NASAA

The Gramm-Leach-Bliley Financial Modernization Act of 1999: Summary and Analysis for State Securities Regulators

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Introduction

On November 12, 1999, President William Jefferson Clinton signed the **Gramm-Leach-Bliley Act** (the "Act") into Public Law No. 106-102. Popularly known as "financial services modernization," this legislation repeals certain provisions of the Banking Act of 1933 (the Glass-Steagall Act), and otherwise facilitates affiliation between banks[1], securities firms and insurance companies. The Act is divided into seven titles.

Title I amends certain federal banking laws to allow banks, securities firms and insurance companies to affiliate under a new "financial holding company" structure. This new holding company entity may engage in activities that are "financial in nature" or closely related thereto. In addition, certain financial activities may be carried out in operating subsidiaries of national banks (and, to the extent permitted by State law, by operating subsidiaries of State banks). Title I also generally preempts state law to the extent it prevents or significantly interferes with activities or affiliations authorized by the Act. However, Title I does expressly preserve all aspects of state securities law.

Title II amends certain federal securities laws to establish "functional regulation" of the securities activities of banks and financial holding companies.

Title III affirms that the States are the regulators of insurance activities of all persons, but provides that States may not prevent banks and their affiliates from conducting insurance activities.

Title IV eliminates the "unitary thrift loophole," which permitted commercial entities to own and operate a single savings and loan institution.

Title V the "privacy" title, establishes new standards for financial institution policies and procedures regarding customer financial data.

Title VI implements certain modernizations to the Federal Home Loan Bank System.

Title VII requires certain disclosure regarding automatic teller machine fees, and also makes certain reforms to the Community Reinvestment Act ("CRA").

This summary provides an overview of Titles I and III through VII, and a detailed discussion of Title II.

Title I: Facilitating Affiliations Among Banks, Securities Firms and Insurance Companies.

Title I/Subtitle A: Affiliations (Sections 101 to 109).

To facilitate affiliations among financial services firms, Section 101 of the Act eliminates two provisions of the Glass-Steagall Act. First, Section 20, which prohibited banks from being affiliated with firms "engaged

[1] The terms "bank" and "depository institution" are used interchangeably throughout this summary.

principally" in securities activities,[2] is repealed. Second, Section 32, which prohibited employee, officer and director interlocks between banks and firms "primarily engaged" in securities activities, is repealed.

Section 103 of the Act replaces these repealed prohibitions with several new subsections of Section 4 of the Bank Holding Company Act of 1956 ("BHCA"). These new subsections permit a bank holding company to engage in various financial activities through a newly authorized entity known as a "financial holding company" ("FHC"). **New BHCA Section 4(l)** provides that a bank holding company may elect to become an FHC if all of its subsidiary banks are "well-capitalized," "well-managed," and received at least a "satisfactory" CRA rating. FHCs will be subject to the oversight of the Board of Governors of the Federal Reserve System (the "Fed").[3]

New BHCA Section 4(k) permits FHCs to engage in activities, and acquire companies engaged in activities, that are "financial in nature" or "incidental" to such financial activities. FHCs are also permitted to engage in activities that are "complementary" to financial activities if the Fed determines that the activity does not pose a substantial risk to the safety or soundness of depository institutions or the financial system in general.

Permitting banks to affiliate with firms engaged in financial activities represents an expansion of prior law which limited bank affiliates to activities that were "closely related" to banking.[4] For national banks and their subsidiaries, the Fed has primary jurisdiction for determining what activities are "financial in nature", "incidental" to financial in nature, or "complementary." The Fed may act by regulation or order, but the Fed must notify the Secretary of the Treasury ("Treasury") of applications or requests to engage in new financial activities. The Fed may not determine that an activity is "financial in nature" or "incidental" thereto if Treasury objects. Treasury may also propose that the Fed find that a particular activity is "financial in nature" or "incidental" thereto.

New BHCA Section 4(k)(4) contains nine categories of activities that are considered to be "financial in nature." For state securities purposes, it is important to note that one category includes securities underwriting, dealing and market making, while another category includes providing investment advice. Because of the repeal of Section 20 of the Glass-Steagall Act, these securities activities may be undertaken without any revenue limitation.

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[2] Since Section 20 did not establish an absolute prohibition, in 1987 the Board of Governors of the Federal Reserve System (the "Fed") took the position that bank holding companies could derive a limited amount of revenue from subsidiaries that engaged in securities activities. This led to the proliferation of so-called "Section 20 Subsidiaries." The Fed set the gross revenue limitation at 10% in 1989, and raised it to 25% in 1996. As discussed further herein, the repeal of Section 20 eliminates the limitation on securities revenues received by the bank holding companies that are "financial holding companies."

[3] Through this new FHC structure, and with the permission of the Fed, securities firms can acquire banks for the first time.

[4] First promulgated in 1971, the Fed's Regulation Y, 12 C.F.R. § 225, listed the activities deemed "closely related to banking" that could be undertaken by bank affiliates in a bank holding company structure. Regulation Y includes the following securities-related activities: trust company functions; investment or financial advice; issuance and sale of money orders, savings bonds and travelers checks; securities brokerage services; and underwriting and dealing in government obligations and money market instruments. As described further herein, activities that the Fed has deemed to be "closely related to banking" are included in codified list of activities that are "financial in nature."

Two other categories of new BHCA Section 4(k)(4) permit FHCs to engage in certain merchant banking and insurance company portfolio activities. **New BHCA Section 4(k)(4)(H)** authorizes FHCs to conduct merchant banking, investment activity for the purpose of appreciation and resale, subject to two restrictions.[5] **New BHCA Section 4(k)(4)(I)** permits an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company if certain requirements are met.[6]

The other five categories of activities deemed to be "financial in nature" are: (i) lending, exchanging, transferring, investing for others, or safeguarding money or securities; (ii) insurance underwriting and agency activities; (iii) issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; (iv) activities deemed "closely related to banking;"[7] and (v) activities allowed for U.S. bank holding companies in other countries (subject to the Fed's approval).

New BHCA Section 4(n) establishes a "commercial basket," which is to say that certain FHCs may derive a limited amount of revenue from non-financial commercial activities. Specifically, a securities firm (or other company) that becomes an FHC may continue to engage in pre-existing commercial activities in an amount not to exceed 15% of its consolidated annual gross revenues (excluding revenues from bank subsidiaries). This "commercial basket" expires in November 2009, unless extended by the Fed for up to five more years. In general, banks within commercial basket FHCs may not cross-market the services of their commercial affiliate.

While Section 103 of the Act authorizes new activities and affiliations, Section 104 of the Act addresses the balance between state and federal regulation of these authorized affiliations and activities. In other words, Section 104 discusses when State law is or is not preempted.

Most of Section 104 deals with State regulation of insurance activities. Section 104(a) reaffirms the McCarran-Ferguson Act, recognizing the primacy and legal authority of States to regulate the insurance activities of all persons. Section 104(b) states that no person shall engage in the business of insurance unless such person is licensed as required by State law. However, Section 104(c) generally prohibits a State from preventing or restricting a depository institution (or affiliate) from being affiliated with another

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5 First, investments may be held only for a period of time that will permit their sale or disposition "on a reasonable basis consistent with the financial viability" of the activity. Second, during the period the investment is held, the FHC may not "routinely manage or operate such company or entity except as may be necessary or required to obtain a reasonable return on investment."

6 The shares held by such a company: (i) must not be acquired or held by a depository institution or a subsidiary of a depository institution; (ii) must be acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance) or in providing and issuing annuities; and (iii) must represent an investment made in the ordinary course of business of such insurance company in accordance with relevant state law governing such investments. Additional restrictions also apply. Deeming insurance portfolio activity to be financial in nature recognizes that in the ordinary course of business (and subject to state law) insurance companies frequently invest funds received from policy holdings in companies not engaged in financial activities.

