bank Premises,* (January 1996) and NASD Notice to Members 97–26, *NASD Regulation Files Amendment to Bank Broker-Dealer Rule* (May 1997).

[28] 1989 Order at 209–210.

[29] 12 U.S.C. 371c–1(c).

[30] 61 FR 57679, 57683 (1996).

[31] Any dual employee engaged in the investment banking or securities business of an NASD member must be registered as a representative with the NASD and comply with its rules. NASD Rule 1031(a), 0115(a). The NASD consistently has taken the position in published interpretations that it is improper for a member or a person associated with a member to make payments of "finders" or referral fees to third parties who introduce or refer prospective brokerage customers to the firm, unless the recipient is registered as a representative of an NASD member firm. Although the NASD has a limited exception for "one-time fees," the exception does not include fees tied to the completion of a transaction or the opening of an account.

subsidiaries from purchasing, as a trustee or in any other fiduciary capacity, for accounts over which they have investment discretion, bank-ineligible securities (a) underwritten by a section 20 affiliate as lead underwriter or syndicate member during the period of any underwriting or selling syndicate, and for a period of 60 days after the termination thereof, and (b) from the section 20 affiliate if it makes a market in that security, unless such purchase is specifically authorized under the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.

Proposal. The Board proposed to rescind this firewall.

Final notice. The Board is rescinding this firewall as superfluous. Section 23B(b)(1)(B) of the Federal Reserve Act duplicates the restrictions of Firewall 18 when a bank or thrift is making the purchase.[32] Indeed, in its 1987 order first imposing this firewall, the Board noted that section 23B was pending as proposed legislation. Section 23B explicitly prohibits a bank from purchasing, as principal or fiduciary, any security for which a section 20 is a principal underwriter during the existence of the underwriting or selling syndicate, unless such a purchase has been approved by a majority of the bank's board of directors who are not officers of any bank or any affiliate. If the purchase is as fiduciary, the purchase must be permitted by the instrument creating the fiduciary relationship, court order, or state law.

Firewall 18 is broader than section 23B in that it applies for 60 days after the underwriting period. However, the Board is not aware of any evidence to justify imposing a restriction that Congress apparently decided was unnecessary in the same context, and commenters did not urge it to do so.

Firewall 18 is also broader than section 23B in that the firewall also applies when a bank holding company or its nonbank subsidiary (and not just a bank) purchases the securities as fiduciary. However, nonbank affiliates of broker-dealers outside of a bank holding company are not subject to such a firewall.

Rather, potential conflicts of interest are addressed by other statutes or regulations. If the purchase is on behalf of a pension plan, then the fiduciary is subject to the standard of care imposed by ERISA.[33] If the purchase is on behalf of a mutual fund, then sections 10 and 17 of the Investment Company Act of 1940 restrict the ability of the mutual fund to purchase securities from an affiliate of the investment advisor.[34] The Board has concluded that these protections, in addition to state laws, are sufficient in the bank holding company context as well.

G. Extensions of Credit and Purchases and Sales of Assets

Firewall 19 (Restrictions on Purchases as Principal During Underwriting Period or From Market Maker)

Existing firewall. Generally prohibits a bank holding company and any of its subsidiaries from purchasing, as principal, bank-ineligible securities that are underwritten by a section 20 subsidiary during the period of the underwriting and for 60 days after the close of the underwriting period, or purchasing from the section 20 subsidiary any bank-ineligible security in which the section 20 subsidiary makes a market.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall, which was intended to prevent a section 20 affiliate from selling unattractive issues to its affiliates. In practice, the firewall has prevented bank and nonbank subsidiaries of a bank holding company subsidiary from obtaining attractive issues underwritten or dealt in by a section 20 affiliate. Other restrictions provide sufficient protection to the bank. As noted above with respect to Firewall 18, section 23B prohibits a bank from purchasing any security for which a section 20 affiliate is a principal underwriter during the existence of the underwriting or selling syndicate, unless such a purchase has been approved by a majority of the bank's board of directors who are not officers of the bank or any affiliate. Section 23B also requires purchases to be on market terms, and section 23A will apply if the bank purchases the security as principal directly from the section 20 affiliate. The bank would also be required to hold capital against these exposures. Moreover, member banks are limited to purchasing only investment securities, generally investment grade debt where compliance with section 23B will be readily determinable.[35]

