October 24, 2002

TO: Board of Governors

FROM: Legal Division[1]

SUBJECT: Summary of comments on the Board's proposed Regulation W

SUMMARY OF COMMENTS ON PROPOSED REGULATION W

On May 11, 2001, the Board proposed for public comment a Regulation W that implements the provisions of sections 23A and 23B of the Federal Reserve Act. The comment period expired on August 15, 2001, and the Board received approximately 100 public comments on the proposed rule.[2] The Board also received 21 comments on the Board's interim final rules on derivative transactions between insured depository institutions and their affiliates and intraday extensions of credit by insured depository institutions to their affiliates.[3] Attached as Appendix A is a list of all the public commenters on Regulation W and the interim rules.

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[1] Ms. Nardolilli and Mr. Van Der Weide.

[2] The Board also received comments from 7 Reserve Banks. These comments are summarized in a separate memorandum.

[3] The Board issued these interim final rules on May 11, 2001, pursuant to provisions of the Gramm-Leach-Bliley Act (the "GLB Act") that required the Board to adopt final rules under section 23A to address as covered transactions credit exposure arising out of derivative transactions between banks and their affiliates and intraday extensions of credit by banks to their affiliates. The interim final rules became effective January 1, 2002, but the Board requested comment on the provisions of the interim final rules. These comments are addressed in this memorandum. All of the commenters on the interim rules also commented on the proposed Regulation W.

Commenters included 3 Members of Congress, 75 banks, thrifts, or bank holding companies; 20 trade groups or trade associations representing the banking or financial services industry, 5 state banking departments or other governmental agencies; 9 law firms or individuals, and 2 other organizations. Nearly all the commenters generally supported the Board's decision to issue Regulation W and the interim rules but opposed or raised concerns about one or more aspects of the regulations.

The comments in support of the rules generally applauded the Board's effort to update, clarify, and codify its interpretations of sections 23A and 23B in a single comprehensive regulation. The positive comments also commended the Board's efforts to balance the prudential policies underlying the statute with the burdens that the statute places on banks. Supporting comments also noted that the adoption of Regulation W should result in more consistent application of sections 23A and 23B and should lessen the compliance burden for banks. Many commenters explicitly expressed support for the numerous new exemptions from section 23A contained in the proposed rule, including the expanded (d)(6) exemption, the exemption for purchases of municipal securities, and the exemption for purchases of assets by banks in formation. Commenters also generally approved of the approach taken by the Board in its interim rules on bank-affiliate derivative transactions and intraday extensions of credit to affiliates.

Comments in opposition to the rules generally registered opposition to particular provisions of proposed Regulation W. The principal objections raised by commenters involved the proposed rule's lack of transition period or grandfather provision; interpretations of the 10 percent quantitative limit, collateral requirements, and attribution rule of section 23A; valuation formula for bank acquisitions of, or investments in, affiliates; failure to clarify and restrict the scope of the definition of financial subsidiary; tightening of the "250.250" exemption for purchases of loans from an affiliate; and extension of the application of sections 23A and 23B to the U.S. branches and agencies of foreign banks.

The following is a more detailed summary of the public comments on particular provisions of the proposed Regulation W and the interim rules.

A. <u>General Comments</u>

Eleven commenters (including the OTS and ABA) urged the Board to provide either a transition period for banks to come into compliance with Regulation W or a grandfather for existing transactions that do not comply with Regulation W. According to these commenters, banks needed such relief in light of the many ways in which the proposed rule varied from existing bank practices or existing staff interpretations of section 23A. Although most commenters did not propose a specific time period, one commenter advocated a 2-3 year transition period.

Many commenters expressed views about the relationship of Regulation W to existing and future Board and staff interpretations of sections 23A and 23B. Three commenters recommended that the Board make all future staff interpretations of sections 23A and 23B in the form of amendments to the rule. Other commenters asked the Board to streamline and update the section 23A rulings in the Federal Reserve Regulatory Service and to identify all existing section 23A interpretations not contained in the rule that would be valid after finalizing the rule. Three commenters requested that the Board create a separate webpage for section 23A and 23B issues on the Board's web site.

One commenter, Bank One, asked that the proposed rule be modified and republished again as a proposed rule so that people could focus on the details one more time before finalization. The Office of Advocacy of the Small Business Administration argued that the Regulatory Flexibility Act section of the preamble to the proposed rule was insufficient to qualify as an initial regulatory flexibility analysis ("IRFA"). The Office of Advocacy urged the Board to perform another IRFA and publish it for public comment prior to finalizing Regulation W.

Format

Commenters generally expressed support for the format of the regulation and believed that the rule conveyed the Board's interpretations of section 23A in plain language. Several commenters did recommend, however, that the Board move the definitional sections of the rule to the front.

Scope

The FDIC provided the principal comment on the scope of Regulation W. According to the FDIC, the regulation should not cover state nonmember banks because the Federal Reserve Act only applies, by its terms, to member banks. The FDIC also noted that the rule does not cover thrifts and claimed that the FDIC has authority to interpret and enforce sections 23A and 23B for state nonmember banks. The FDIC expressed a particular desire to preserve its ability to define "control" under section 23A for state nonmember banks.

B. Subpart B -- General Provisions of Section 23A

Sections 223.2/223.3 (Quantitative limits)

Twelve commenters (including the OCC and OTS) argued that the rule should not prohibit a bank from engaging in a new covered transaction with one affiliate simply because the bank is past the 10 percent threshold with another affiliate. Many of these commenters contended that this provision of the proposed rule is inconsistent with the statute and existing bank practices and is unnecessarily strict in light of all the Board's tools for enforcing 23A.

The OTS asked the Board to conform Regulation W to the OTS's more strict interpretation of the 10 percent limit. The OTS applies the 10 percent limit to covered transactions with any single affiliate <u>including any company controlled by that single affiliate</u> (except with respect to the holding company that owns the bank).

Several commenters also asked the Board to clarify in sections 223.2 and 223.3 of Regulation W that (i) a bank is not required to reduce existing covered transactions when its capital declines or when a preexisting covered transaction increases in value and (ii) transactions with financial subsidiaries are not subject to the 10 percent limit.

<u>Section 223.5 (Collateral requirements)</u>

<u>Section 223.5(a-b) (General provisions)</u>

The OTS requested that the Board clarify how the collateral requirements of section 23A apply to loans secured by mixed collateral types (<u>e.g.</u>, government securities and real estate). The OTS also requested that the rule clarify that the following securities are acceptable government securities collateral under section 23A: (i) all the securities listed in the Board's Regulation A; and (ii) notes eligible for purchase by a Federal Home Loan Bank. The OTS further asked that the rule indicate that VA and FHA loans are not acceptable government securities collateral for section 23A purposes.

Section 23A provides that a credit transaction with an affiliate meets the collateral requirements of the statute if the transaction is fully secured by a "segregated, earmarked deposit account" at the bank. Regulation W further required that such deposit account be "for the sole purpose of securing the transaction and be so identified." Fifteen commenters (including the OCC, ABA, and FSR) urged the Board to remove this regulatory gloss and explicitly note that banks are allowed to have (i) a single deposit account collateralize multiple covered transactions with multiple affiliates; and (ii) cross-collateralization agreements with affiliates under which all of an affiliate's deposit accounts are pledged as collateral for all of the affiliate's extensions of credit from the bank. According to the commenters, these types of collateral arrangements are a common, safe, and efficient existing practice that is permitted by the statutory language of section 23A. One commenter alleged that an omnibus deposit account for all affiliates and all covered transactions actually provides greater protection to the bank and is easier for the bank to administer.

Two commenters argued that the Board should replace the statutory "segregated, earmarked" requirement for deposit accounts with a requirement that the bank have a first priority, perfected security interest in the deposit account. These commenters explained that recent changes to Article 9 of the Uniform Commercial Code have eliminated the old common law "segregated, earmarked" requirement for perfecting a security interest in a deposit account.

One commenter remarked that the final rule, unlike the proposed rule and the statute, should permit banks to secure extensions of credit to an affiliate with a segregated, earmarked deposit account at another insured depository institution.

Section 223.5(c) (Ineligible collateral)

The OTS advocated excluding both bank-issued debt and equity securities from the list of acceptable section 23A collateral. The NYCHA, on the other hand, argued that the rule should permit banks to take their own equity and debt securities as 23A collateral. Other commenters suggested a more nuanced approach. Three commenters (including the OCC) explicitly supported excluding bank-issued equity securities, while six commenters argued that banks should be allowed to take their own debt securities as section 23A collateral. These six commenters noted that bank deposits (another form of bank liability) count as a preferred form of collateral under section 23A, and that selling or retiring bank debt securities acquired through foreclosure would provide real benefit to the bank.

Two commenters (including the OCC) supported the provision in the proposed rule that excluded intangible assets from the list of eligible section 23A collateral. These commenters agreed that intangible assets are hard to value and sell.

Five other commenters argued that the rule should permit banks to take "safe" intangible assets, like servicing rights and purchased credit card relationships, as collateral because these assets are marketable and count (with some quantitative limits) as capital under the Board's capital adequacy guidelines. Several of these commenters pointed out that the statute allows all real and personal property to be eligible collateral, even illiquid and hard-to-value collateral like real estate. Other commenters (including the OTS) urged the Board to permit banks to use "safe" intangibles as collateral subject to a higher haircut. The NYCHA, for example, suggested a 150 percent collateral requirement for intangible assets. J.P. Morgan Chase argued that accounting conventions regarding tangibility should not govern the definition of acceptable collateral under section 23A. Accordingly, Morgan Chase argued that banks should be allowed to use any intangible asset as collateral, subject to an appropriately higher haircut.

Six commenters believed that the rule should permit banks to satisfy the collateral requirements of section 23A with letters of credit. These commenters stated that letters of credit are less likely to fluctuate in value than many other types of collateral, represent senior claims on banks, are not subject to an automatic stay in bankruptcy, involve lower administrative costs, convey an immediate right to cash rather than a possibly illiquid piece of collateral, and are recognized as 99 percent effective under the SEC's net capital rule.

Four banking organizations argued that banks should be allowed to use guarantees to comply with section 23A's collateral requirements. Two of these commenters noted that the Board's Capital Guidelines recognize the value of guarantees as a credit risk mitigation device.

Section 223.5(d) (Perfection and priority)

Two commenters (including the OCC) supported the provisions of Regulation W that count only first priority, perfected security interests toward the collateral requirements.