7 *I.e.* the activities listed in Regulation Y. *See supra* note 4.

business (such as insurance) as permitted by the Act or other provisions of federal law (although in the case of insurance, certain rights are preserved to the insurer's State of domicile).

Similarly, Section 104(d)(1) generally prohibits a State from preventing or restricting a depository institution (or affiliate) from engaging in the activities authorized by the Act or other provisions of federal law. With respect to insurance sales, solicitation or cross-marketing activities, Section 104(d)(2)(A) provides that no State may "prevent or significantly interfere with" the ability of a depository institution (or affiliate) to engage in any insurance sales, solicitation or cross-marketing activities (codifying Barnett Bank of Marion County N.A. v. Nelson, 517 U.S. 25 (1996)). Notwithstanding Section 104(d)(2)(A), Section 104(d)(2)(B) provides that States may impose certain insurance restrictions in thirteen specific areas, provided that the State restrictions are "substantially the same as but no more burdensome or restrictive than" the restrictions in the Act's "safe harbors" in these thirteen areas.

However, Section 104(e) provides that, except as described in Section 104(d)(2)(b), a State may not regulate the insurance activities of a bank (or affiliate) if the regulation adversely discriminates against banks (or affiliates), effectively prevents bank insurance activities or conflicts with the intent of the Act to permit affiliations between banks and insurance providers.

Most importantly for NASAA members, Section 104(f)(1) preserves the authority of state securities commissioners to investigate and bring enforcement actions consistent with Section 18(c) of the Securities Act of 1933, and to require the registration of securities or the licensure or registration of brokers, dealers, investment advisers (consistent with Section 203A of the Investment Advisers Act of 1940) and their associated persons. Section 104(f)(2) preserves state general corporation law. This preservation goes a long way in establishing the "functional regulation" of securities activities discussed further herein.

Title I/Subtitle B: Streamlining Supervision of Bank Holding Companies (Sections 111 to 119).

Subtitle B of Title I of the Act makes a series of amendments to BHCA Section 5 and introduces the concept of "functional regulation," which holds that particular financial activities are to be regulated by the regulator with the expertise in that area. For state securities regulation purposes, it is important to note that **new BHCA Section 5(c)(4)(A)** states:

> Securities activities conducted in a functionally regulated subsidiary of a depository institution shall be subject to regulation by the Securities and Exchange Commission and by relevant State securities authorities, as appropriate, subject to section 104 of [the Act], to the same extent as if they were conducted in a nondepository institution subsidiary of a bank holding company.

Subtitle B of Title I also makes clear that the Fed is the umbrella regulator of bank holding companies and FHCs, and amends BHCA section 5(c) to provide that the Fed may require bank holding companies and subsidiaries to submit to the Fed reports regarding, among other things, financial condition. **New BHCA Section 5(c)(2),** establishes the so-called "Fed-Light" provisions pursuant to which the Fed generally must forego examinations and instead review examination reports of "functionally regulated" subsidiaries as follows: (i) of depository institution by State and federal depository institution regulators; (ii) of registered broker/dealers by the Securities and Exchange Commission (the "SEC"); (iii) of investment advisers by either the SEC or the States; and (iv) of insurance companies by State insurance authorities. New BHCA 5(c)(2) does, however, reserve to the Fed the right to conduct an examination "for cause."

Consistent with the notion of functional regulation, **new BHCA Section 5(c)(3)** prohibits the Fed from prescribing capital requirements for a functionally regulated subsidiary that is in compliance with the capital requirements of its functional regulator. Further, **new BHCA Section 5(g)** generally prohibits the Fed from requiring a broker-dealer or insurance company that is a bank holding company to infuse funds into a depository institution if the functional regulator determines that such action would have a material adverse effect on the broker-dealer or insurance company. Finally, Section 113 of the Act adds **new BHCA Section 10A(b)**, which limits the Fed's authority to take action against a functionally regulated affiliate of an FHC.

Section 114 of the Act empowers the federal banking regulators to adopt prudential safeguards governing transactions between depository institutions, their subsidiaries and affiliates so as to avoid, among other things, significant risk to the safety and soundness of the depository institution.

Title I/Subtitle C: Subsidiaries of National Banks (Sections 121 and 122).

While Section 103 of the Act permits a wide range of financial activities to take place within an FHC, Section 121 allows certain financial activities to take place in an operating subsidiary of a national bank. As a result, with respect to many financial activities, institutions are able to make a business decision regarding whether to conduct financial activities in a holding company or subsidiary structure. Section 121 of the Act authorizes a national bank to control or own an interest in a "financial subsidiary" if certain conditions are met.

The first condition is that the financial subsidiary engage only in activities that are "financial in nature" (as defined in new BHCA Section 4(k)) or "incidental" thereto. However, a financial subsidiary is specifically prohibited from engaging in the following activities: insurance (including annuity) underwriting; real estate development and real estate investment; and insurance company portfolio investment and merchant banking.[8] The second condition is that the national bank and each depository institution affiliate of the national bank must be "well-capitalized" and "well-managed." The third condition is that the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of 45% of the consolidated total assets of the parent bank, or $50 billion. The fourth condition, applicable only to the nation's 100 largest banks, requires that the bank have a specified investment grade level rating. Finally, in all cases, the national bank must receive the approval of the Office of the Comptroller of the Currency (the "OCC").[9]

Section 121 of the Act also **adds to the Federal Deposit Insurance Act ("FDIA") a new Section 46**, which permits an insured State bank, to the extent permitted by State law, to control or hold an interest in a financial subsidiary under certain conditions. This provision grants "parity" to State banks on the issue of financial activities of operating subsidiaries.

[8] Note that the activities as to which financial subsidiaries are precluded may be conducted in an FHC affiliate.

[9] Section 121 also requires the OCC to promulgate implementing regulations by September 9, 2000.

Section 122 permits the Fed and Treasury to allow operating subsidiaries to engage in merchant banking activities beginning in 2004, after carefully evaluating the experience of FHCs with merchant banking up to that point.

Title I/Subtitle D: Preservation of Federal Trade Commission ("FTC") Authority (Sections 131 to 133).

Section 131 of the Act provides for anti-trust review by the FTC of certain financial service provider combinations and affiliations. Section 132 provides for inter-agency data sharing for purposes of anti-trust review.

Title I/Subtitle E: National Treatment of Foreign Banks (Sections 141 and 142).

Section 141 of the Act essentially provides for national treatment of foreign banks that wish to engage in the financial activities authorized by the Act.

Title I/Subtitle F: Direct Activities of Banks (Section 151).

Section 151 of the Act authorizes well-capitalized national banks to deal in, underwrite and purchase municipal bonds.

Title I/Subtitle G: Effective Date (Section 161).

Section 161 of the Act provides that Title I (except Section 104) takes effect 120 days after enactment, which translates to March 11, 2000. Section 104 took effect on the date of enactment, November 12, 1999.

Title II: Functional Regulation.[10]

At the outset of this discussion of Title II, it is important to note that the amendments to the federal securities laws contained in Subtitles A and B of Title II do not become effective until May 12, 2001 (*see* Sections 209 and 225).

Title II/Subtitle A: Brokers and Dealers (Sections 201 to 210).

Title II/Subtitle A/Section 201: Definition of Broker.

Section 3(a)(4) of the Securities Exchange Act of 1934 (the "1934 Act") currently provides a complete exclusion for banks from the definition of "broker."[11] Section 201 of the Act replaces this "blanket" exclusion with a series of enumerated exclusions. As a result, under **amended Section 3(a)(4) of the 1934 Act**, a bank is excluded from the definition of broker only to the extent that the bank's securities activities fall into

[10] This discussion of Title II incorporates materials prepared by former NASAA Associate General Counsel Jeffrey O. Himstreet and contained in "H.R. 10: The Financial Services Act of 1998" (Aug. 20, 1998).