Finally, since 1989, the Board has authorized bank holding companies engaged in private placement activities to place up to 50 percent of an issue of securities with their nonbank affiliates and no supervisory concerns have arisen from this practice.[36] The SEC has recently permitted investment companies to purchase limited amounts of securities for which an affiliate is acting as a principal underwriter.[37]

Firewall 20 (Restriction on underwriting and dealing in affiliates' securities)

Existing firewall (as amended). Generally prohibits a section 20 affiliate from underwriting or dealing in any bank-ineligible securities issued by its affiliates or representing an interest in, or secured by, obligations originated or sponsored by its affiliates, unless they are (1) rated by an unaffiliated, nationally recognized statistical rating organization, or (2) issued or guaranteed by FNMA, FHLMC or GNMA (or represent interests in securities issued or guaranteed by FNMA, FHLMC, or GNMA).

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall. NASD Rule 2720 already imposes substantially the same restriction. Rule 2720, to which section 20 subsidiaries are subject, provides that if a member of the NASD proposes to underwrite, participate as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of a public offering of its own or an affiliate's securities, then either (1) the securities must be rated by a qualified, independent rating agency, (2) the price or yield of the issue must be set by a qualified independent underwriter who shall also participate in the preparation of the registration statement and prospectus, offering circular, or similar document, exercising due diligence, or (3) in the case of equity securities only, there must be an independent market in the security. The Board has concluded that this protection is sufficient in the bank holding company context.

Firewall 21(a) (Prohibition on Extensions of Credit to Section 20 Subsidiary)

Existing firewall. Requires a bank holding company to ensure that no bank subsidiary extends credit in any manner

[32] 12 U.S.C. 371c–1(b)(1)(B).

[33] 29 U.S.C. 1002(21), 1104.

[34] 15 U.S.C. 80a–10, 80a–17.

[35] 12 U.S.C. 24 (Seventh), 335.

[36] *J.P. Morgan & Co.*, 76 Federal Reserve Bulletin 26, 28 (1990).

[37] *Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate*, SEC Investment Company Act Release No. 22775 (July 31, 1997). In addition to limiting the amount of such purchases, the SEC requires that the securities be purchased ''prior to the end of the first day on which any sales are made, at a price that is not more than the price paid by each other purchaser of securities in that offering or in any concurrent offering of the securities.'' This standard is akin to the market-terms requirement of section 23B of the Federal Reserve Act.

to an affiliated underwriting subsidiary or a subsidiary thereof, or issues a guarantee, acceptance, or letter of credit for the benefit of a section 20 affiliate or a subsidiary thereof.

Proposal. The Board proposed to rescind this restriction except insofar as it applies to intra-day extensions of credit for clearing purposes, requiring that such intra-day extensions of credit be: (1) on market terms consistent with section 23B of the Federal Reserve Act, and (2) fully secured, even if the bank's general policy (and section 23B) does not require the bank to be fully secured in clearing.

Final action. The Board is rescinding the blanket prohibition on funding, imposed by this firewall but retaining as Operating Standard #5 the restriction on intra-day funding in modified form. Because the operating standards apply to all section 20 subsidiaries, the Board will thereby be imposing this restriction for the first time on section 20 subsidiaries operating under the *1987 Order*.

Commenters strongly supported elimination of the funding restriction. As for the remaining restriction on intra-day credit, several commenters opposed requiring that intra-day credit be fully secured even when market practice is less stringent. One commenter stressed that such loans are intended to be intra-day transactions to finance the purchase of securities, and historically have been extremely low-risk. The commenter argued that the proposed operating standard would continue to put section 20 companies at a competitive disadvantage to dealers outside of bank holding companies. Finally, the commenter noted that although the Board has previously encouraged clearing banks to obtain collateral to secure daylight overdrafts, it has not required them to obtain collateral.