Section 223.5(g) (Undrawn lines of credit)

Five commenters explicitly endorsed the provision of the proposed rule that stated that the collateral requirements of section 23A do not apply to the undrawn portion of an extension of credit to an affiliate so long as the bank does not have a legal obligation to advance additional funds in the absence of appropriate section 23A collateral to cover the new draw. The OTS asked the Board to clarify why this rule for collateralizing the undrawn amount of a line of credit does not apply to guarantees and letters of credit. Bank One stated its view that the section 23A collateral requirements should not apply to the undrawn portion of a line of credit regardless of the nature of the bank's obligation to make future advances.

Section 223.6 (Prohibition on the purchase of a low-quality asset)

Five commenters argued that the rule should exempt certain purchases of low-quality assets from an affiliate. All five commenters believed that the Board should exempt a bank's purchase of low-quality assets from an insured sister bank if the assets qualified for the (d)(6) exemption in section 23A. These commenters stated that FDICIA's cross-guarantee provisions eradicate any concern about sister bank low-quality asset transactions, and several of these commenters indicated that Regulation W could require that the sister banks provide notice to their primary federal supervisor and the Board of low-quality asset transactions to prevent the banks from moving low-quality assets around to avoid examination. Two of these commenters argued that a bank should be able to purchase low-quality assets from any affiliate pursuant to the (d)(6) exemption. Three of these commenters argued that the rule should exempt low-quality asset purchases by a bank from an insured sister bank regardless of whether the purchase would qualify for the (d)(6) exemption.

The FSR asked the Board to add a procedure to Regulation W for a bank to request an exemption from the Board for purchases of low-quality assets from an affiliate.

Section 223.6(b) (Exemption for renewals of participations in a low-quality asset)

Regulation W contains a specific exemption from section 23A's prohibition of the purchase of a low-quality asset from an affiliate. The exemption (which has been available to banks since the early 1980s) allows a bank that purchased a loan participation from an affiliated depository institution to renew its participation in the underlying loan, even if the underlying loan has become a low-quality asset, so long as, among other things: (i) the bank's board of directors approves the renewal; (ii) the bank's proportionate share of the credit does not increase; and (iii) the bank provides its primary federal regulator with 20 days' prior notice.

Although commenters supported this exemption in general, they criticized each of the three conditions. Seven commenters criticized the prior board of directors approval requirement. Four commenters argued that the requirement should be deleted because it is time consuming and because these renewals are not sufficiently important to the bank to require board level attention in most cases. Five commenters (including the OCC) asked the Board to permit a bank to obtain approval from an executive committee of the board of directors. Two of these commenters also thought that the bank should be allowed to obtain approval from senior bank management. Two commenters urged the Board to allow a bank to qualify for the exemption by using its normal approval process for restructuring problem credits. Two other commenters asked the Board to consider requiring only that the board of directors adopt policies for these renewals and that the bank's management file periodic reports with the board of directors relating to such renewals. The OCC and Morgan Chase asked the Board to consider requiring board of directors approval only for renewals that exceed a particular quantitative threshold.

Four commenters discussed the "no increase in share" requirement. Three of them urged the Board to delete the requirement because credit restructurings often require lead banks to increase their position to allow small banks to get out. The ICBA asked the Board to allow banks to increase their share by 5-10 percent in these restructurings.

Thirteen commenters addressed the "20-days' prior notice" requirement. Of these commenters, only the OCC supported the requirement. Most of the remaining commenters (including the FDIC) asked the Board to delete the requirement or to replace it with an after-the-fact notice requirement. Merrill Lynch suggested that the prior notice requirement be replaced by a recordkeeping requirement, and Morgan Chase believed that the requirement should be replaced with a grant of authority to each banking agency to require advance notice as appropriate. These commenters argued that speed is of the essence in workout situations and there is no evidence of abuse of this exemption. The OTS asked the Board to revise the prior notice requirement so that it only applies when the bank proposes to make an additional extension of credit in connection with the restructuring.

As proposed in Regulation W, this restructuring exemption only applies when a bank renews a participation in a loan originated by an affiliated depository institution. Four commenters expressed a view that the exemption should be expanded to permit a bank to renew a participation in a loan originated by any affiliate (not just an affiliated depository institution). According to these commenters, such an expansion of the exemption would enhance a bank's ability to protect itself from troubled borrowers by restructuring loans.

<u>Section 223.7 (Attribution Rule)</u>

Commenters offered several general suggestions on the scope of section 23A's attribution rule. Five commenters recommended that the Board include a "bona fide, ordinary course transactions" exemption to the attribution rule, which the Board did in Regulation O. Sixteen commenters (including the OCC) argued that the attribution rule should not apply to ordinary course transactions where the bank does not know -- or perhaps have reason to know -- that the proceeds are transferred to or used for the benefit of an affiliate. Some of these commenters alleged that the 1997 amendments to Regulation Y and the original statutory language of the attribution rule make clear that the purpose of the rule is to prevent sham transactions, not to prevent an affiliate from receiving unintended or accidental benefits from bank action. Three commenters even asked the Board to remove all the particular exemptions from the attribution rule granted in Regulation W because, in the view of the commenters, the exemptions create the negative implication that all other transactions with third parties in which money flows to an affiliate are covered.

The OTS asked the Board to provide examples of when the attribution rule applies. In particular, the OTS inquired as to whether the rule only covers transactions in which an affiliate receives cash from the third party or whether the rule covers transactions in which an affiliate receives any direct or indirect benefit from a bank's transaction with a third party. The OTS specifically asked the Board to clarify whether a bank must be aware that an affiliate benefits from the bank's transaction with the third party in order for the attribution rule to apply.

Bank One requested clarification that transactions in which a bank is acting in an agency or riskless principal capacity for an affiliate, or vice versa, are not subject to section 23A.

Section 223.7(b)(1) or (2) (exemptions for riskless principal and agency transactions)

The proposed rule exempted from section 23A a loan from a bank to a nonaffiliate who uses the loan proceeds to purchase securities from a broker-dealer affiliate of the bank acting solely as a riskless principal. Eleven commenters recommended extending the riskless principal exemption to include assets other than securities and selling affiliates other than securities broker-dealers. One of these commenters, Shearman & Sterling, noted that it was not aware that other assets are sold in riskless principal transactions. Three commenters (including the OCC) stated that Regulation W should clarify that agency transactions are not subject to the attribution rule.

Discover Bank requested an additional exemption from the attribution rule for the discount fee paid by merchants to a bank-affiliated credit card company for processing credit card transactions paid for with a bank credit card. According to the bank, such an exemption would be consistent with the spirit of the exemption for agency and riskless principal fees.

Section 223.7(b)(3) (preexisting line of credit exemption)

Regulation W exempted from the attribution rule a loan by a bank to a nonaffiliate if the proceeds are used to purchase securities from a securities affiliate of the bank and the loan is pursuant to a preexisting line of credit not entered into in contemplation of securities purchases from the affiliate. Eight commenters (including the OCC) recommended that the

Board expand this preexisting line of credit exemption to cover purchases of any asset from any affiliate. Wells Fargo specifically requested that the exemption be expanded to cover purchases of affiliated mutual funds. The OCC requested that the rule clarify that a line of credit would qualify for the preexisting line of credit exemption if the documentation for the line of credit stated that the line was extended for "general corporate purposes."

Section 223.7(b)(4) (general purpose credit card exemption)

The proposed regulation exempted from section 23A's attribution rule a loan by a bank to a nonaffiliate pursuant to a general purpose credit card. The rule defined a general purpose credit card as a credit card that is widely accepted by merchants that are not affiliates of the bank and where less than 25 percent of the aggregate amount of purchases with the card are purchases from an affiliate of the bank. Commenters generally supported inclusion of an exemption for extensions of credit to nonaffiliates pursuant to a general purpose credit card, but 25 commenters (including the OCC, FDIC, and OTS) criticized the rule's definition of general purpose credit card.

Ten commenters argued that the policies behind the exemption for general purpose credit cards would apply to other general revolving consumer debt, including home equity lines of credit, overdraft lines on checking accounts, and margin loans and would apply to credit accessed not only by a credit card but also by check, biometric or retinal information, or PIN numbers. These commenters expressed concern that Regulation W's general purpose credit exemption suggests by negative implication that these other general purpose credit transactions are subject to the attribution rule.

These commenters (including the OCC, FDIC, and OTS) contended that the 25 percent limit in the definition of general purpose credit card will be burdensome for banks in terms of monitoring and recordkeeping. They also alleged that the limit is not needed for safety and soundness given that the card must be widely accepted by merchants and given the virtual impossibility of a bank using general purpose credit card transactions to shore up an affiliate. These commenters also argued that (i) the possibility that customers may use credit card credit to buy goods from a nonaffiliate should ensure that credit is granted on market terms; (ii) the 25 percent test may result in a credit card arrangement moving periodically in and out of the attribution rule; (iii) a bank has no way of controlling how often a customer uses a general purpose credit card to buy goods from an affiliate; (iv) general purpose credit card transactions expose the bank to the credit risk of thousands or millions of individual credit card customers and do not expose the bank to the credit risk of the affiliate; (v) the 25 percent test is inconsistent with Regulation O's tangible economic benefit rule; and (vi) the 25 percent test would inhibit the development of new credit card products (which are initially used predominantly at affiliates of the issuing bank).

The OCC asked the Board to treat any co-branded credit card as a general purpose credit card. The FDIC, on the other hand, suggested that the Board could treat co-branded credit cards as special purpose credit cards. The NYCHA and FleetBoston argued that the rule should define a general purpose credit card as a credit card not specifically designed for the purchase of products and services from an affiliate.

Several commenters made suggestions about how the Board should modify, or clarify the application of, the quantitative limit in the definition of general purpose credit card. A couple of commenters believed that the rule should raise the 25 percent limit to 50 percent. Discover Bank recommended that the 25 percent test be replaced with a "percentage of affiliate sales" test, as per the staff 50 percent test in the 250.250 exemption. The FDIC expressed its view that banks should only to have to satisfy the 25 percent test once per year and should have a cure period if they fail to meet the test. Other commenters (including the OCC and OTS) asked the Board to clarify how banks should include cash advances and whether banks must do continuous or only periodic (weekly, monthly, annually) compliance checks with the quantitative limit. The OCC also asked for clarification as to whether a bank that crosses the 25 percent limit needs to hold collateral only for the amount of affiliate transactions that exceeds the 25 percent threshold.