[11] Notwithstanding this exclusion, banks are subject to the anti-fraud standards of the federal securities laws.

one of the categories enumerated in new Sections 3(a)(4)(B)(i) through 3(a)(4)(B)(xi).[12] As discussed below, three of the exclusions are available for transactions in "publicly traded securities" only under certain circumstances.[13]

•*New 1934 Act Section 3(a)(4)(B)(i): Third Party Brokerage Arrangements.*

New Section 3(a)(4)(B)(i) permits banks to enter into contractual or other written arrangements with SEC-registered broker/dealers to engage in the offer and sale of securities on or off bank premises without the bank itself meeting the definition of "broker." This exception is similar, but actually narrower than, the NASD "Bank Broker/Dealer Rule" (NASD Rule 2350) and the NASAA Model Rules for Sale of Securities at Financial Institutions.

Section 3(a)(4)(B)(i) provides an exclusion from the definition of "broker" if the bank and the broker/dealer with whom the bank has engaged to offer securities, comply with the following nine conditions:

(1) the broker/dealer is clearly identified as the person performing the brokerage services;[14]

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12 When the Glass-Stegall barriers showed their first signs of erosion, the SEC attempted to eliminate the bank blanket exclusion by promulgating Rule 3b-9 in 1985. Essentially, Rule 3b-9 required banks to establish separate broker/dealers for activities involving either the public solicitation of brokerage business for transaction-related compensation or the receipt of transaction-related compensation for trust, managing agency, or other account to which the bank provided advice. The American Bankers Association immediately challenged the rule. The D.C. Circuit Court of Appeals ultimately invalidated Rule 3b-9 on the grounds that the SEC could not by rule rescind the blanket exclusion established by the 1934 Act. American Bankers Association v. SEC, 804 F2d 739 (D.C. Cir. 1986). Some of the exclusions contained in amended Section 3(a)(4) are the same as or similar to exclusions contained in Rule 3b-9.

13 **New Section 3(a)(4)(c) of the 1934 Act**, "Execution by Broker or Dealer," states: The exception to being considered a broker for a bank engaged in activities described in clauses (ii), (iv) and (viii) of subparagraph (B) shall not apply if the activities described in such provisions result in the trade in the United States of any security that is a publicly traded security in the United States, unless:

(i) the bank directs such trade to a registered broker or dealer for execution;

(ii) the trade is a cross trade or other substantially similar trade of a security that:

(I) is made by the bank or between the bank and an affiliated fiduciary; and

(II) is not in contravention of fiduciary principles established under applicable Federal or State law; or

(iii) the trade is conducted in some other manner permitted under rules, regulations, or orders as the Commission may prescribe or issue.

14 NASD Rule 2350(c)(1) states, in pertinent part, that: "In all situations, members shall identify the member's broker/dealer services in a manner that is clearly distinguished from the financial institution's deposit-taking activities. The member's name shall be clearly displayed in the area in which the member conducts its broker/dealer services." NASAA Model Rule (c)(1) states, in pertinent part, that: "In all situations, the broker/dealer shall identify its services in a manner that clearly distinguishes those services from the financial institution's retail deposit-taking activities. The broker-dealer's name shall be clearly displayed in the area in which the broker/dealer conducts its broker/dealer services."

(2) the broker/dealer performs brokerage services in an area that is clearly marked and, to the extend practicable, physically separate from the routine deposit-taking activities of the bank;[15]

(3) any materials used by the bank to advertise or promote generally the availability of brokerage services clearly disclose that the brokerage services are being provided by the broker/dealer, and not by the bank;[16]

(4) any materials used by the bank to advertise or promote generally the availability of brokerage services under the contractual or other arrangement comply with the federal securities laws before distribution;[17]

(5) bank employees (other than associated persons of the broker/dealer who are qualified pursuant to the rules of a self-regulatory organization) perform only certain clerical or ministerial functions in connection with brokerage transactions;[18]

(6) bank employees do not directly receive incentive compensation for any brokerage transaction unless such employees are associated persons of a broker or dealer and are qualified pursuant to the rules of a self-regulatory organization, except that the bank employees may receive compensation for the referral of any customer if the compensation is a nominal one-time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in a transaction;[19]

(7) such services are provided by the broker or dealer on a basis in which all customers which receive any services are fully disclosed to the broker or dealer;[20]

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[15] Both NASD Rule 2350(c)(1) and NASAA Model Rule (c)(1) provide that "wherever practical," broker/dealer services must be conducted in a "physical location distinct from the area in which the financial institution's retail deposits are taken."

[16] NASD Rule 2350(c)(4)(A) requires this disclosure only on transaction confirmations and account statements. NASAA Model Rule (c)(4)(i) requires such disclosure on confirmations, account statements, and Rule (c)(4)(ii) requires such disclosure in advertisements and sales literature that announce the location of broker/dealer services, or are distributed on the premises of financial institutions.

[17] This concept is not expressly contained in NASD Rule 2350 or the NASAA Model Rules, but is an underlying requirement of broker/dealer use of sales literature.

[18] These ministerial functions include "scheduling appointments with the associated persons of a broker or dealer, except that bank employees may forward customer funds or securities and may describe in general terms the range of investment vehicles available from the bank and the broker or dealer under the contractual or other arrangement . . ." This "clerical or ministerial function" concept is not contained in the NASD Rule 2350 or the NASAA Model Rules, although the concept was contained in SEC Rule 3b-9 discussed in note 12, *supra*.

[19] This concept is not contained in NASD Rule 2350 or the NASAA Model Rules. However, other securities law provisions may prevent licensed securities brokers/dealers from sharing or providing compensation to unlicensed persons or entities.

[20] This concept is not contained in NASD Rule 2350 or the NASAA Model Rules.

(8) the bank does not carry a securities account of the customer except in a customary custodian or trustee capacity;[21] and

(9) the bank, or broker/dealer informs each customer that the brokerage services are provided by the broker or dealer and not by the bank and that the securities are not deposits or other obligations of the bank, are not guaranteed by the bank, and are not insured by the Federal Deposit Insurance Corporation.[22]

•*New 1934 Act Section 3(a)(4)(B)(ii): Trust Activities.*

Under **new Section 3(a)(4)(B)(ii)**, a bank is excluded from the definition of broker if the bank effects transactions in a trustee capacity, or effects transactions in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principals and standards. In addition, the bank must be chiefly compensated for such transactions on the basis of certain fee structures that are consistent with fiduciary principals, and must not publicly solicit brokerage business, other than by advertising that it effects transactions in securities in conjunction with advertising in other trust activities.

For purposes of Section 3(a)(4)(B)(ii), "fiduciary capacity" is defined in **new Section 3(a)(4)(D)** as:

> (i) in the capacity as trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gift to minor act, or as an investment adviser if the bank receives a fee for its investment advice;
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> (ii) in any capacity in which the bank possesses investment discretion on behalf of another; or
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> (iii) in any other similar capacity.

The conduct of trust activities is a traditional banking function. Historically, trust and fiduciary activities have been confined to bank trust departments. However, the Act permits a bank to engage in "trust-like" activities outside of its trust department (without becoming a "broker"), so long as the department in which the activities are engaged is examined regularly by bank examiners for compliance with fiduciary principals and standards.

However, the bank cannot rely upon this exception to trade in any "publicly traded security," unless the trade is directed to a registered broker/dealer for execution, is a "cross trade" or substantially similar trade of a security made by the bank or between the bank and an affiliate and does not violate the bank's fiduciary duty, or is otherwise permitted by SEC Rules.[23]

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21 This concept is not contained in NASD Rule 2350 or the NASAA Model Rules.