Another commenter asked the Board to clarify that any limit on intra-day credit for clearing purposes would apply only to intra-day overdrafts related to the bank's clearing of securities trades for the affiliated section 20 company, and not to daylight overdrafts in demand deposit accounts that an affiliated bank may maintain as a settlement bank for a section 20 company that is a clearing member on an exchange (whether the product being cleared is a security or a commodity.) The commenter also asked the Board to clarify that the proposed standard would not apply to intra-day overdrafts in deposit accounts maintained at an affiliated bank as a settlement bank for a section 20 company that is engaged in clearing futures, options on futures, options traded on a nationally recognized securities exchange as a futures commission merchant or as a broker-dealer. Lastly, the commenter asked the Board to clarify whether removal of the funding firewall would allow a bank lending securities to a section 20 affiliate to issue a guarantee or indemnity to protect its customers against losses in the event of the section 20 company's nonperformance.

The Board is rescinding the general prohibition on funding.[38] A bank's funding of an affiliate will continue to be limited by sections 23A and 23B of the Federal Reserve Act. Thus, a bank will be subject to the quantitative limitations of section 23A, will have to deal with the section 20 affiliate on market terms, will be prohibited from purchasing low-quality assets from the affiliate, and will be prohibited from purchasing securities underwritten by a section 20 affiliate during the existence of the underwriting or selling syndicate unless a majority of the bank's outside board of directors approves. These restrictions have been sufficient with respect to the fourteen companies operating under the 1987 Order that have not been subject to this firewall.

The Board will continue to prohibit intra-day extensions of credit for clearing or other purposes unless they are on market terms consistent with section 23B of the Federal Reserve Act. In effect, the Board is requiring that the bank apply to a section 20 affiliate the same internal exposure limits and collateral requirements for intra-day credit that it applies to third parties. The Board believes that the application of section 23B to all intra-day extensions of credit to a section 20 affiliate is appropriate to ensure that such credit is not subsidizing the activities of the section 20 affiliate to the detriment of the bank and the section 20 affiliate's competitors. However, the Board will not require that intra-day extensions of credit be fully secured when market practice does not.

Finally, the operating standard being adopted by the Board applies sections 23A and 23B of the Federal Reserve Act to U.S. branches and agencies of foreign banks for purposes of extensions of credit to a section 20 affiliate. Under the current firewall, lending to a section 20 affiliate by a U.S. branch and agency of a foreign bank is prohibited, as is lending by a U.S. bank.[39] Elimination of the firewall and adoption of this operating standard will liberalize the funding restriction for U.S. branches and agencies of foreign banks to the same extent that the restriction is liberalized for U.S. banking organizations.

Commenters sought clarification on how certain provisions of sections 23A and 23B would apply to U.S. branches and agencies of foreign banks. In applying the quantitative limitations of sections 23A and 23B, a U.S. branch or agency of a foreign bank shall refer to the capital of its foreign bank parent as calculated under its home country capital standards if the home country supervisor of the foreign bank has adopted capital standards consistent in all respects with the Capital Accord of the Basle Committee on Banking Supervision (Basle Accord). If the home country supervisor has not adopted capital standards consistent in all respects with the Basle Accord, the branch or agency shall refer to the capital of its foreign bank parent as calculated under standards applicable to U.S. banking organizations. Furthermore, in applying the provisions of section 23B that require outside director approval for certain transactions, a foreign bank may, at its option, seek approval for a transaction from a majority of the senior executive officers of the foreign bank who are both located outside the U.S. and are not officers or employees of any U.S. branch or agency of the foreign bank.

Firewall 21(b)

Existing firewall. Established an exception to Firewall 21(a) for clearing purposes.

Proposal. If Firewall 21(a) were rescinded, the Board proposed to rescind Firewall 21(b) as moot.

Final action. The Board is rescinding this firewall.

Firewall 22 (Financial Assets Restriction).

Existing firewall (as amended).[40] Prohibits a bank (or U.S. branch or agency of a foreign bank) from purchasing for its own account any financial assets of a section 20 affiliate or a subsidiary thereof, or selling from its own account such assets to the section 20 affiliate or a subsidiary thereof. The limitation does not apply to

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[38] Although the funding firewall will permit a bank lending securities to issue a guarantee or indemnification in case of a section 20 affiliate's non-performance, any such transaction will be subject to sections 23A and 23B of the Federal Reserve Act.