First Electronic Bank argued that the rule should exempt special purpose credit cards as well as general purpose credit cards because banks are required to have credit policies that are reviewed by their primary federal supervisor, section 23B would apply to loans made pursuant to special purpose credit cards, and the obligors under a special purpose credit card are third-party customers rather than affiliates of the bank.

The National Retail Foundation asked that the rule clarify that the "widely accepted" prong of the general purpose credit card definition would include American Express, VISA, Master Card, Discover, and Diner's Club.

The OCC inquired about the meaning of the exemption's requirement that loans pursuant to the general purpose credit card exemption must be "consistent with any conditions imposed in a general purpose credit card issued by the bank to the nonaffiliate." In particular, the OCC asked for clarification as to whether it would be permissible for the bank to give cardholders free shipping or rebates if the card is used to purchase goods from an affiliated retailer.

C. Valuation and Timing Principles under Section 23A

Section 223.8 (Valuation and timing of extensions of credit)

Section 223.8(a) (Valuation rule for extensions of credit)

The proposed regulation provides that a line of credit should be valued for section 23A purposes at the total amount of the credit line (both the drawn and undrawn portions). Three commenters argued that the undrawn portion of a line of credit should never count toward the section 23A amount of the transaction. The OCC argued that the undrawn portion of a line of credit should not count toward the section 23A amount of an extension of credit if the bank is only conditionally obligated to advance additional funds.

In addition, the OCC asked the Board to clarify whether a bank must include the full amount of the credit limit or just the amount of credit outstanding on a credit card issued by a bank to an affiliate.

Section 223.8(b)(1) (Timing rule for extensions of credit)

The proposed rule stated that a bank engages in an extension of credit to an affiliate for purposes of 23A at the time during the day that the bank becomes legally obligated to extend credit to the affiliate. Ten commenters (including the OCC) indicated that forcing banks to keep track of loans to an affiliate on an intraday basis presents serious compliance burdens. These commenters advised that banks can without difficulty ensure that loans are on market terms and can satisfy section 23A's collateral requirements at the intraday time of the loan, but they asked the Board to permit banks to maintain their current practice of keeping records of, and valuing, loans (including loans to affiliates) on an end-of-day basis.

Section 223.8(b)(2) (Loans to nonaffiliates that become affiliates)

The proposed rule provides that if a bank extends credit to a nonaffiliate that later becomes an affiliate of the bank, the bank must (i) consider the credit extension to be a covered transaction for purposes of computing compliance with the quantitative limits of section 23A in connection with potential future covered transactions; and (ii) ensure that the credit extension complies with the collateral requirements of section 23A "promptly" after the nonaffiliate becomes an affiliate. Many commenters expressed dissatisfaction with these provisions.

Ten commenters believed that loans to a nonaffiliate that becomes an affiliate should be eternally exempt from the quantitative limits and collateral requirements of section 23A because the loans were made on arms-length terms at inception, the terms of the loans do not change when the nonaffiliate becomes an affiliate, and banks have no incentive to shore up nonaffiliates. Several of these commenters argued that the Regulation W approach to these loans is highly burdensome, especially for banking organizations that have a significant equity investment business (where new companies are constantly becoming, and ceasing to be, 15 percent portfolio company affiliates). According to these commenters, banks currently treat such loans as grandfathered, and the Regulation W approach to these loans would put banks and their portfolio companies at a serious disadvantage with nonregulated lenders and their venture firms. If the Board retains this approach, FleetBoston recommended that its applicability be limited to nonaffiliates that become wholly owned affiliates. Bank of America asked the Board not to apply this approach to nonaffiliates that become affiliates for reasons beyond the bank or bank holding company's control (e.g., stock redemptions).

The NYCHA and Bank One contended that the "prompt" collateral requirement aspect of this approach would be burdensome because it may be impossible to obtain collateral if the new affiliate is less than wholly owned or has other debt outstanding with negative covenants.

Morgan Chase expressed opposition to this approach on the grounds that it is inconsistent with the language of section 23A, which states that the collateral requirements apply at the time of the loan to the affiliate. Morgan Chase also represented that a uniform regulatory approach to these loans is unnecessary because most of the transactions in which a nonaffiliate becomes an affiliate will be subject to Board authority under section 4 of the Bank Holding Company Act ("BHC Act") and could be conditioned by the Board.

<u>In contemplation transactions</u>

Proposed Regulation W recommended a slightly stricter approach to transactions in which a bank makes a loan to a nonaffiliate "in contemplation of" the nonaffiliate becoming an affiliate of the bank. Bank One and Citigroup argued that the "in contemplation" standard in the rule is too vague and should be replaced with a more objective standard that focuses on whether the nonaffiliate has entered into a binding agreement under the terms of which the nonaffiliate would become an affiliate or whether there has been a publicly announced transaction in which the nonaffiliate would become an affiliate. The OCC and Merrill Lynch also contended that the "in contemplation" standard is too vague. They asserted that the Board should clarify that a transaction will be deemed "in contemplation" of a nonaffiliate becoming an affiliate only if the bank personnel involved in making and approving the transaction were aware of negotiations concerning the nonaffiliate's affiliation with the bank.

According to these commenters, any other formulation would require a bank to disseminate broadly prospective merger information (in contravention of good securities law compliance policies).

Shearman & Sterling also stated that the "in contemplation" standard is too vague and should be abandoned.

Section 223.9 (Valuation and timing of asset purchases)

The NYCHA asked the Board to express a willingness to grant exemptions for asset purchases from an affiliate that are useful to the bank and consistent with section 23B. Wells Fargo requested that the rule include a specific exemption for intraday purchases by a bank of affiliate-issued mutual fund shares through an omnibus account in connection with sweep accounts where the customer allocation does not occur until the end of the day.

Merrill Lynch requested clarification of two points relating to when a bank purchases from an affiliate a line of credit to a third party: (i) that the amount of the covered transaction is the amount of consideration paid by the bank and not the face amount of the line of credit; and (ii) that the bank may count borrower principal repayments first against the amount of the covered transaction, regardless of whatever other draws have been made. The OCC and Merrill Lynch requested confirmation that if a bank receives an encumbered asset from an affiliate, it is not forever a covered transaction in the amount of the encumbrance.

The proposed rule provides that if a bank purchases assets from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate, the asset purchase becomes a covered transaction at the time that the nonaffiliate becomes an affiliate of the bank. The OTS asked the Board to clarify that a bank may not purchase a low-quality asset from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate.

Section 223.10 (Valuation and timing of investments in affiliate securities)

Under the proposed rule, an investment in securities issued by an affiliate must be valued at the greater of: (i) the total amount of consideration paid for the securities; and (ii) the carrying value of the securities on the financial statements of the bank. Nine commenters (including the OCC) objected to this valuation formula. The ABA and Shearman & Sterling argued that investments in an affiliate's securities should be valued at the lower of carrying value and purchase price. Under this alternative formula, a contribution of affiliate securities would be valued at zero, and a bank would be permitted to reduce the covered transaction amount for an investment in affiliate securities as the value of the securities declines. These commenters justified their formula's treatment of bank investments in a declining affiliate by pointing out that a bank's capital must be reduced to reflect the decline in value of the affiliate's securities and by noting that their approach more accurately reflects the bank's actual remaining financial exposure to the affiliate.

Four other commenters argued that investments in an affiliate's securities should be valued at the purchase price (and should not increase as the value of the securities increases). These commenters argued that an increase in the value of an equity investment does not create additional exposure to the investor and that there is no justification for restricting section 23A lending as an affiliate increases in financial strength. One of these commenters contended that the regulation's valuation rule is inconsistent in increasing the section 23A value of an investment as the affiliate prospers but not decreasing the section 23A value of the investment as the affiliate swoons.

The OCC and four other commenters argued that the proposed rule should at least provide that a contribution of affiliate securities is initially valued at zero.

One of the justifications for the valuation formula set forth in the proposed rule is the fact that section 23A refers to this covered transaction type as a "purchase of or an investment in" affiliate securities. Several commenters provided alternative explanations for why Congress provided that both "purchases of" and "investments in" affiliate securities are covered transactions. The NYCHA explained that the "investment in" language in is meant to pick up purchases of equity securities. The Banking Law Section of the American Bar Association contended that the "investment in" language is meant to pick up partial acquisitions of securities rather than an entire "purchase" of securities. This commenter also argued that the ordinary meaning of "investment in" involves a payment of consideration. The ABA argued that the "investment in" language is meant to pick up purchases with non-cash consideration.

Section 223.11 (Valuation of extensions of credit secured by affiliate securities)

Exemption for transactions secured by proprietary mutual funds

The preamble to Regulation W sought public comment on whether to include in the rule an exemption for loans to third parties secured by affiliate-issued mutual fund shares. Eighteen commenters advocated granting this exemption and offered the following principal arguments in support of their position: (i) the bank is not funding an affiliate in these transactions; (ii) although section 23A includes as a covered transaction a loan to a third party collateralized by affiliate securities, the purpose of including this covered transaction is to prevent evasion, and evasion is implausible when the collateral taken by the bank is affiliate-issued mutual funds; (iii) tracking these loans can be very burdensome as many of the loans are small and the value of the mutual fund collateral changes daily; (iv) the assets of a proprietary mutual fund generally are shares of nonaffiliates, which could otherwise serve as collateral under section 23A; (v) mutual funds are highly regulated, their shares are highly liquid and can only be purchased at their daily net asset value, and mutual funds are required by law to have boards of directors that are largely independent of the bank and its affiliates; (vi) mutual fund shareholders often prefer to borrow against their mutual fund shares rather than sell their mutual fund shares for tax reasons; and (vii) without an exemption, banks are at a competitive disadvantage to broker-dealers, who can accept proprietary mutual fund shares as collateral. Merrill Lynch supported the proposed exemption and asked the Board to expand the exemption to cover all registered investment companies and not just mutual funds.

In the proposal, the Board suggested five potential conditions to the availability of this exemption: (i) the borrower does not use the proceeds of the loan to purchase shares of proprietary mutual funds; (ii) the borrower is not an executive officer of the bank or its affiliates; (iii) the price of the mutual fund shares is quoted routinely in a widely disseminated news source; (iv) the shares of the mutual fund are widely held by the public; and (v) the bank and its affiliates do not own in the aggregate more than 5 percent of the shares of the mutual fund. Two banking organizations recommended that the Board drop all five of these conditions. Other commenters specifically endorsed or raised specific objections to the particular conditions. These specific comments are addressed in the following sections.