22 These customer disclosures are contained in NASD Rules 2350(c)(3) and (4), and NASAA Model Rules (c)(3) and (4).

23 Section 3(a)(4)(C) (*see supra* note 13 for text).

•New 1934 Act Section 3(a)(4)(B)(iii): Permissible Securities Transactions.

New Section 3(a)(4)(B)(iii) sets out a list of securities transactions in which a bank may engage without being deemed a broker. It is important to note that banks are permitted under current law to engage in these transactions without being deemed a broker. In other words, the provisions of this new section largely codify existing administrative orders and rules promulgated by the Fed and the OCC.

First, banks may effect transactions in commercial paper, bankers acceptances, or commercial bills. Banks are currently permitted to engage in these transactions. [24] Second, banks may effect transactions in exempted securities.[25] Pursuant to various Fed rulings, banks are currently permitted to effect transactions, without federal broker/dealer registration, in securities exempt from registration under the Securities Act of 1933 (the "1933 Act"). [26] Third, banks may effect transactions in qualified Canadian government obligations. Finally, banks may effect transactions in so-called "Brady bonds." Banks currently are permitted to effect transaction in both qualified Canadian debt and "Brady bonds."[27]

•New 1934 Act Section 3(a)(4)(B)(iv): Certain Stock Purchase Plans.

New Section 3(a)(4)(B)(iv) is three exceptions in one, dealing with employee benefit plans (3(a)(4)(B)(iv)(I)), dividend reinvestment plans ("DRPs") (3(a)(4)(B)(iv)(II)) and issuer plans (3(a)(4)(B)(iv)(III)). Also, under new Section 3(a)(4)(B)(iv), banks may deliver written materials regarding the foregoing plans to an issuer's employees or shareholders, or members of affinity groups, so long as these materials are "comparable in scope or nature" to those permitted by the SEC, or otherwise permitted by the SEC. Banks are permitted to engage in most, albeit not all, of these services under current law.

New Section 3(a)(4)(B)(iv)(I) permits banks, in connection with its transfer agent activities, to effect transactions in the securities of an issuer as part of an employee benefit plan[28] for the employees of the issuer or affiliates of the issuer. To meet this exception, the bank cannot solicit transactions or provide investment advice regarding the purchase or sale of plan securities. This exception codifies the Fed's current stance permitting banks to provide administrative services for employee benefit plans.

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[24] Since the mid-1980s, the ability of banks to act as agent in the distribution of commercial paper and bankers acceptances has been upheld consistently. *See, e.g.,* Securities Industry Association v. Board of Governors of the Federal Reserve System, 468 U.S. 137 (1984) (also known as the "Becker" case).

[25] Under Section 3(a)(12) of the 1934 Act, "exempt securities" includes government securities, municipal securities, bank common trust funds, certain pools and plans that are excluded from the definition of "investment company" under the Investment Company Act of 1940, and certain employee benefit plans.

[26] *E.g.* Canadian Imperial Bank of Commerce, 1997 WL 666760 (FRB) at *1 (Oct. 27, 1997);
BankAmerica Corporation of San Francisco, 1997 WL 576547 (FRB) at *1, note 4 (Sept. 17, 1997); *and* NationsBank Corporation Charlotte, North Carolina, 1997 WL 560034 (FRB) at *1 (Sept. 10, 1997).

[27] Named such as these standardized, enhanced credit debt securities are issued by foreign banks domestically to retire outstanding commercial bank loans, under permission granted by then Secretary of the Treasury Brady.

[28] Described as "any pension, retirement, profit-sharing, bonus, thrift, savings, incentive, or other similar benefit plan for the employees of that issuer."

Similarly, under **new Section 3(a)(4)(B)(iv)(II)** a bank, as part of its transfer agent activities, may effect transactions in the securities of an issuer as part of that issuer's DRP. To meet this exception, the bank cannot solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan, and cannot "net" shareholders' buy and sell orders (other than for programs for odd-lot holders or plans registered with the SEC).[29] This exception loosens current law, which requires broker/dealer registration for entities that administer DRP.

New Section 3(a)(4)(B)(iv)(III) permits banks to effect transactions in the securities of an issuer as part of a plan for the purchase or sale of that issuer's shares. This exception permits banks to provide administrative services in connection with an employee stock purchase plan. Employee stock ownership plans and stock option plans are the most common form of these transactions. As with the DRP exception described above, the bank cannot solicit transactions or provide investment advice with respect to the purchase or sale of the issuer's securities in connection with the plan, and cannot "net" shareholders' buy and sell orders (except for odd-lot holders or plans registered with SEC).

The bank cannot rely on these exceptions to trade in any "publicly traded security," unless the trade is directed to a registered broker/dealer for execution, is a "cross trade" or substantially similar trade of a security made by the bank or between the bank and an affiliate and does not violate the bank's fiduciary duty, or is otherwise permitted by SEC Rules.[30]

•*New 1934 Act Section 3(a)(4)(B)(v): Sweep Accounts.*

Currently, banks are permitted to offer so-called "sweep" accounts to customers of a broker/dealer or investment adviser subsidiary. This permission is based in part upon a 1986 SEC no-action letter to Fidelity Capital Management, in which Fidelity sought to enter into an agreement with various banks to cross-market its funds, one feature of which included a "sweep" account to collect periodic fund distributions.[31] **New Section 3(a)(4)(B)(v)** codifies this position, and permits bank to effect transactions as part of an investment or reinvestment of deposit funds into money market funds.

•*New 1934 Act Section 3(a)(4)(B)(vi): Affiliate Transactions.*

New Section 3(a)(4)(B)(vi) permits a bank to effect transactions on behalf of any affiliate of the bank. However, affiliates that are registered broker/dealers or engaged in merchant banking are excepted from this exception. In other words, securities transactions for the accounts of affiliated broker/dealers or affiliated merchant bankers must be effected through a registered broker/dealer.

•*New 1934 Act Section 3(a)(4)(B)(vii): Private Securities Offerings.*

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29 This latter condition prohibits the bank from "crossing" orders internally, and essentially requires that the orders be executed against other orders in the marketplace, providing buyers and sellers of securities for which the bank provides services in connection with the DRP program and opportunity for price improvement.

30 Section 3(a)(4)(C) (*see* note 13, *supra*, for text).

31 Fidelity Distributors Corporation, SEC No-Action Letter (June 12, 1986).

New Section 3(a)(4)(B)(vii) permits banks to "effect sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(b), 4(2) or 4(6) of the Securities Act of 1933 or the rules and regulations issued thereunder." However, a bank can effect such sales only if at any time after November 12, 2000, the bank is not affiliated with a broker or dealer that has been registered under the 1934 Act for more than one year and engages in dealing, market making, or underwriting activities other than with respect to exempted securities. Further, a bank that can rely on this exception may not effect a primary offering the aggregate amount of which exceeds 25 percent of the capital of the bank.[32]

•*New 1934 Act Section 3(a)(4)(B)(viii): Safekeeping and Custody Activities.*

New Section 3(a)(4)(B)(viii) permits banks "as part of customer banking activities" to provide a variety of securities custody services. These services include safekeeping and custody services (including the exercise of warrants and other rights), facilitating the transfer of funds or securities in connection with clearance and settlement activities, effecting securities lending or borrowing by customers, safekeeping of hypothecated securities pledged by one customer to another person subject to purchase or resale agreements. However, this exception expressly prohibits banks from acting as a carrying broker for any broker/dealer, unless the carrying broker activities are limited to government securities.[33] Further, the bank cannot rely upon this exception to trade in any "publicly traded security," unless the trade is directed to a registered broker/dealer for execution, is a "cross trade" or substantially similar trade of a security made by the bank or between the bank and an affiliate and does not violate the bank's fiduciary duty, or is otherwise permitted by SEC Rules.[34]

•*New 1934 Act Section 3(a)(4)(B)(ix): Identified Banking Products.*

New Section 3(a)(4)(B)(ix) permits a bank to effect transactions in "identified banking products" without being deemed a broker. The term "identified banking product" is defined in Section 206(a) of the Act.[35]

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[32] This 25% limitation does not apply with respect to any sale of government or municipal securities.