[39] With respect to foreign banks operating under the 1990 Order, the proposal represents relief from a restriction. Although this proposal would impose new requirements on foreign banks operating under the 1987 Order, the Board specifically reserved its right to impose new restrictions should circumstances change to make such requirements appropriate. See Sanwa Bank, Ltd., 76 Federal Reserve Bulletin 568, 570 (1990).

[40] 61 FR 57679, 57683.

the purchase and sale of assets having a readily identifiable and publicly available market quotation and purchased at that market quotation (and therefore exempt from section 23A of the Federal Reserve Act), provided that those assets are not subject to a repurchase or reverse repurchase agreement.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall, which was designed to prevent a bank from using purchases and sales as a means of evading Firewall 21 and indirectly funding a section 20 affiliate. The same protections on which the Board has relied in permitting direct funding will still require that all such purchases be made on market terms, and section 23A of the Federal Reserve Act will impose quantitative limits. Section 23A also generally prohibits a bank from purchasing a low-quality asset from an affiliate.[41] Moreover, the National Bank Act limits the type of investment securities that a national bank may hold, generally to investment grade debt securities.

Elimination of this restriction will allow repurchase and reverse repurchase agreements as a funding vehicle between a section 20 subsidiary and its affiliated banks. Such agreements would have to be consistent with sections 23A and 23B, however, and market terms generally require over-collateralization with government securities. The Board notes that as a safety and soundness matter, it generally emphasizes that section 20 subsidiaries should develop diverse funding sources. Thus, a section 20 company should not rely on repurchase agreements with an affiliated bank as its sole funding source.

H. Limitations on Transfers of Information

Firewall 23 (Disclosure of Nonpublic Information)

Existing firewall. Prohibits a bank from disclosing to a section 20 affiliate or a section 20 affiliate from disclosing to an affiliated bank, any nonpublic customer information (including an evaluation of the creditworthiness of an issuer or other customer of that bank, or underwriting subsidiary) without the consent of that customer.

Proposal. The Board proposed to include this firewall as an operating standard.

Final action. The Board is rescinding this firewall and not adopting the proposed operating standard. Many commenters objected to retention of this restriction. These commenters argued that although the restriction was initially implemented to prevent a section 20 subsidiary from gaining an unfair competitive advantage through access to its affiliated bank's credit files, it now places section 20 subsidiaries at a competitive disadvantage. Investment banks not affiliated with bank holding companies increasingly have access to financial information of issuers through participation in syndicated and other commercial lending transactions, yet they may share that information with their affiliates.

These commenters also noted that the restriction is at odds with, and impracticable in light of, the Board's recent removal of the cross-marketing and dual employee restrictions, which will entail sharing of nonpublic information. Commenters also contended that existing statutory and regulatory provisions such as the Fair Credit Reporting Act and state consumer privacy statutes are adequate to protect retail customers, and that retention of the restriction would impede customer convenience. Commenters noted that the Board has recently removed restrictions on the sharing of customer information between a bank and an affiliate engaged in providing investment advice or full-service brokerage.[42] Finally, one commenter noted that many customers, particularly large institutional customers, simply assume the sharing of information will occur consistent with applicable law.

After considering these comments, the Board has decided not to adopt this operating standard, as the chances for a bank holding company to gain a competitive advantage or harm a customer through the sharing of information appear to be remote. The Board will continue to monitor this area to determine if abuses do occur.

I. Reports

Firewall 24 (Reports to Federal Reserve)

Existing firewall. Requires bank holding companies to submit quarterly to the appropriate Federal Reserve Bank copies of FOCUS reports filed with the NASD or other self-regulatory organizations, and detailed information breaking down the section 20 subsidiary's business with respect to eligible and bank-ineligible securities.

Proposal. The Board proposed to retain this requirement in modified form as one of the operating standards.

Final action. The Board is retaining this requirement as Operating Standard #7, as it wishes the filing of these reports to be a condition of section 20 approval and enforceable as such.