Use of proceeds

Morgan Chase supported the use of proceeds condition, but four commenters objected to the condition because the use of loan proceeds is hard to monitor and control. One bank asked the Board to interpret the use of proceeds condition to bless any general purpose, preexisting line of credit.

Executive officers

Seven commenters expressed opposition to this condition. Many of them noted that the Board's Regulation O already comprehensively regulates bank lending to executive officers. Seven other commenters (including the ABA, FSR, and NYCHA) expressed a willingness to support the condition if it were modified to cover only executive officers of the bank and its affiliates that are subject to Regulation O restrictions.

Old (d)(6) pricing mechanism

Two commenters supported the pricing mechanism condition. One commenter opposed the condition on the grounds that major newspapers only report on large mutual funds, and even small mutual funds are liquid (and must redeem shares at all times) and have prices quoted on internet sites and in other news sources. Four commenters asked the Board to widen this condition to explicitly permit mutual fund price quotes to be obtained from Morningstar, Lipper, Bloomberg, fund supermarket websites, and any other unaffiliated, real-time, electronic pricing system.

Widely held

Two commenters expressly supported the widely held condition. Four commenters criticized the condition. These commenters noted that the daily redemption requirement to which mutual funds are subject should satisfy any liquidity concerns that the Board may have. They advised that concentrated ownership of a fund would not adversely impact the fund's liquidity or the reliability of pricing information. Two of these commenters asked that the vague "widely held" condition be replaced with a requirement that the mutual fund have an SEC registration statement or other foreign registration statement.

5 percent ownership limit

One commenter supported the 5 percent ownership limit condition. Ten commenters opposed the condition, largely because of its redundance on the widely held condition. Five of these commenters asked the Board to replace the 5 condition with a "no control" condition.

Numerous commenters asked the Board to exclude certain shares when computing compliance with the 5 percent limit. Ten commenters asked that the rule exclude mutual fund shares held by the bank or an affiliate in a fiduciary capacity. According to these commenters, this exclusion is consistent with exemptions in the BHC Act and section 23A, and would preserve the usefulness of the exemption. These commenters explained that many proprietary mutual fund shares are held by the bank as trustee or custodian for customers. Other commenters asked the Board to exclude mutual fund shares purchased by the bank in order to facilitate sweep arrangements on behalf of deposit customers. Yet another commenter believed that the rule should exempt from the 5 percent condition proprietary mutual funds that invest in bank-eligible securities and money market mutual funds subject to SEC Rule 2a-7.

Other comments

Commenters recommended two additional exemptions for extensions of credit secured by affiliate securities. The NYCHA and Bank of America asked the Board to exempt these transactions from the quantitative limits of section 23A if the affiliate securities meet the requirements of the (d)(6) exemption. Bank of America indicated that it would be reasonable for the Board to condition such an exemption on a requirement that the loan proceeds not be used to buy the affiliate securities. The NYCHA also asked the Board to exempt extensions of credit secured by both affiliate securities and other collateral from section 23A if the affiliate securities represent less than 50 percent of the total collateral. According to the NYCHA, monitoring these transactions is highly burdensome.

In addition, Merrill Lynch requested that the Board clarify a number of points in the final rule, including that (i) a bank may use the higher of the two valuation options provided in the proposed rule if the bank so chooses (because, for example, the bank does not have the procedures in place to do valuations under the other option); and (ii) a bank can use its normal collateral valuation procedures for valuing affiliate and nonaffiliate collateral for these transactions.

D. Other Considerations under Section 23A

Section 223.12 (Valuation of constructive asset purchases)

The proposed rule provided that if a bank holding company transfers one of its nonbank subsidiaries to its subsidiary bank, the transaction should be treated as a bank's purchase of assets from an affiliate and should valued at the bank's purchase price plus the total amount of liabilities of the transferred company. Approximately 20 commenters objected to this approach on a variety of grounds. Many of them complained that the approach prevents banks from efficiently reorganizing their operations and ignores the reality of the corporate limited liability shield. These commenters also noted that the approach puts bank holding companies at a competitive disadvantage with other companies that can more easily reorganize themselves.

Five commenters simply asserted that the rule should not treat a donation of shares as a covered transaction because the bank is obtaining an asset (shares) at no cost. Other commenters offered a variety of alternative formulas for valuing these transactions:

- National City argued that the rule should exempt these transactions from section 23A if the value of the assets of the transferred company exceeds the liabilities of the transferred company plus the purchase price.
- NYCHA and Fleet argued that the rule should exempt these transactions from section 23A if (i) the value of the assets of the transferred company exceeds the liabilities of the transferred company plus the purchase price; and (ii) the asset values are verified by an independent third party.
- Five other commenters (including the ABA and FSR) believed that the rule should use the purchase price of the transferred company's shares or the GAAP net worth of the transferred company as the covered transaction amount.
- Another five commenters (including the OCC) contended that the rule should preserve staff's traditional approach to these transactions, which would value the transactions at the bank's purchase price for the shares plus any liabilities to affiliates owed by the transferred company.

- Discover Bank stated that the rule should retain staff's traditional approach, but also add to the covered transaction amount the amount by which the non-affiliate liabilities owed by the transferred company exceed the fair market value of the company's assets that have readily determinable market values.

One law firm contended that the proposed rule's approach to these reorganization transactions unfairly counts 100 percent of the liabilities of the transferred company even if only 25 percent of the shares of the company are transferred. The OCC asked for clarification as to whether the proposed rule actually works in this manner. The OCC also asked for clarification on how to treat transfers of low-quality assets in connection with a donation of affiliate securities to a bank.

Several commenters commented on the mechanics of the valuation formula. The OTS asked for Clarification as to whether the "total liabilities assumed" component of the valuation formula includes off-balance sheet liabilities. Citigroup and USB encouraged the Board to allow a transferred company to exclude accounts payable, tax liabilities, and payroll accruables from its total liabilities because such liabilities are very difficult to repay prior to the contribution. Merrill Lynch asked for guidance as to whether and how the covered transaction amount for these transactions would decline over time.

<u>Section 223.12(d) (step transactions)</u>

The proposed rule created an exemption from the approach outlined above for transactions in which a bank holding company acquired a third party company and immediately transferred ownership of all the securities of the acquired company to its subsidiary bank. Eleven commenters objected to the “immediate” transfer requirement, mostly on the grounds that a bank holding company may want to hold the acquired company at the holding company level for some time for tax, business line integration, or regulatory approval reasons. Five commenters (including the OCC) advised that the “immediate” transfer requirement could be replaced with a requirement that the target company be acquired by the bank holding company “in contemplation of” being put under the bank. Other commenters recommended that the “immediate” transfer requirement be replaced with a 3-month, 6-month, or 1-year requirement.

Seven commenters objected to the “bank must acquire all of the acquired company” requirement, mainly on the grounds that there are legitimate business, regulatory, and tax reasons to distribute an acquired company’s assets and subsidiaries to various bank and nonbank subsidiaries of the holding company. The NYCHA recommended replacing the “100 percent” requirement with a “majority of the assets” requirement because certain acquired assets may be low-quality assets or assets that are not permissible for a bank to hold. Three large banking organizations argued that the Board should replace the “100 percent” requirement with an “acquired company becomes a 23A subsidiary of the bank after the transaction” requirement. The OTS, on the other hand, asked that the final rule clarify that the exemption does not apply where the holding company keeps the good subsidiaries of an acquired company and transfers to the bank the bad subsidiaries of an acquired company.

Bank One believed that the exemption should be expanded to apply to asset transfers as well as securities transfers.

Corporate reorganization exemptions

In the preamble to the proposed rule, the Board indicated that it frequently grants case-by-case exemptions for internal corporate reorganization transactions. Four commenters responded by noting that ad hoc exemptions for corporate reorganization transactions are no substitute for regulatory clarity that an entire class of transactions is not subject to section 23A. Several other commenters made specific recommendations about how the Board should exempt routine corporate reorganizations. NYCHA urged the Board to modify its traditional approach to exempting reorganizations by not waiting to approve a corporate reorganization exemption until the FDIC and the bank's primary federal supervisor transmit a non-objection letter. If the Board must wait, in the view of NYCHA, the Board should wait only for the views of the primary federal supervisor (as per the Bank Merger Act). Morgan Chase, Merrill Lynch, and Wells Fargo urged the Board to establish a procedure in Regulation W for banks to submit corporate reorganization exemption requests with a standard set of commitments. Morgan Chase thought that the Board should commit to granting these exemptions within 30 days. Merrill Lynch asked the Board to clarify that the transfer of an affiliate need not be related to a "one-time" reorganization as long as the transfer relates to an internal corporate reorganization. Wells Fargo indicated that, in addition to the standard corporate reorganization commitments, the rule could require that the recipient bank be well capitalized and well managed and that the transferred company be well capitalized under the capital guidelines of the federal banking agencies.

Section 223.13 (Financial Subsidiaries)

Definition

The proposed rule defined financial subsidiary by restating the somewhat ambiguous statutory definition: any subsidiary of a bank that would be a financial subsidiary of a national bank under section 5136A of the Revised Statutes. Commenters offered a wide variety of alternative ways for the Board to flesh out the meaning of this term:

- Four commenters (including the CSBS and the ABA) believed that the rule should define financial subsidiary for state banks to include only those subsidiaries that are engaged in activities that the state bank could not engage in directly. According to these commenters, (i) a broader definition would disrupt the existing insurance agency operating subsidiaries of state banks in 36 states; (ii) this more limited approach would be consistent with the Board's Regulation H; and (iii) there is no evidence of abuse and no safety and soundness rationale that would justify any broader definition.
- The ICBA argued that the rule should define financial subsidiary for state banks to include only those subsidiaries that are engaged in activities that neither a national bank nor the state bank could engage in directly.
- The NYCHA asked the Board to define financial subsidiary for state banks to include only those subsidiaries that are engaged in non-agency activities that the state bank could not engage in directly.
- The FDIC believed that the rule should define financial subsidiary for state banks to include only those subsidiaries that are engaged in activities that a financial subsidiary of a

national bank could engage in. For example, because a national bank financial subsidiary cannot engage in real estate development, the FDIC contended that a subsidiary of a state bank engaged in this activity is not a financial subsidiary for purposes of section 23A. The FDIC also believed that the rule should clarify, consistent with section 46 of the Federal Deposit Insurance Act ("FDIA"), that agency subsidiaries of a state bank cannot be financial subsidiaries of the bank.