[33] Banks are currently permitted to act as carrying brokers for government securities.

[34] Section 3(a)(4)(C) (*see supra* note 13 for text).

[35] Section 206(a) of the Act, "Definition of Identified Banking Product," states: For purposes of paragraphs (4) and (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a) (4), (5)), the term "identified banking product" means:

(1) a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank;

(2) a banker's acceptance;

(3) a letter of credit issued or loan made by a bank;

(4) a debit account at a bank arising from a credit card or similar arrangement;

(5) a participation in a loan which the bank or an affiliate of the bank (other than a broker or dealer) funds, participates in, or owns that is sold:

(A) to qualified investors; or

•*New 1934 Act Section 3(a)(4)(B)(x): Municipal Securities.*

New Section 3(a)(4)(B)(x) permits banks to effect transactions in municipal securities without being deemed a broker.

•*New 1934 Act Section 3(a)(4)(B)(xi): De Minimis Exception.*

In addition to transactions effected pursuant to sections 3(a)(4)(B)(i) through (x), **new Section 3(a)(4)(B)(xi**) allows a bank to effect not more than 500 securities transactions in a calendar year without being deemed a broker. Transactions under this de minimis exception may not be effected by an employee of a bank who is also an employee of a broker/dealer.

Title II/Subtitle A/Section 202: Definition of Dealer.

Section 3(a)(5) of the 1934 Act currently provides a complete exclusion for banks from the definition of "dealer."[36] Section 202 of the Act replaces this "blanket" exclusion with four specific exclusions. As a result, under **amended Section 3(a)(5) of the 1934 Act**, a bank is excluded from the definition of dealer only to the extent that the bank's securities activities fall into one of the four specific exclusions.

•*New 1934 Act Section 3(a)(5)(C)(i): Permissible Securities Transactions.*

New Section 3(a)(5)(C)(i) provides that a bank does not meet the definition of dealer to the extent it engages in the same "permissible securities transactions" permitted under the Section 3(a)(4)(B)(iii) exception to "broker."

•*New 1934 Act Section 3(a)(5)(C)(ii): Investment, Trustee and Fiduciary Transactions.*

New Section 3(a)(5)(C)(ii) provides that a bank will not be deemed a dealer when it buys or sells securities for investment purposes for the bank or for accounts for which the bank acts as a trustee or fiduciary.

(B) to other persons that:

(i) have the opportunity to review and assess any material information, including information regarding the borrower's creditworthiness; and

(ii) based on such factors as financial sophistication, net worth, and knowledge and experience in financial matters, have the capability to evaluate the information available, as determined under generally applicable banking standards or guidelines; or

(6) any swap agreement, including credit and equity swaps, except that an equity swap that is sold directly to any person other than a qualified investor (as defined in section 3(a)(54) of the Securities Act of 1934) shall not be treated as an identified banking product.

[36] Notwithstanding this exclusion, banks are subject to the anti-fraud standards of the federal securities laws.

•*New 1934 Act Section 3(a)(5)(C)(iii): Asset-Backed Transactions.*

New Section 3(a)(5)(C)(iii) permits a bank to engage in the issuance or sale of certain asset-backed securities to "qualified investors" without being deemed a dealer. The issuance or sale must be through a separate entity such as a grantor trust. Items that may be securitized are items backed by or representing an interest in notes, drafts, acceptances, loans, leases, receivables, other obligations (other than securities of which the bank is not the issuer), or pools of any such obligations. The pools must be predominantly originated by the bank, a non-broker/dealer affiliate of the bank, or a syndicate of banks if the obligations or pool of obligations consist of mortgage obligations or consumer-related receivables.

•*New 1934 Act Section 3(a)(5)(C)(iv): Identified Banking Products.*

New Section 3(a)(5)(C)(iv) provides that a bank does not meet the definition of dealer to the extent it effects transactions in the same "identified banking products" permitted under the Section 3(a)(4)(B)(ix) exception to "broker."

Title II/Subtitle A/Section 203: Registration for Sales of Private Securities Offerings.

Section 203 requires the NASD to create a new test for persons who wish to sell only private placements. Specifically, **new Section 15A(j) of the 1934 Act** provides that the NASD "shall create a limited qualification category for any associated person of a member who effects sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(b), 4(2), or 4(6) of the Securities Act of 1933 and the rules and regulations thereunder." Further, new Section 15A(j) directs that the NASD "shall deem qualified in such limited qualification category, without testing, any bank employee who, in the six month period preceding the date of the enactment of the [Act], engaged in effecting such sales."

In light of Section 104(f)(1) of the Act, associated persons falling within this new limited qualification category are still subject to state securities qualification requirements.

Title II/Subtitle A/Section 204: Information Sharing.

Section 204 **amends Section 18 of the FDIA** to require that the federal banking agencies (after consultation with the SEC) establish recordkeeping requirements for banks relying on the new exceptions to the definition of "broker" (Section 3(a)(4)) and "dealer" (Section 3(a)(5)). Further, the federal banking agencies are directed to make available to the SEC the records that are kept in this regard.

Title II/Subtitle A/Section 205: Treatment of New Hybrid Products.

Section 205 is referred to as the "jump ball" provision because it establishes the procedure for the SEC and Fed to follow in establishing the regulation of newly developed "hybrid" products. "New hybrid product" is defined as a product that: (i) was not subject to regulation by the SEC as a "security" prior to the Act; (ii) is not an "identified banking product" as defined in Section 206 of the Act; and (iii) is not an "equity swap" as defined in Section 206(a)(6) of the Act.

In general, Section 205 (which adds a **new subsection (i) to Section 15 of the 1934 Act**) prohibits the SEC from imposing broker/dealer regulation on a bank that sells a "new hybrid product" without first following the public rulemaking process. In commencing the rulemaking process, the SEC is directed to "consult with and seek the concurrence of" the Fed. In promulgating the rules, the SEC is obligated to consider the nature of the new hybrid product and the history, purpose, extent and appropriateness of regulating such product under the federal banking laws. The Fed, and any other aggrieved party, may file in the D.C. Circuit Court of Appeals a petition for review of final SEC rules promulgated in this regard.

Title II/Subtitle A/Section 206: Definition of Identified Banking Product.

See supra footnote 35.

Title II/Subtitle A/Section 207: Additional Definitions.

Section 207 adds "qualified investor" as a newly defined term in **new Section 3(a)(54) of the 1934 Act**. Included in the definition are: registered investment companies; banks; foreign banks; business development companies; state-sponsored employee benefit plans and ERISA benefit plans (except Individual Retirement Accounts); corporations, companies, partnership and natural persons who own and invest on a discretionary basis not less than $25,000,000 in investments (the threshold is $10,000,000 for the sale of asset-backed securities); and government agencies, subdivisions and instrumentalities that own and invest on a discretionary basis not less that $50,000,000 in investments. Under new section 3(a)(54)(c), the SEC may add to this list by rule. The exclusion from the definition of dealer for banks that sell certain asset-backed securities (new Section 3(a)(5)(C)(iii)) requires that such securities be sold only to "qualified investors."

Title II/Subtitle A/Section 208: Government Securities Defined.

Section 208 **amends Section 3(a)(42) of the 1934 Act** to include qualified Canadian government obligations within the definition of "government securities."