J. Transfer of Activities and Formation of Subsidiaries of an Underwriting Subsidiary to Engage in Underwriting and Dealing

Firewall 25 (Scope of Order)

Existing firewall. Clarifies that approval of a section 20 application extends only to the subsidiaries for which approval has been sought in the instant application. Also prohibits any corporate reorganization without prior Board approval.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this information, as each order approving section 20 activities makes plain the scope and organizational structure of the activities approved.

K. Limitations on Reciprocal Arrangements and Discriminatory Treatment

Firewall 26 (Prohibition on Reciprocity Arrangements)

Existing firewall. Prohibits a bank holding company or any subsidiary from entering into any reciprocity arrangement. A reciprocity arrangement means any agreement, understanding, or other arrangement under which one bank holding company (or subsidiary thereof) agrees to engage in a transaction with, or on behalf of, another bank holding company (or subsidiary thereof), in exchange for the agreement of the second bank holding company (or any subsidiary thereof) to engage in a transaction with, or on behalf of, the first bank holding company (or any subsidiary thereof) for the purpose of evading the firewalls or any prohibition on transactions between, or for the benefit of, affiliates of banks established pursuant to federal banking law or regulation.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall. Anti-competitive reciprocity arrangements are prohibited by the antitrust laws, and reciprocity arrangements involving a bank are subject to a special per se prohibition in section 106 of the Bank Holding Company Act Amendments of 1970.[43] The Board will rely on the examination process to identify any evasions of the proposed operating standards.

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[41] 12 U.S.C. 371c(a)(3), (b)(10).

[42] 62 FR 9336 (1997) (amending 12 CFR 225.28(b)(7)(i)).

[43] 12 U.S.C. 1972(1).

Firewall 27 (Prohibition on Discriminatory Treatment)

Existing firewall. Prohibits a bank from:

(a) Extending or denying credit or services (including clearing services), or varying the terms or conditions thereof, if the effect of such action would be to treat an unaffiliated securities firm less favorably than its section 20 affiliate; or

(b) Extending or denying credit or services or varying the terms or conditions thereof with the intent of creating a competitive advantage for a section 20 affiliate.

Proposal. The Board proposed to rescind this firewall.

Final action. The Board is rescinding this firewall. This firewall addresses a potential conflict of interest that arises when a bank is dealing with competitors of its section 20 affiliate. However, other laws adequately address or diminish the potential for conflict of interest. First, the Board notes that whereas securities firms had been restricted by section 8(a) of the Securities Exchange Act of 1934 in the types of lenders from which they could obtain loans secured by securities collateral—generally, to banks and other broker-dealers—section 8(a) was recently repealed, and such restriction thereby eliminated.[44] Thus, the possibility that a bank would be able to enforce unfavorable credit terms on a competitor of a section 20 affiliate is remote. Second, section 106 of the Bank Holding Company Act Amendments of 1970 prohibits a bank from, among other things, restricting the availability of, or offering discounts on, its products on the condition that the customer not obtain products from any competitor of the bank or its affiliates.

L. Requirement for Supervisory Review Before Commencement of Activities

Firewall 28 (Infrastructure Review)

Existing firewall. Requires a review of a bank holding company's policies and procedures—including computer, audit and accounting systems, internal risk management controls and the necessary operational and managerial infrastructure—before approval to commence corporate debt and equity underwriting and dealing activities.

Proposal. The Board proposed to require an infrastructure review in the context of each application rather than including it as an operating standard for section 20 subsidiaries.

Final action. The Board is rescinding the firewall. The Board generally will continue to conduct an inspection prior to allowing commencement of underwriting and dealing in corporate debt or equity securities pursuant to the *1989 Order.* Such inspections now frequently begin shortly after the filing of an application, and may be completed before the application is considered by the Board. Thus, the pre-commencement examination generally does not create a substantial delay beyond the application processing period. In special cases, such as an acquisition of a going concern, the inspection will occur as soon as possible after consummation.

For the foregoing reasons, the Board is (1) rescinding conditions 2–20 in its 1987 Order (and any other order incorporating those conditions), conditions 1–28 in its 1989 Order (and any other order incorporating those conditions), and conditions 1–28 in its 1990 Order (and any other order incorporating those conditions).

[44] National Securities Markets Improvement Act of 1996, Pub. L. 104–290 (1996) (amending 15 U.S.C. 78h(a)(1995)) .