- Morgan Chase stated that the rule should define financial subsidiary for state banks to exclude those subsidiaries that are engaged in agency activities permissible for the parent state bank to engage in directly because (i) these subsidiaries are low risk and consolidated on the books of the bank; and (ii) such an approach would be consistent with Regulation H.
- Four commenters asked the Board to define financial subsidiary for state banks to exclude those subsidiaries that are engaged in insurance agency or real estate activities because (i) such subsidiaries are subject to FDIC review and restrictions under section 24 of FDIA; and (ii) there has been no evidence of abuse.
- Ten commenters contended that the rule should exempt all state bank subsidiaries from the definition of financial subsidiary because FDICIA establishes a separate framework for such subsidiaries and the GLB Act did not explicitly cover them as affiliates (despite the fact that the

GLB Act carefully covered certain subsidiaries of national banks).

- Approximately 46 commenters (including three Members of Congress and over 26 Massachusetts state banks and associations) opined that the rule should define financial subsidiary for state banks to exclude those subsidiaries that are engaged in securities investment activities under section 24(f) of FDIA because (i) the activities are governed by FDIA and supervised by the FDIC; (ii) these subsidiaries invest in securities similar to those held by the bank itself; and (iii) state tax benefits would be lost if the Board deemed these subsidiaries to be affiliates of the bank (because the banks would have to bring the investments into the bank).
- Nineteen commenters argued that the rule should exempt agency subsidiaries from the definition of financial subsidiary because (i) agency subsidiaries impose little risk on the parent bank; (ii) agency subsidiaries hold few assets; (iii) agency subsidiaries are not capital-intensive; and (iv) Congress has expressed a lesser concern for agency activities in section 24 of FDIA. Along these lines, the OCC stated that, if the Board exempts the agency subsidiaries of state banks from the definition of financial subsidiary, the Board should also exempt agency subsidiaries of national banks.
- CalFed argued that the Board should exempt thrift service corporations from the definition of financial subsidiary because (i) thrift service corporations are comprehensively

> regulated by the OTS; (ii) a thrift may only invest in service corporations up to 2-3 percent of the thrift's assets; (iii) HOLA requires a capital deduction for investments in service corporations engaged in activities not permissible for national banks; and (iv) the inability of a service corporation to provide collateral to secure loans from its thrift parent will result in thrifts making only equity investments in service corporations and thus increasing risk to the thrift parent.

The Regulation W preamble clarified that a bank may add back to its section 23A "capital and surplus" any amounts deducted from regulatory capital as an investment in a financial subsidiary. The OCC and FDIC asked the Board to include this clarification in the rule text.

<u>Section 223.13(b) (Valuation rules)</u>

The OCC objected to the proposed rule's valuation formula for an investment by a bank in the securities of its financial subsidiary. According to the OCC, valuation of an investment in securities issued by a financial subsidiary should not depend upon the carrying value of the investment. As a consequence, in the view of the OCC, a donation of shares of a financial subsidiary should not have a section 23A value.

<u>Section 223.13(c) (Anti-evasion rules)</u>

The GLB Act provided that a loan from an affiliate of a bank to a financial subsidiary of the bank will be treated as a covered transaction only if the Board determines that such treatment is necessary or appropriate. The FDIC asked the Board to clarify that a bank's primary federal supervisor has discretion to determine when a loan from an affiliate to a bank's financial subsidiary should be a covered transaction.

In exercising the discretion committed to the Board by the GLB Act as described in the preceding paragraph, the proposed rule provided that a loan by an affiliate to a financial subsidiary of a bank will be treated as a loan by the bank to the financial subsidiary if the loan counts as regulatory capital of the financial subsidiary. The American Bar Association's Banking Law Committee asked the Board to determine that loans from an affiliate to a financial subsidiary of a bank that count as regulatory capital of the financial subsidiary are treated as "investments in the securities of an affiliate" rather than "loans to an affiliate" or to otherwise exempt such transactions from the collateral requirements of section 23A. According to the Committee, such a determination would be consistent with the reason for extending the GLB Act's anti-evasion principle to cover these loans -- that the loans are equivalent to equity investments.

In addition, Morgan Chase and U.S. Bancorp argued that the Board should not extend the anti-evasion rule to cover subordinated loans to a bank's financial subsidiary because such an approach creates a disincentive for a bank holding company to be a source of strength for a subsidiary of a bank whose earnings accrue to the benefit of the bank. The OCC recommended that the Board create an exception to this regulatory anti-evasion rule for short-term subordinated debt provided by an affiliate to a financial subsidiary since such financing may be valuable for short-term liquidity purposes.

Section 223.14 (Derivatives)

The Board issued an interim final rule on bank-affiliate derivative transactions concurrently with proposed Regulation W. The interim rule clarified the bank-affiliate derivative transactions are subject to section 23B and required banks to adopt policies and procedures to manage the credit exposure arising from its derivative transactions with affiliates. About 16 commenters (including the ABA, FSR, and SIA) wrote in support of the interim rule approach to derivatives. The OCC supported an expanded interim rule approach to derivatives that requires banks to adopt specific policies and procedures relating to managerial oversight and responsibilities, scope of activities, legal analysis of activities, risk limits, risk measurement and reporting processes, operational controls, and accounting guidelines. The Independent Insurance Agents of America, however, argued that the interim rule is ineffective and insufficiently detailed to satisfy the GLB Act requirement that the Board issue a final rule addressing derivatives as covered transactions. Deutsche Bank objected to the interim rule on a different ground, arguing that, as long as a bank holding company manages derivatives credit risk effectively, each subsidiary bank of the bank holding company should not be required to have separate policies and procedures on derivatives. According to Deutsche Bank, it is most efficient and prudent to manage these risks at the holding company level.

Commenters uniformly argued against subjecting bank-affiliate derivative transactions to the quantitative limits and collateral requirements of section 23A. The principal arguments advanced by these commenters were:

- derivatives do not fit within any of the five categories of covered transaction;
- there is no demonstrated need for governmental regulation of these transactions in light of the well-developed risk management practices in the institutional derivatives market;
- derivatives are generally not done for funding purposes;

- covering derivatives under section 23A may reduce the ability of a consolidated banking organization to centralize its risk management in the unit(s) best able to bear the risk;
- covering derivatives under section 23A may raise banks' risk management costs by forcing banks to do derivatives with third parties;
- covering derivatives under section 23A would put commercial banks at a competitive disadvantage to nonbank organizations;
- the multifaceted and ever-changing derivatives marketplace is more appropriately regulated through the supervisory process; and
- the daily compliance burden would be substantial because credit exposure on derivatives is volatile and bi-directional and potential future exposure ("PFE") on derivatives is hard to measure.

Citibank and Wells Fargo articulated the view that the rule should not apply section 23A to bank-affiliate derivatives that are hedges of bank or affiliate customer transactions. Discover Bank and Wells Fargo stated that the rule should exempt all derivatives from section 23A that are not for the purpose of funding the affiliate. Discover Bank also asked the Board to give the interim rule policies and procedures a chance to work before subjecting derivatives to section 23A.

Definition of derivative

Commenters had a number of diverse ideas about how to define derivative transaction for purposes of section 23A. Mellon and PNC expressed support for the definition of derivative transaction provided in the interim rule. The SIA advocated use of the definitions of "qualified financial contract" and "swap agreement" in FDIA. Citigroup recommended using both the definition of "swap agreements" in section 206(b) of the GLB Act and the definition of derivative contract in the capital guidelines. Deutsche Bank, Discover Bank, and U.S. Bancorp suggested that the rule should use the definition of derivative contract in the Board's capital guidelines.

Functional equivalent of a covered transaction

The proposed rule asked for comment on whether derivative transactions that are the functional equivalent of a loan or guarantee should be fully subject to section 23A. Two commenters (SIA and Discover Bank) did not think the rule should fully subject these transactions to section 23A until abuses are discovered. SIA and ISDA further contended that these derivatives need not be subject to section 23A because section 23B will protect the bank. Four commenters (including the OCC and ISDA) argued that these derivative transactions would be more appropriately addressed in the supervisory process. Merrill Lynch urged the Board to delay addressing these derivatives until the interim rules have been given a chance to work. Three commenters (including NYCHA and ISDA) believed that the Board should issue a further detailed proposal on abusive bank-affiliate derivative transactions found in the examination process before subjecting these derivatives to section 23A.

Other commenters took a more articulated approach. Five commenters (including ABA, NYCHA, and ISDA) argued that the rule should not treat derivatives that are the functional equivalent of a covered transaction as fully subject to section 23A unless the derivative was entered into for the purpose of funding the affiliate (as opposed to hedging a customer derivative). Similarly, three other commenters (including FSR) argued that the only derivatives that should be subject to section 23A are derivatives that, viewed from inception, (i) establish a temporal disparity of payments; (ii) establish a two-way payment mechanism (like a swap, unlike an option); and (iii) are for the purpose of transferring funds to an affiliate and not hedging risk.

Several commenters provided advice regarding how to distinguish "functional equivalent" derivative transactions from other derivative transactions if the Board were to decide to provide a different section 23A treatment for "functional equivalent" derivatives. The SIA and Bank One asked the Board not to use IRS standards to determine which derivatives are the functional equivalent of a loan because the IRS standards are vague and designed for tax purposes not bank regulatory purposes. ISDA and Citigroup represented that any rule should distinguish between a deep-in-the-money option that is deep-in-the-money at inception and one that only becomes deep-in-the-money after inception. According to Citigroup, the only derivatives that should be subject to section 23A are those where the bank makes a payment to the affiliate at inception, and the covered transaction amount for such derivatives should be the up front payment (as netted against any similar derivatives where the affiliate makes up front payments to the bank).

Credit derivatives with an affiliate

Four commenters discussed the appropriate treatment under section 23A of credit derivatives between a bank and an affiliate where the bank provides credit protection on the affiliate's assets. Three of these commenters argued that the rule should not treat these derivatives as a covered transaction. According to these commenters, these derivatives most closely resemble bank letters of credit where an affiliate is the beneficiary, and the Board has not considered these to be covered transactions. These commenters noted that the bank's credit risk in such derivatives is to third-party assets. Citigroup noted that the Board could count the amount of any payment by the bank to the affiliate under such credit derivatives as a covered transaction at the time of the payment.