Title II/Subtitle A/Section 209: Effective Date.

Section 209 provides that Subtitle A of Title II of the Act (Sections 201 through 210 of the Act) shall take effect 18 months after the date of enactment, which translates into May 12, 2001.

Title II/Subtitle A/Section 210: Commodities Exchange Act ("CEA").

Section 210 states that nothing in the Act "shall supercede, affect, or otherwise limit the scope and applicability" of the CEA.

Title II/Subtitle B: Bank Investment Company Activities (Sections 211 to 225).

In light of banks' increasing involvement with investment companies and investment advising, the Subtitle B of Title II of the Act amends both the Investment Company Act of 1940 (the "Investment Company Act") and the Investment Advisers Act of 1940 (the "Advisers Act"). The amendments are designed to establish functional regulation of bank mutual fund and investment advisory activities.

Title II/Subtitle B/Section 211: Custody of Investment Company Assets by Affiliated Banks.

The Investment Company Act does not prohibit a bank from providing custodial services to federally registered investment companies. Section 211 of the Act **amends Section 17(f) of the Investment Company Act** to expressly authorize the SEC to adopt rules prescribing the conditions under which a bank or an affiliate of a bank can engage in such custody for an investment company. Section 211 also makes a corresponding change to Section 26 of the Investment Company Act regarding unit investment trusts.

Title II/Subtitle B/Section 212: Lending to an Affiliated Investment Company.

Section 17(a) of the Investment Company Act prohibits an affiliated person of a mutual fund from borrowing money or other property from the fund. Section 212 of the Act **amends section 17(a) of the Investment Company Act** to provide that an affiliated person is prohibited from lending money or other property to a fund in contravention of SEC rules.

Title II/Subtitle B/Section 213: Independent Directors.

Section 213 **amends Section 2(a)(19)(A) of the Investment Company Act** to modify the definition of "interested person." In general, an "interested person" is one who has a material relationship with a fund, its advisers or underwriters. To prevent conflicts of interest, the Investment Company Act places limits on interested persons. Currently, an "interested person" of an investment company includes any registered broker or dealer and any affiliated person of that broker or dealer. Section 213 amends the definition of "interested person" to include persons who engage in certain transactions, services, and loans during the six months preceding determination of an "interested person" status. This amendment also prohibits a registered investment company from having a majority of its board of directors consisting of personnel or senior officers of the subsidiaries of any one bank, or of any single bank holding company, its affiliates and subsidiaries.

Title II/Subtitle B/Section 214: Additional SEC Disclosure Authority.

Section 214 **amends Section 35(a) of the Investment Company Act** to make it unlawful for any person, in issuing or selling investment company securities, to represent that such securities are guaranteed by the federal government, are insured by the FDIC or are guaranteed by a bank. Further, any person issuing or selling a fund that is advised by or sold through a bank must prominently disclose that the fund is not insured by the FDIC or other government agency.

Title II/Subtitle B/Section 215: Definition of Broker under the Investment Company Act.

Section 215 **amends Section 2(a)(6) of the Investment Company Act** to read as follows: "The term 'broker' has the same meaning as given in section 3 of the [1934 Act], except that such term does not include any person solely by reason of the fact that such person is an underwriter for one or more investment companies."

Title II/Subtitle B/Section 216: Definition of Dealer under the Investment Company Act.

Section 216 **amends Section 2(a)(11) of the Investment Company Act** to read as follows: "The term 'dealer' has the same meaning as given in the [1934 Act], but does not include an insurance company or investment company."

Title II/Subtitle B/Section 217: Removal of the Exclusion from the Definition of Investment Adviser for Banks that Advise Investment Companies.

The caption of Section 217 is self-explanatory. Specifically, this section **amends Section 202(a)(11)(A) of the Advisers Act** to read in pertinent part that: "the term 'investment adviser' includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser."

Title II/Subtitle B/Section 218: Definition of Broker under the Advisers Act.

Section 218 **amends Section 202(a)(3) of the Advisers Act** to read as follows: "The term 'broker' has the same meaning as given in section 3 of the [1934 Act]."

Title II/Subtitle B/Section 219: Definition of Dealer under the Advisers Act.

Section 219 **amends section 202(a)(7) of the Advisers Act** to read as follows: "The term 'dealer' has the same meaning as given in section 3 of the [1934 Act], but does not include an insurance company or investment company."

Title II/Subtitle B/Section 220: Interagency Consultation.

This section **adds to the Advisers Act a new Section 210A**, which directs the SEC and the federal banking agencies to share information (including examination reports) regarding the investment advisory activities of banks and bank holding companies.

Title II/Subtitle B/Section 221: Treatment of Bank Common Trust Funds.

Bank common trust funds, which are used to assist in the administration of trust and other fiduciary accounts, have characteristics of a "security." Section 221 clarifies that such funds are "exempt" securities under the 1933 Act and the 1934 Act, and not deemed to be an "investment company" under the Investment Company Act, if: (i) such funds are employed solely as an aid to the administration of trust or other fiduciary accounts; (ii) interests in such funds are not advertised or offered for sale to the general public (except in connection with ordinary advertising of the bank's fiduciary services); and (iii) the fees and expenses charged by such funds do not contravene fiduciary principles.

Title II/Subtitle B/Section 222: Statutory Disqualification for Bank Wrongdoing.

This section **amends Section 9(a) of the Investment Company Act** to include banks among the entities that are disqualified from acting as investment advisers because of certain legal, disciplinary or regulatory incidents.

Title II/Subtitle B/Sections 223 and 224: Conforming Amendments.

Section 223 amends the Investment Company Act to extend it to cover branches and agencies of foreign banks, and Section 224 amends the Advisers Act to require the SEC to consider "efficiency, competition and capital formation" when promulgating rules under the Adviser Act.

Title II/Subtitle B/Section 225: Effective Date.

Section 225 provides that Subtitle B of Title II of the Act (Sections 211 through 225 of the Act) shall take effect 18 months after the date of enactment, which translates into May 12, 2001.

Title II/Subtitle C/SEC Supervision of Investment Bank Holding Companies (Section 231).

Section 231 **amends Section 17 of the 1934 Act** to create and provide for the regulation of a new entity called an "investment bank holding company." The structure is designed to be an alternative to the financial holding company structure established by Title I of the Act. New section 17(i)(5)(A) defines "investment bank holding company" as any person (other than a natural person) that owns or controls one or more brokers or dealers, and the associated persons (directly or indirectly controlling, controlled by or under common control with) of such investment bank holding company.

An investment bank holding company that is not an affiliate of a bank or a thrift may elect to become supervised by the SEC by filing with the SEC a notice of intention to become supervised. Such election is voluntary, and may be withdrawn. The primary purpose of Section 231 is to permit a broker/dealer holding company, which otherwise would be unregulated, to more easily engage in certain foreign activities, because foreign regulators will permit U.S. financial firms to operate in their countries only (or more easily) if such firms have a principal holding company regulator.

Title II/Subtitle D/Banks and Bank Holding Companies (Section 241).

Section 241 requires the SEC to consult and coordinate comments with appropriate federal banking agencies before taking any action or rendering any opinion with respect to the manner in which any insured depository institution or depository institution holding company reports loan loss reserves in its financial statements.

Title III: Insurance.

Title III/Subtitle A: State Regulation of Insurance (Sections 301 to 308).

Section 301 of the Act reaffirms that the insurance activities of all persons (including banks) are subject to functional regulation by state insurance authorities, except as that regulation may be reallocated by Section 104 of the Act. Section 302 prohibits national banks from underwriting insurance products, except for those products authorized by the OCC as of January 1, 1999. Section 303 prohibits national banks from underwriting title insurance, except in those States where State banks are authorized to underwrite title insurance.