List of Subjects 12 CFR Part 225

Administrative practice and procedure, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board amends 12 CFR Part 225 as follows:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for Part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1831p–1, 1843(c)(8), 1844(b), 1972(l), 3106, 3108, 3310, 3331–3351, 3907, 3908, and 3909.

2. An undesignated center heading and § 225.200 would be added to read as follows:

Conditions to Orders

§ 225.200 Conditions to Board's section 20 orders.

(a) *Introduction.* Under section 20 of the Glass-Steagall Act (12 U.S.C. 377) and section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), a nonbank subsidiary of a bank holding company may to a limited extent underwrite and deal in securities for which underwriting and dealing by a member bank is prohibited. Pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, these so-called section 20 subsidiaries are required to register with the SEC as broker-dealers and are subject to all the financial reporting, anti-fraud and financial responsibility rules applicable to broker-dealers. In addition, transactions between insured depository institutions and their section 20 affiliates are restricted by sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1). The Board expects a section 20 subsidiary, like any other subsidiary of a bank holding company, to be operated prudently. Doing so would include observing corporate formalities (such as the maintenance of separate accounting and corporate records), and instituting appropriate risk management, including independent trading and exposure limits consistent with parent company guidelines.

(b) *Conditions.* As a condition of each order approving establishment of a section 20 subsidiary, a bank holding company shall comply with the following conditions.

(1) *Capital.* (i) A bank holding company shall maintain adequate capital on a fully consolidated basis. If operating a section 20 authorized to underwrite and deal in all types of debt and equity securities, a bank holding company shall maintain strong capital on a fully consolidated basis.

(ii) In the event that a bank or thrift affiliate of a section 20 subsidiary shall become less than well capitalized (as defined in section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o), and the bank holding company shall fail to restore it promptly to the well capitalized level, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1989 order allowing underwriting and dealing in bank-ineligible securities,[1] or order the bank holding company to divest the section 20 subsidiary.

(iii) A foreign bank that operates a branch or agency in the United States shall maintain strong capital on a fully consolidated basis at levels above the minimum levels required by the Basle Capital Accord. In the event that the Board determines that the foreign bank's capital has fallen below these levels and the foreign bank fails to restore its capital position promptly, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1990 order allowing foreign banks to underwrite and deal in bank-ineligible securities,[2] or order the foreign bank to divest the section 20 subsidiary.

[1] Firewalls 5–8, 19, 21 and 22 of *J.P. Morgan & Co., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 Federal Reserve Bulletin 192, 214–16 (1989).

[2] Firewalls 5–8, 19, 21 and 22 of *Canadian Imperial Bank of Commerce, The Royal Bank of*

(2) *Internal controls.* (i) Each bank holding company or foreign bank shall cause its subsidiary banks, thrifts, branches or agencies [3] to adopt policies and procedures, including appropriate limits on exposure, to govern their participation in transactions underwritten or arranged by a section 20 affiliate.

(ii) Each bank holding company or foreign bank shall ensure that an independent and thorough credit evaluation has been undertaken in connection with participation by a bank, thrift, or branch or agency in such transactions, and that adequate documentation of that evaluation is maintained for review by examiners of the appropriate federal banking agency and the Federal Reserve.

(3) *Interlocks restriction.* (i) Directors, officers or employees of a bank or thrift subsidiary of a bank holding company, or a bank or thrift subsidiary or branch or agency of a foreign bank, shall not serve as a majority of the board of directors or the chief executive officer of an affiliated section 20 subsidiary.

(ii) Directors, officers or employees of a section 20 subsidiary shall not serve as a majority of the board of directors or the chief executive officer of an affiliated bank or thrift subsidiary or branch or agency, except that the manager of a branch or agency may act as a director of the underwriting subsidiary.

(iii) For purposes of this standard, the manager of a branch or agency of a foreign bank generally will be considered to be the chief executive officer of the branch or agency.

(4) *Customer disclosure*—(i) *Disclosure to section 20 customers.* A section 20 subsidiary shall provide each of its retail customers [4] the same written and oral disclosures, and obtain the same customer acknowledgment, required by the Interagency Statement on Retail Sales of Nondeposit Investment Products as if it were a depository institution.