Merrill Lynch contended that the rule should not treat credit derivatives between a bank and an affiliate as covered transactions if the bank has hedged its exposure to the affiliate's assets with a third party.

Credit derivatives with a nonaffiliate on behalf of an affiliate

Seven commenters discussed the appropriate treatment under section 23A of credit derivatives between a bank and a third party that reference an affiliate's obligations. OTS, Citigroup, and Mellon supported treating as a guarantee under section 23A a credit derivative between a bank and a nonaffiliate that references affiliate obligations. The ABA and two other commenters argued that the rule should not treat as a section 23A guarantee a credit derivative between a bank and a nonaffiliate that references affiliate obligations so long as the bank has hedged its exposure to the affiliate with a third party. The OCC and Merrill Lynch expressed the view that the rule should not treat as a section 23A guarantee a credit derivative between a bank and a nonaffiliate that references affiliate obligations so long as the affiliate's obligations represent a small portion of the reference assets for the credit derivative.

Best practices

The proposed rule asked for comment on whether the Board should impose specific "best practices" on banks that engage in derivative transactions with affiliates, such as requirements that banks mark such transactions to market on a daily basis and enter into such transactions only with affiliates that have entered into a bilateral netting agreement with the bank. Eight commenters (including the OCC and SIA) opposed imposing any best practices requirements on bank-affiliate derivatives. These commenters contended that a "one-size-fits-all" approach fails to accommodate the diversity of firms and derivative transactions in the marketplace and that existing bank derivatives policies should be adequate.

Discover Bank noted specifically that requiring banks to perform valuations of their derivatives more frequently than monthly would not be worth the cost and may force some banks to unwind risk-reducing hedging transactions. PNC also stated that requiring banks that are not derivatives dealers to perform daily valuations of their derivatives would be highly burdensome. In addition, PNC noted that bilateral netting agreements will usually be required by section 23B.

Reporting requirements

The OCC and Shearman & Sterling supported requiring disclosure of bank-affiliate derivatives, although the OCC believed that banks should not have to disclose such transactions below a materiality threshold.

Four commenters advocated, on the other hand, that the rule should not require additional disclosure of bank derivative transactions. Citigroup, in particular, contended that the rule should not require additional disclosure of bank-affiliate derivative transactions because such disclosure may suggest a bank has taken on additional risk even though most of the derivative transactions are hedging transactions designed to reduce a bank's risk profile. Citigroup also noted that it was not aware of evidence that bank creditors are clamoring for additional disclosure about bank-affiliate derivatives. SIA and Bank One advised that, if the Board decides to require special bank-affiliate derivative reports, the Board should do so through the Call Report.

<u>Quantitative limits and collateral requirements</u>

Two commenters (the OTS and U.S. Bancorp) supported subjecting bank-affiliate derivatives to the quantitative limits and collateral requirements of section 23A. U.S. Bancorp supported using the capital guidelines for determining the amount of the covered transaction.

The remaining commenters on the bank-affiliate derivatives issue expressed opposition to subjecting derivatives to section 23A. Notwithstanding their objections, some of these negative commenters offered advice to the Board about how to subject bank-affiliate derivatives to the quantitative limits and collateral requirements of section 23A if the Board decided to do so. The principal suggestions included:

- The OCC advised that the rule should include a 1-week PFE measure in the computation of value, recognize netting and partial collateral, and not force a bank to unwind derivative transactions if the bank exceeds a quantitative limit because of increased exposure on derivatives.
- Bank One, Mellon, and PNC advocated using net current credit exposure as the covered transaction amount. Mellon and PNC recommended determining the current credit exposure by reference to the ISDA Credit Support Annex and recommended giving banks partial credit for taking partial collateral and allowing banks to use assets receiving

up to a 20 percent risk weight in the capital guidelines to reduce the covered transaction amount.

- Discover Bank argued that the rule should provide banks with a separate quantitative limit for derivatives, permit netting as per the capital guidelines, allow banks to determine the section 23A amount of the transaction using the capital guidelines approach (current exposure plus a standardized PFE) or current exposure plus an internal models PFE, and not require a bank to unwind transactions if the bank exceeds a quantitative limit because of increased exposure on derivatives. Discover Bank also asserted that the rule should permit a bank to use any kind of securities or real estate collateral and should give banks partial credit for taking partial collateral.
- Citigroup advised that the amount of the covered transaction should equal the net uncollateralized mark-to-market amounts with all affiliates (where all investment grade collateral -- and all marketable equity securities taken as collateral for an equity derivative -- counts to reduce the amount of the covered transaction). Citigroup also expressed its views that the rule should not adjust the mark-to-market amount to reflect affiliate credit quality, should include a separate quantitative limit for derivatives (which should not be less than 50 percent of the bank's capital), and should not require a bank to unwind transactions if the bank exceeds a quantitative limit because of increased exposure on derivatives.

- SIA urged the Board to fashion a separate quantitative limit for bank-affiliate derivatives beyond the existing 20 percent limit in the statute.

Grandfathering

Six commenters (including the OCC) asked the Board to grandfather existing bank-affiliate derivatives from any quantitative or collateral requirements imposed by Regulation W.

E. Subpart E -- Exemptions from the Provisions of Section 23A

Section 223.15-16 (Exemptions)

Section 223.15(a) (sister bank exemption)

The proposed rule restricted the availability of the sister bank exemption in section 23A to transactions between insured depository institutions. One commenter (MBNA) wrote in support of this restriction of the sister bank exemption. Five commenters (including the OCC and NYCHA) objected to this action. They argued that restricting the sister-bank exemption to insured depository institutions is inconsistent with the statutory language and the legislative history and primary purpose behind the exemption, which attended not to the insured status of the depository institutions (which Congress could easily have clarified) but to the regulated status of the institutions. In addition, the OCC and State Street expressed the view that the Board does not have rulemaking authority to restrict the sister bank exemption to insured depository institutions. These same two commenters asserted that the Board's restriction of the sister bank exemption especially makes no sense with respect to trust companies that do not take deposits or make commercial loans.

Five commenters also advised that, if the Board finalizes the proposal on the sister bank exemption, the final rule should confirm that an uninsured depository institution subsidiary of a member bank would be a subsidiary (and not an affiliate) of the member bank. According to these commenters, there is no section 23A reason to treat an uninsured depository institution subsidiary of a member bank any differently than other uninsured subsidiaries (e.g., mortgage lending or investment advisory subsidiaries).

The OTS and two banking organizations also asked the Board to clarify that the sister bank exemption would apply to transactions between a member bank and a subsidiary of a sister "insured depository institution." According to these commenters, the proposed rule is ambiguous on this point because "insured depository institution" is defined by reference to the FDIA, which may not include subsidiaries.

Section 223.16(a) (correspondent banking exemption)

The NYCHA and Deutsche Bank recommended an expansion of this exemption to allow affiliates of a bank to use correspondent accounts at the bank to maintain and clear cash and securities transactions in the ordinary course of business. Shearman & Sterling asked the Board to remove the proposed regulatory gloss on this exemption that prevents a bank from using the exemption for "occasional" deposits in a correspondent bank.

Section 223.16(c) (exemption for transactions secured by cash or U.S. government securities)

The OTS and Morgan Chase asked for confirmation that transactions partially secured by cash or U.S. government securities are to that extent exempt from section 23A.

Section 223.16(e)(1) (Old "(d)(6)" exemption)

A number of commenters requested that the Board clarify that certain assets would be eligible for purchase by a bank under the statutory (d)(6) exemption. These assets included: (i) an asset whose price can be verified in an electronic news media that is widely disseminated for the purpose of providing general market information; (ii) an asset whose price is quoted on an internet web site that is generally available to the public (with or without a subscription fee) and that provides actual prices of securities traded on at least a daily basis; (iii) all securities issued by an affiliate, or at least asset-backed or mutual fund securities issued by an affiliate (so long as the mutual fund affiliation arises by advisory relationship only), or affiliate-issued securities that are fully guaranteed by the U.S. government or its agencies; and (iv) OTC securities, loans, or derivative contracts that would satisfy the Wall Street Journal test.

Section 223.16(e)(2) (New "(d)(6)" exemption)

The proposed rule expanded the statutory (d)(6) exemption to allow a bank to purchase securities from an affiliate based on price quotes obtained from an electronic screen so long as, among other things, the selling affiliate is a broker-dealer registered with the SEC; the securities are eligible for purchase by state member banks; the securities are not purchased within 30 days of an underwriting; and the securities are not issued by an affiliate. Commenters expressed general support for the new exemption but criticized the particular conditions to the exemption.

Broker-dealer requirement

Three commenters believed that the new (d)(6) exemption should not contain a U.S. registered broker-dealer requirement. Six commenters urged the Board, in light of the increasing globalization of fixed income markets and the rigorous supervisory frameworks for securities firms in many foreign jurisdictions, to expand the new (d)(6) exemption to allow banks to purchase securities from a registered foreign broker-dealer. The SIA noted that the Board could exclude those foreign jurisdictions that do not provide adequate supervision to securities firms. Merrill Lynch argued that, if the new (d)(6) exemption is not expanded to include purchases from any affiliate, the Board should allow purchases from any affiliate under the new (d)(6) exemption so long as a U.S. broker-dealer affiliate acts as broker or riskless principal in the transaction.

Securities eligible for purchase by a member bank

Seven commenters (including the FDIC and the ABA) asked the Board to eliminate the requirement in the new (d)(6) exemption that the securities be eligible for purchase by a state member bank. These commenters noted that certain depository institutions (notably state nonmember banks) and certain overseas (e.g., Edge corporation) and domestic subsidiaries of banks have broader investment powers, including equity investment powers, than state member banks. Moreover, according to these commenters, this requirement would impose a high recordkeeping and compliance burden on state nonmember banks that are not subject to the state member bank investment rules but are already subject to a host of state and federal investment regulations.

In addition, Merrill Lynch requested clarification that this requirement would allow a bank to purchase securities permissible for the bank to hold as a hedge (even if not otherwise permissible under the bank's general investment powers).

Underwriting period

The SIA argued that the new (d)(6) exemption should allow banks to purchase debt securities during the underwriting period because the price of debt securities is verifiable. The SIA, Citigroup, and National City argued that the new (d)(6) exemption also should allow banks to purchase equity securities during the underwriting period if pre-approved by the bank's board of directors and if the purchase does not amount to more than 50 percent of the total offering.