Section 304 establishes an expedited dispute resolution process for conflicts between federal regulators and State insurance regulators. Section 305 requires federal banking authorities to promulgate regulations for consumer protection in the sale of insurance products by banks.[37] Section 307 provides for regulatory coordination between the federal banking authorities and State insurance authorities.

State laws that prevent or significantly interfere with the ability of insurers to affiliate with depository institutions, become FHCs or demutualize are generally preempted by Section 306.

Recall that Section 104 of the Act, discussed previously, also addresses State insurance law.

Title III/Subtitle B: Redomestication of Mutual Insurers (Sections 311 to 316).

Generally, and subject to several levels of notice and approval, Section 312 of the Act authorizes a mutual insurance company to redomesticate and reorganize into a mutual holding company or stock company. This authorization permits mutual insurance companies to reorganize in order to take advantage of the new affiliations allowed by the Act. However, Section 311 provides that such authorization is not applicable to mutual insurance companies domiciled in States that have reasonable terms and conditions governing reorganization into a mutual holding company. Section 313 provides that certain "unreasonable" State laws may be preempted. Section 312(f)(2) provides that any initial public offering of stock by a reorganized insurance company must be in compliance with applicable securities laws.

Title III/Subtitle C: National Association of Registered Agents and Brokers ("NARAB") (Sections 321 to 336).

Section 321 of the Act directs State insurance authorities to establish and implement uniform and reciprocal laws and regulations governing the licensure of individuals and entities authorized to solicit and sell insurance in a State. To encourage States to move towards uniformity or reciprocity, the Act calls for the establishment of NARAB on November 12, 2002, unless a majority of the States have enacted: (i) uniform laws and regulations governing the licensure of individuals and entities authorized to sell and solicit the purchase of insurance within the States; or (ii) reciprocal laws and regulations governing the licensure of nonresident individuals and entities authorized to sell and solicit insurance within those States.

To meet the uniformity mandate, a majority of States must have: (i) uniform criteria regarding the integrity, personal qualifications, education, training, and experience of licensed insurance producers (including the qualification and training of sales personnel); (ii) uniform continuing education requirements for licensed insurance producers; (iii) uniform ethics course requirements for licensed insurance producers; and (iv) uniform consumer suitability criteria for insurance products. In addition a State may not impose any requirements upon any insurance producer to be licensed or qualified to do business as a nonresident that has the effect of limiting or conditioning the producer's activities because of its residence or place of operations.

To meet the alternative reciprocity mandate, a majority of States must: (i) permit out-of-state producers to receive a license in their states to the same extent as resident producers; and (ii) accept satisfaction of a

[37] These consumer protection standards are similar to the standards for the sale of securities by banks established by NASD Rule 2350 and the NASAA model Rules, and address issues of disclosure, physical separation, advertising and fee arrangements.

state's continuing education requirements in another state to satisfy the state's own continuing education requirement.

Subtitle C of Title III also provides that if at any time uniformity or reciprocity no longer exists and cannot be restored within a two-year period, the NARAB will be established.

Structurally, NARAB would be a non-profit corporation subject to supervision and oversight by the National Association of Insurance Commissioners, and in existence until dissolved by an act of Congress. NARAB would be responsible for administering the multi-state licensing, reciprocity and continuing education programs.

Title III/Subtitle D: Rental Car Agency Insurance Activities (Section 341).

Section 341 of the Act creates a presumption for three years from enactment that no State law imposes any insurance regulation on a person who solicits or sells insurance in connection with the rental of motor vehicles for ninety days or less. States may enact prospective laws in this regard.

Title III/Effective Date.

Title III of the Act does not contain a section establishing an effective date, which means that the provisions of Title III took effect on the date of enactment of the Act, November 12, 1999.

Title IV: Unitary Savings and Loan Holding Companies ("USLHCs") (Section 401).

Previous federal savings and loan law allowed USLHCs, which are entities that own a single federal savings and loan, to engage in non-financial activities. Section 401 of the Act amends the Home Owner's Loan Act to provide that after May 4, 1999, USLHCs may not engage in non-financial activities. Non-financial USLHCs in existence on May 4, 1999, may continue their non-financial activities. Title IV took effect on November 12, 1999.

Title V: Privacy.

Title V/Subtitle A: Disclosure of Nonpublic Personal Information (Sections 501 to 510).

Section 501 of the Act recites that it is "the policy of Congress that each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' nonpublic personal information." "Financial institution" is defined in Section 509(3) and generally means any institution, the business of which is engaging in the financial activities described in BHCA Section 4(k) (which includes banking, securities underwriting, investment advisory and insurance services). "Nonpublic personal financial information" is defined in Section 509(4) and means personally identifiable financial information: (i) provided by a consumer to a financial institution; (ii) resulting from any transaction with the consumer or any service performed for the consumer; or (iii) otherwise obtained by the financial institution.

To carry out the Congressional policy, Section 501(b) of the Act directs regulatory agencies[38] to establish standards: (i) to insure the security and confidentiality of consumer records and information; (ii) to protect against any anticipated threats or hazards to the security or integrity of such records; and (iii) to protect against unauthorized access to or use of such records or information which could result in substantial harm or inconvenience to any customer. Section 504(a)(3) calls for the regulations in this regard to be issued in final form by May 12, 2000.

Section 503 requires that at the time of establishing a customer relationship with a consumer, and not less than annually during such relationship, a financial institution shall provide a clear and conspicuous disclosure describing the institution's policies and practices with respect to the disclosure of and protection of nonpublic personal information. Under Section 502, no institution may disclose such information to a non-affiliated third party if, after notice, a customer "opts out," or directs that such information not be disclosed.[39] There are no conditions or restrictions on the sharing of non public personal financial information among the affiliates of a financial institution. As described in footnote 38, compliance with the privacy standards is to be enforced by the pertinent functional regulator.

Under the "Sarbanes Amendment," Section 507 of the Act permits a State to enact laws that provide a level of privacy protection that is greater than the protection established by Title V of the Act. However, the federal Fair Credit Reporting Act may preempt any State law that attempts to regulate the flow of information between affiliates.

<u>Title V/Subtitle B: Fraudulent Access to Financial Information (Sections 521 to 527)</u>.

Sections 521 and 523 of the Act make it a crime to obtain or attempt to obtain, or to disclose or attempt to disclose, customer information of a financial institution through fraudulent or deceptive means. Under Section 522, the prohibitions are to be enforced generally by the FTC, except for enforcement by certain federal banking regulators in the case of certain financial institutions.

Section 526 requires the Comptroller General, in consultation with the FTC, federal banking agencies, the NCUA, the appropriate federal law enforcement agencies and appropriate State insurance regulators to report to Congress within 18 months on (i) efficacy and adequacy of the remedies provided in this subtitle in

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[38] The regulatory agencies charged with the rulemaking (*see* Section 504) and enforcement (*see* Section 505) of the privacy provisions are as follows: (i) for financial institutions: the OCC, the Fed, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration ("NCUA") (with respect to the institutions under each regulator's jurisdiction); (ii) for broker-dealers, investment companies and investment advisers, the SEC (it appears to be an oversight that the States were not recognized as the authority for non-SEC registered investment advisers, and NASAA is pursuing a technical amendment in this regard); (iii) for insurance companies, State insurance authorities; and (iv) for any other institutions or person not subject to oversight by one of the foregoing regulators, the Federal Trade Commission. Section 504(a)(2) of the Act requires these agencies to "consult and coordinate" for purposes of "assuring, to the extent possible, that the regulations prescribed by each agency and authority are consistent and comparable with the regulations prescribed by the other such agencies and authorities."