(ii) *Disclosures accompanying investment advice.* A director, officer, or employee of a bank, thrift, branch or agency may not express an opinion on the value or the advisability of the purchase or the sale of a bank-ineligible security that he or she knows is being underwritten or dealt in by a section 20 affiliate unless he or she notifies the customer of the affiliate's role.

Canada, Barclays PLC and Barclays Bank PLC, 76 Federal Reserve Bulletin 158, (1990).

[3] The terms ''branch'' and ''agency'' refer to a U.S. branch and agency of a foreign bank.

[4] For purposes of this operating standard, a retail customer is any customer that is not an ''accredited investor'' as defined in 17 CFR 230.501(a).

(5) *Intra-day credit.* Any intra-day extension of credit to a section 20 subsidiary by an affiliated bank, thrift, branch or agency shall be on market terms consistent with section 23B of the Federal Reserve Act.

(6) *Restriction on funding purchases of securities during underwriting period.* No bank, thrift, branch or agency shall knowingly extend credit to a customer secured by, or for the purpose of purchasing, any bank-ineligible security that a section 20 affiliate is underwriting or has underwritten within the past 30 days, unless:

(i) The extension of credit is made pursuant to, and consistent with any conditions imposed in a preexisting line of credit that was not established in contemplation of the underwriting; or

(ii) The extension of credit is made in connection with clearing transactions for the section 20 affiliate.

(7) *Reporting requirement.* (i) Each bank holding company or foreign bank shall submit quarterly to the appropriate Federal Reserve Bank any FOCUS report filed with the NASD or other self-regulatory organizations, and any information required by the Board to monitor compliance with these operating standards and section 20 of the Glass-Steagall Act, on forms provided by the Board.

(ii) In the event that a section 20 subsidiary is required to furnish notice concerning its capitalization to the Securities and Exchange Commission pursuant to 17 CFR 240.17a–11, a copy of the notice shall be filed concurrently with the appropriate Federal Reserve Bank.

(8) *Foreign banks.* A foreign bank shall ensure that any extension of credit by its branch or agency to a section 20 affiliate, and any purchase by such branch or agency, as principal or fiduciary, of securities for which a section 20 affiliate is a principal underwriter, conforms to sections 23A and 23B of the Federal Reserve Act, and that its branches and agencies not advertise or suggest that they are responsible for the obligations of a section 20 affiliate, consistent with section 23B(c) of the Federal Reserve Act.

By order of the Board of Governors of the Federal Reserve System, August 22, 1997.

William W. Wiles,

Secretary of the Board.

[FR Doc. 97–22840 Filed 8–26–97; 8:45 am]

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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 543

[No. 97–83]

RIN 1550–AB06

Incorporation, Organization, and Conversion of Federal Mutual Associations

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS) is issuing a final rule amending its regulations governing conversions to federal mutual savings associations. The final rule permits the direct conversion of all types of mutual depository institutions into federal mutual savings associations. This final rule simplifies the conversion process.

EFFECTIVE DATE: August 27, 1997.

FOR FURTHER INFORMATION CONTACT: David A. Permut, Counsel (Banking and Finance) Business Transactions Division (202/906–7505); Scott Ciardi, Senior Analyst, Corporate Activities Division (202/906–6960); or Kevin A. Corcoran, Assistant Chief Counsel for Business Transactions (202/906–6962), Business Transactions Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

I. Background

The OTS is issuing a final regulation that permits all types of mutual depository institutions to convert directly to a federal mutual savings association charter.[1] The regulation is consistent with OTS's long-standing position that depository institutions should be free to operate under whatever charter best suits their business needs, consistent with safety and soundness. The OTS previously has granted federal savings associations explicit authority to convert directly to a bank charter,[2] and has promulgated regulations enabling stock depository institutions to convert directly to a federal stock savings association charter.[3]

The OTS published a notice of proposed rulemaking regarding direct

[1] Section 2(5) of the Home Owners' Loan Act defines ''federal savings associations'' to include federal savings associations and federal savings banks. Accordingly, references herein to federal savings associations include federal savings banks.

[2] 12 CFR 552.2–7.

[3] 12 CFR 552.2–6.