Moreover, the OTS requested clarification, in light of the fact that an argument can be made that mutual funds are continuously underwritten, as to whether the new (d)(6) exemption could apply to the purchase of mutual fund shares.

Securities issued by an affiliate

Commenters generally supported limiting the availability of the new (d)(6) exemption to purchases of securities that are not issued by an affiliate. Five commenters (including the ABA, FSR, and ISDA) argued, however, that the new (d)(6) exemption should allow banks to purchase affiliate-issued asset-backed securities because of the liquidity of the market for asset-backed securities. Merrill Lynch contended, on the other hand, that the new (d)(6) exemption is not the right vehicle for allowing banks to buy affiliate-issued asset-backed securities because most of these securities do not have a listed market price.

Eight commenters (including the ABA, FSR, ISDA, and SIA) argued that the new (d)(6) exemption should allow banks to purchase affiliate-issued mutual fund shares, especially if the mutual fund is an affiliate simply because the bank or an affiliate is the advisor to the fund. These commenters noted that mutual funds have public prices, the SEC regulates mutual funds and mutual fund pricing, the purchase price for an affiliated mutual fund share does not directly flow to the affiliate, and expanding the ability of banks to purchase mutual funds would enhance the ability of banks to diversify their investment portfolios. The OCC offered a more limited version of this position and advised that the new (d)(6) exemption should allow banks to purchase affiliate-issued mutual fund shares on an intraday basis so long as such shares are allocated to customer sweep accounts at the end of each business day.

The Canadian Bankers Association opined that the new (d)(6) exemption should allow banks to purchase affiliate-issued securities that are guaranteed by the Canadian government (in addition to securities guaranteed by the U.S. government). The Association pointed out that many Canadian mortgage-backed securities are issued by banks but backed by the full faith and credit of the Canadian government. The Association also represented that a 1988 treaty between the United States and Canada commits the United States to permitting U.S. banks to underwrite and purchase Canadian government-backed securities to the same extent as U.S. government-backed securities.

Pricing mechanisms

The new (d)(6) exemption applies only in situations where the bank is able to obtain price quotes on the purchased securities from an unaffiliated electronic, real-time pricing service. Eleven commenters (including the OCC and several trade associations) expressed a view that the new (d)(6) exemption should allow banks to purchase securities based on price quotes from two independent dealers. The principal arguments of these commenters were: (i) independent dealers have no incentive to quote an artificial price; (ii) the Board has determined that two dealer bids are an acceptable pricing mechanism for purchases of municipal securities under section 223.16(f) of the proposed rule; (iii) the SEC allows mutual funds to purchase securities from an affiliate at current market price and has defined current market price to include the lowest offer price from a disinterested third party after a reasonable inquiry by the mutual fund; (iv) NASD rules require the use of dealer quotes to price certain securities where multiple quotes from an interdealer quotation system are not available; (v) dealer quotes are routinely used by securities traders because some seasoned corporate and mortgage-backed securities are traded infrequently; and (vi) dealer quotes are used to establish the value of securities for close-out and netting purposes in ISDA derivatives master agreements. On the other hand, Discover Bank advised that independent dealer bid pricing is not a valuable option for banks because independent dealers would be generally unwilling to provide bids to a bank where it seems likely that the bank will ultimately buy the security from its broker-dealer affiliate.

Commenters offered a few other suggestions regarding the pricing mechanism of the new (d)(6) exemption. Merrill Lynch asked the Board to permit banks to use quotes on comparable securities under the exemption in the context of separate classes of mutual funds because these classes have a minimal per share price differential. ISDA asked the Board to expand the new (d)(6) exemption to allow banks to purchase investment-grade assets from affiliates to hedge derivatives. Finally, the Bond Market Association asked the Board to clarify that an electronic service is an acceptable pricing mechanism even if the bank or an affiliate is a minority stakeholder in the electronic service so long as neither the bank nor any affiliate of the bank has day-to-day operational control of the service.

Section 223.16(f) (municipal securities exemption)

Several commenters expressly supported the new exemption for the purchase of municipal securities from an affiliate. The Bond Market Association asked the Board to expand the exemption to allow banks to purchase municipal securities during the underwriting period (even in the absence of an underwriting syndicate) so long as the bank's purchase price is at or below prices at which sales are made to third parties. Discover Bank asked for clarification as to whether a bank that meets the terms of the municipal securities exemption need do anything more to meet section 23B's market terms requirement or section 23B's requirements with respect to purchases of securities during an underwriting.

Section 223.16(h) (bank in formation exemption)

Three commenters (including the ACB) wrote in support of the proposed exemption for purchases by a "bank in formation" of assets from an affiliate. The OTS asked for clarification as to whether a bank in formation may have a reasonable time after obtaining the relevant approval of its primary federal supervisor to consummate the asset purchase.

Section 223.16(i) (Bank Merger Act exemption)

The proposed rule, consistent with an existing Board exemption, exempted from section 23A transactions between insured depository institutions that are approved under the Bank Merger Act. Seven commenters (including the OCC, the ABA, and the FSR) argued that the Board should expand the Bank Merger Act exemption to include mergers between a national bank and a nonbank subsidiary or affiliate of the bank, which are reviewed by the OCC under the National Bank Consolidation and Merger Act (12 USC 215a-3). The OTS and Bank One urged the Board to expand this exemption to include Bank Merger Act transactions with any affiliate (not just an insured depository affiliate) and any other transactions with affiliates (e.g., asset sales, liability assumptions, and subsidiary formations) that are subject to approval by the bank's primary federal supervisor.

Section 223.16(j) ("250.250" exemption)

The proposal provided an exemption, consistent with an existing Board exemption, for a bank's purchase of credit extensions from an affiliate, so long as (i) the bank, based on an independent credit evaluation, commits to purchase the credit extension prior to the affiliate making the credit extension; (ii) the bank does not purchase more than 50 percent of the credit extensions made by the affiliate; and (iii) the bank does not provide substantial, ongoing funding to the affiliate.

Traditional 50 percent test

MBNA supported the Board's retention of a 50 percent limit on the amount of loans a bank could purchase from an affiliate under the 250.250 exemption. Six commenters (including the OCC and OTS) requested that the Board remove the 50 percent test because it is unnecessary and burdensome and most of these bank/affiliate arrangements are designed to benefit the bank. Two commenters asked the Board to modify the 50 percent test. NYCHA stated that, if the rule retains the 50 percent limit, the limit should be revised to be 50 percent of the entire assets of the affiliate (not just the credit portfolio of the affiliate). Another commenter asked that the 50 percent per affiliate limit be revised to be 50 percent of the lending portfolio of all lending affiliates together to reduce the burden of monitoring each small affiliate.

Two commenters asked the Board to clarify the application of the 50 percent test. The OTS asked for clarification as to whether banks must compute compliance with the test continuously or on a periodic basis. Merrill Lynch recommended that banks be required to calculate compliance with the 50 percent test over a defined period (for example, a rolling 12-month period). Merrill Lynch also asked the Board to clarify that, for purposes of compliance with the 50 percent test, the total dollar amount of credit extended by the affiliate (including the full amount of all lines of credit) counts in the denominator, even if the affiliate participates out or syndicates the credits to third parties.

Substantial, ongoing funding test

One commenter (the OCC) supported the rule's inclusion of the "substantial, ongoing funding" test. Eighteen commenters (including the OTS, ABA, FSR, NYCHA, and ACB) urged the Board to remove the test because it is too vague and subjective, it may disrupt many existing operations, it prevents banks and their affiliates from accomplishing rational business planning, and there is no evidence that the existing 50 percent test has failed to check abuse.

Test based on size of bank

The preamble to Regulation W asked for comment on whether the rule should include another quantitative condition to the 250.250 exemption based on the size of the purchasing bank. Eleven commenters (including the OTS and FSR) objected to such an action and argued that case-by-case review is a better approach to handling situations where a large portion of the bank's assets are loans purchased from an affiliate. These commenters believed that the remaining conditions of the exemption should suffice to prevent abuse of the bank. The NYCHA, on the other hand, recommended that the rule include a 50 percent limit based on the assets of the bank.

Independent bank evaluation requirement

Seven commenters (including the ABA, FSR, and ACB) requested that the Board interpret the "independent evaluation" requirement so as not to require an actual evaluation of the credit by the bank if the affiliate uses the same credit underwriting process as the bank. According to these commenters, such an interpretation would recognize appropriately that banks and affiliates often use the same underwriting standards and would encourage banks and affiliates to share effective underwriting practices with each other and to work toward harmonization of underwriting practices within a single organization. These commenters indicated that, as currently interpreted, the 250.250 exemption interferes with centralized and efficient formula-based credit underwriting processes.

The OTS argued for a more limited form of this relief. The OTS believed that the Board should interpret the "independent evaluation" requirement so as not to require an actual evaluation of the credit by the bank if (i) the affiliate uses the same credit underwriting process as the bank; and (ii) and the affiliate underwriting activity is purely nondiscretionary.

Five commenters (including the OCC and various trade associations) further contended that the Board should interpret the "independent evaluation" requirement so as not to require an actual evaluation of the credit by the bank if the affiliate uses the underwriting standards of Fannie Mae, Freddie Mac, or Ginnie Mae. The Principal Bank expressed its view that a bank should be able to use the 250.250 exemption to purchase residential mortgages from an affiliate without separately evaluating or approving each mortgage loan due to the automated, objective underwriting processes used in mortgage lending and the fungibility of residential mortgages.

Other aspects of the 250.250 exemption

Two commenters asked for clarification of other aspects of the 250.250 exemption. The OTS requested clarification as to whether a bank may purchase loans with recourse from an affiliate under the 250.250 exemption and whether a bank must be "taking advantage of an investment opportunity" to use the exemption. Merrill Lynch asked the Board to clarify that the 250.250 exemption applies to situations where a bank makes a direct loan to a borrower after the affiliate makes a binding commitment to lend to the borrower. Although there has been no technical asset purchase by the bank from an affiliate in this situation, Merrill Lynch believed that such transactions should be exempt.