[39] The disclosure requirements of Section 503 apply to all financial institutions. The notice and opt out requirements of Section 502 apply only to financial institutions who wish to share non-public personal financial information with non-affiliates. Section 502 provides certain exceptions to the notice and opt out requirements, including the sharing information with a consumer reporting agency pursuant to the Fair Credit Reporting Act.

addressing attempts to obtain financial information by fraudulent means or by false pretenses.; and (ii) any recommendations for additional legislative or regulatory action to address threats to the privacy of financial information created by attempts to obtain information by fraudulent means or false pretenses.

Title V/Effective Date.

Title V of the Act does not contain a section establishing an effective date, which means that the provisions of Title V took effect on the date of enactment of the Act, November 12, 1999.

Title VI: Federal Home Loan Bank System Modernization (Sections 601 to 608).

The Federal Home Loan Bank ("FHLB") System seeks to ensure the availability of funds for home financing, for affordable housing and for community development. The FHLB System consists of twelve district banks. Financial institutions that are members of the FHLB System hold stock in their respective district bank. In general, the Act's FHLB amendments: make it easier for certain small institutions to make loans to small businesses and small farms; amend the System's capital structure and equalize the stock purchase requirement between banks and thrifts; and decentralize the management of the district banks. The FHLB amendments took effect on November 12, 1999.

Title VII: Other Provisions.[40]

Title VII/Subtitle A: ATM Fee Reform (Sections 701 to 705).

Section 702 of the Act amends the federal Electronic Funds Transfer Act to require ATM operators who impose a fee for use of an ATM by a consumer to post a notice on the machine that a fee will be charged, and on the screen that a fee will be charged and the amount of the fee. The notice must be posted before the customer elects to proceed with the transaction.

Title VII/Subtitle B: Community Reinvestment (Sections 711 to 715).

The CRA generally requires financial institutions to make certain loans to traditionally underserved areas and groups. Federal banking regulators regularly review and grade an institution's CRA compliance. Regulators also review CRA compliance in connection with certain requests for expanded powers, affiliations and mergers. Section 714 of the Act expressly states that the Act does not repeal the CRA. However, the Act does make certain amendments to the CRA.

As previously discussed, a bank holding company cannot become an FHC unless its subsidiary institutions received at least "satisfactory" ratings on its most recent CRA examination. Similarly, a national bank cannot operate a financial subsidiary unless the bank received at least a "satisfactory" rating.

Section 711 of the Act adds to the CRA a new Section 48, a "sunshine provision" that requires full disclosure of agreements between a financial institution (or affiliate) and a non-government agency where

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[40] The provisions contained in Title VII took effect on November 12, 1999.

the agreement is made pursuant to or in connection with the CRA. The federal banking authorities are empowered to promulgate rules in this regard.

Section 712 of the Act adds to the CRA a new Section 809, which provides smaller institutions some relief from the CRA examination process. Specifically, institutions with assets of not more than $250 million will be subject to CRA examinations: (i) not more than once every 60 months if the institution receives a rating of "outstanding," and (ii) not more than once every 48 months if the institution receives a rating of "satisfactory."

Finally, Section 713 of the Act directs the Fed to conduct a study regarding the default rates, delinquency rates and profitability of CRA loans. Section 715 of the Act directs the Treasury to conduct a study regarding the extent to which the services contemplated by CRA are being provided.

Title VII/Subtitle C: Other Regulatory Improvements (Sections 721 to 740).

Section 721 of the Act requires the Government Accounting Office ("GAO") to study and report to Congress regarding certain revisions to the "S Corporation" rules that would permit greater access by community banks to "S Corporation" treatment.

Section 722 of the Act requires the federal banking agencies to use "plain English" in their rule-making.

Section 723 of the Act permits federal savings associations that convert to national or state bank charters to retain "Federal" in their names.

Section 724 of the Act allows thrift institutions to own a state-chartered bank or trust company whose business is restricted to: accepting deposits from thrift institutions or savings banks; accepting deposits arising from the corporate business of thrift institutions or savings banks that own the bank or trust company; or accepting deposits of public funds.

Section 725 of the Act establishes a grant program to fund non-profit "microenterprise" development initiatives engaged in: (i) providing training and technical assistance to low-income and disadvantaged entrepreneurs interested in starting or expanding their own businesses; (ii) building the capacity of organizations that serve low-income and disadvantaged entrepreneurs; and (iii) supporting research and development aimed at identifying and promoting training and technical assistance programs that effectively serve low-income and disadvantaged entrepreneurs. The new program is known as the Program for Investment in Microentrepreneuers ("PRIME"), and will be administered by the Small Business Association.

Section 726 of the Act amends the Federal Reserve Act ("FRA") to require the Fed to order an annual independent audit of the financial statements of each Federal Reserve Bank and of the Fed itself.

Section 727 of the Act amends the FRA to permit the Fed, at its discretion, to furnish examination reports and other confidential supervisory information concerning State member banks or other entities it examines to: any federal or State authorities with supervisory authority over an examined entity; to officers, directors, or receivers of the entity; or any other person that the Fed determines to be proper. Such disclosure is subject to certain procedural and confidentiality requirements.

Section 728 of the Act requires the GAO to study the conflict of interest faced by the Fed between its role as a primary regulator of the banking industry and its role as a vendor of services. Specifically, the GAO is directed to study the conflict between the Fed's role as a regulator of the payment system and its role as a competitor with private sector providers of payment services, and how best to resolve that conflict.

Section 729 of the Act requires the federal banking agencies to conduct a study of banking regulations regarding the delivery of financial services, including those regulations that may assume that there will be face-to-face contact, and report their recommendations on adapting those existing requirements to online banking and lending.

Section 730 of the Act enhances the "source of strength doctrine" by, in certain circumstances, protecting the federal banking agencies and the deposit insurance funds from claims brought by the bankruptcy trustee of a depository institution holding company or other person for the return of capital infusions.

Section 731 of the Act amends the FDIA to provide for "loan pricing parity" among interstate banks. Specifically, if an interstate bank can charge a particular interest rate, then a local bank in the State into which the interstate bank has branched may charge a comparable rate.

Section 732 of the Act authorizes interstate branching by foreign banks, subject to appropriate regulatory approval.

Section 733 of the Act states that it is the sense of the Congress that individuals offering financial advice and products should do so in a nondiscriminatory, nongender-specific manner.

Section 734 of the Act amends the membership of the Emergency Steel Loan Guarantee Board and the Emergency Oil and Gas Loan Guarantee Board. Under prior law, the Chairmen of the Fed and SEC were designated as members; the new provisions permit both to designate another member of the Fed or another SEC Commissioner to serve on the respective boards.

Section 735 of the Act repeals the restrictions in FRA Section 11(m) on loans by Fed member banks secured by stock or bond collateral. Limitations on loans to one borrower imposed pursuant to other statutory authority are not affected.

Section 736 of the Act eliminates the need for the establishment of the SAIF "special reserve," which the FDIC was required to establish beginning in 1999, and the DIF "special reserve."

Section 737 of the Act amends the Federal Power Act to permit officers or directors of public utilities to serve as officers or directors of banks, trust companies, or securities firms, subject to certain safeguards against conflicts of interest.

Section 738 of the Act amends the FRA to authorize a majority of the entire board of directors of a bank to vote on the purchase of securities from an affiliate, based on a determination that the purchase is a sound investment for the bank. This amendment represents a higher standard than imposed by prior law, which simply required the vote to be taken by a majority of independent directors.

Section 739 of the Act amends the Home Owners' Loan Act to permit a federal savings association chartered prior to November 12, 1999, to convert into one or more State or national banks, subject to appropriate regulatory approval, each of which may encompass one or more of the branches of the federal savings association in one or more States.

The final Section of the Act, 740, permits U.S. Attorneys to seek a court order to provide financial institution regulatory agencies with access to grand jury material, which provides State regulatory agencies parity with federal regulatory agencies.