Section 223.16(k) (Intraday extensions of credit)

The Board issued an interim final rule on intraday credit extensions by banks to affiliates concurrently with proposed Regulation W. The interim rule clarified that such intraday credits are subject to section 23B and required banks to adopt policies and procedures to manage the credit exposure arising from their intraday credit extensions to affiliates. Proposed Regulation W provided an alternative approach to intraday credit. Under the proposed rule, intraday credit extensions by a bank to an affiliate were covered transactions under section 23A but were exempt from the quantitative and collateral requirements of the statute if the credit was extended in the ordinary course of payment and securities clearing transactions and the bank met certain other prudential requirements. Most commenters on the intraday credit issue expressed support for either the interim rule approach to intraday credit or the proposed Regulation W approach to intraday credit, with slightly more support garnered by the interim rule approach. Three bank commenters rejected both approaches, however, and urged the Board to treat intraday credit as not subject to section 23A. Although no commenter directly criticized the interim rule approach, a number of commenters criticized or suggested improvements to the proposed Regulation W approach.

Four commenters asked for a reduction in the preconditions for qualifying for the proposed Regulation W exemption for intraday extensions of credit because (i) they are too onerous (especially for third-party processors); (ii) the Board already limits bank intraday exposures through its payment systems risk policy; (iii) some bank holding companies have relationships with lenders that prevent the pledging of certain assets; and (iv) the conditions may reduce the liquidity of the payments system. Eight commenters (including the SIA and the Bond Market Association) recommended abandoning the Regulation W approach to intraday credit because (i) banks do not use intraday credit to fund affiliates; (ii) intraday credit becomes covered by section 23A at the end of the day and, accordingly, banks have incentives to monitor intraday overdrafts by affiliates; (iii) banks do not have the systems to monitor these intraday transactions in real time and it would be very costly to develop and maintain such systems; (iv) banks already have policies and procedures in place to regulate intraday credit; and (v) there is no evidence that problems have arisen. According to these commenters, the minimal benefits of the Regulation W approach would not outweigh the substantial costs.

Bank of America and MBNA asked the Board to expand the proposed Regulation W approach to cover all intraday credit, not only credit extended in connection with payment and securities clearing transactions. According to these organizations, it would not be cost-effective to force a bank to apply section 23A to the small amount of non-payment/non-clearing intraday credit that it may grant to hundreds of affiliates around the world.

Nine commenters (including the OCC and OTS) urged the Board to provide an exemption for intraday credit arising from special purpose credit card transactions if the Board determines to treat intraday credit extensions as covered transactions under section 23A. These commenters explained that, under current practice, special purpose credit card banks either (i) sell their receivables at the end of each day to a third party or an affiliate; or (ii) keep their receivables at the end of each day and record the associated liabilities to the affiliated merchant as a segregated, earmarked deposit account. According to these commenters, the Regulation W approach to intraday credit would significantly disrupt existing practices for special purpose credit card banks and would create substantial inefficiencies for these banks (requiring several thousand daily sales of receivables instead of one sale at the end of each day). These commenters emphasized that third-party customers are liable for repayment to the bank on these transactions, not the affiliated merchants and that the intraday risk to the bank on these transactions is similar to the risk on payment or settlement transactions. Three of these commenters stated that, if the Board does not grant an additional exemption for special purpose credit card transactions, the Board should clarify that it would consider a special purpose credit card bank to be fully secured by a segregated, earmarked deposit account if at the same time during the day that the credit card receivable is created, the bank takes collateral in the form of the corresponding obligation of the bank to pay the affiliated merchant.

Several commenters expressed support for inclusion of a transition period for banks to put the necessary systems in place to comply with Regulation W's treatment of intraday credit. The ABA and FSR requested a 2-year transition period; the American Bar Association's Banking Law Committee asked for a 270-day transition period.

Overnight definition

The proposal sought comment on how the rule should determine when an intraday credit extension becomes an overnight credit extension. Three banking organizations advised the Board to keep the intraday/overnight cutoff at one particular daily time for each banking organization and not to require a bank to use the local end of business day in different jurisdictions. According to these commenters, this approach would prevent banks from rolling credits around the world to avoid ever becoming overnight credits. These commenters also believed that the end of the U.S. business day would be a reasonable cutoff time because, among other things, it is the latest time in the worldwide business day for most U.S. banking organizations.

Two banks expressed a contrary view and asked the Board to require banks to use as the intraday/overnight cutoff the end of the business day in the local jurisdiction where the credit was extended. According to these commenters, this approach is necessary to prevent a nationwide bank from, for example, moving an East Coast loan to the West Coast at the end of the East Coast business day to extend its intraday period.

Citibank represented that the intraday/overnight cutoff for a loan by a bank's foreign branch to a foreign affiliate in the same jurisdiction should be the end of the local business day in the foreign jurisdiction. Citibank also contended that, for a loan by a bank's foreign branch to a foreign affiliate in another jurisdiction, the intraday/overnight cutoff should be the end of the local business day in the foreign affiliate's jurisdiction.

Another bank requested that each bank be allowed flexibility in defining the intraday/overnight cutoff.

Section 223.17 (Exemptive authority under section 23A)

Approximately 16 commenters asked the Board to establish formal filing and processing guidelines for section 23A exemption requests. These commenters offered a wide variety of suggested time frames for Board action on such requests but most of them requested that the Board commit to acting within 30-60 days of receipt of a request. The FSR asked the Board to express a greater willingness to provide section 23A exemptions for transactions other than internal corporate reorganizations. NYCHA and Wells Fargo recommended that the Board delegate to the Reserve Banks authority to grant section 23A exemptions. FleetBoston and KeyCorp asked the Board to delegate to Federal Reserve examiners or the other federal banking agencies authority to grant section 23A exemptions.

F. Subpart F -- Section 23B

Section 223.18-19 (Fair market terms requirement of section 23B)

The Board received a number of comments from the other federal banking agencies on section 23B. The FDIC asked for guidance as to what section 23B's "market terms" requirement means. The FDIC expressed particular interest in knowing whether a bank must obtain alternative bids to demonstrate compliance with section 23B.

The OCC asked for an explanation of why some transactions exempt from section 23A under the proposed rule are also exempt under section 23B, while other transactions exempt from section 23A are not exempt under section 23B. The OCC also urged the Board not to restrict the "bank" exception from section 23B's definition of "affiliate" to insured depository institutions.

The OTS asked for clarification of two points: (i) that an affiliate does not have a "financial interest" in another company for purposes of section 23B if the affiliate owns less than 5 percent of a class of voting shares of the other company; and (ii) that section 23B's restrictions on purchases by a bank as fiduciary of an asset from an affiliate only apply where the bank acts as a fiduciary with investment discretion.

Section 223.21 (Section 23B's advertising restriction)

Section 23B prohibits a bank from publishing any advertisement or entering into any agreement stating or suggesting that the bank is responsible for the obligations of its affiliates. Regulation W provided that this restriction does not prohibit a bank from issuing a guarantee, acceptance, or letter of credit on behalf of an affiliate to the extent permitted by section 23A. In light of these provisions, Bank One and Morgan Chase requested that the rule make clear that an affiliate may -- in a prospectus, other disclosure materials for a securities offering, or other advertisement -- mention the fact that the bank has issued a guarantee or letter of credit on behalf of the affiliate. Merrill Lynch asked the Board to clarify that, if the Board treats certain credit derivatives as the functional equivalent of a guarantee, the advertising restriction also would not prohibit such credit derivatives.

G. Subpart G -- Application of Sections 23A and 23B to the U.S. Branches and Agencies of Foreign Banks

The proposed rule applied section 23A to transactions between the U.S. branch or agency of a foreign bank and affiliates of the foreign bank engaged in the United States in securities underwriting and dealing, insurance underwriting, merchant banking, and insurance company investment activities. Eight commenters urged the Board not to apply section 23A to foreign banks.

Legal authority under section 114 of the GLB Act

Five commenters challenged the Board's authority under section 114 of the GLB Act to apply section 23A to the U.S. branches and agencies of foreign banks. According to these commenters, the Board's action fails to meet the first requirement of section 114 (consistency with federal banking law) because federal banking law does not generally subject

U.S. branches and agencies of foreign banks to section 23A. In the commenters' view, the Board's action also fails to meet the second prong of section 114 (intention to prevent adverse effects) because the Board has not presented specific evidence of actual abuse and is admittedly acting to fight possible future abuse.

Two Swiss financial services trade associations noted that the Board claimed to impose sections 23A and 23B on foreign banks to ensure competitive equity with U.S. banks, but these commenters argued that competitive equity concerns do not fit within the "unfair competition" rationale in section 114 of the GLB Act. In fact, these commenters noted that the Board previously has acknowledged that the "unfair competition" aspect of section 4(j) of the BHC Act did not authorize the Board to address disparities based on the structure of the banking industry.

Two commenters also contended that section 114 of the GLB Act contains an implicit "narrowly tailored" requirement and, consequently, does not authorize the Board to apply the whole arsenal of sections 23A and 23B when a more narrow approach would suffice.

The substance of the competitive equity issue

Several commenters on the foreign bank provisions of the proposed rule advanced the proposition that foreign banks do not enjoy a subsidy in the United States and do not have a competitive advantage over U.S. banks. These commenters explained that the deposits taken by foreign banks in their U.S. branches are not FDIC-insured and that U.S. branches and agencies raise money in wholesale markets almost exclusively based on their credit ratings and hence do not obtain the cheap deposits that U.S. banks do. According to commenters, certificates of deposit issued by the

U.S. branches of foreign banks offer virtually identical rates of return on similarly situated U.S. bank holding company commercial paper.

Commenters also asserted that the Board has previously concluded that any home country subsidy enjoyed by a foreign bank does not travel to the United States. In fact, according to commenters, U.S. banks have a competitive "home field" advantage in the United States, which the Board has acknowledged in statements to Congress and in research papers.

Five commenters urged the Board not to change its traditional view by applying section 23A to foreign banks until more analysis is done to establish that foreign banks have a competitive advantage or have abused their freedom from section 23A.

Other considerations

Commenters offered the following additional arguments in opposition to the proposed application of sections 23A and 23B to the U.S. branches and agencies of foreign banks. First, commenters represented that sections 23A and 23B are designed to protect the federal deposit insurance funds. In support of this position, these commenters noted that Congress extended section 23A in 1966 and 1989 only to insured state nonmember banks and thrifts. Accordingly, in the view of these commenters, because the U.S. branches of foreign banks are not insured, they should not be subject to sections 23A and 23B. Moreover, commenters pointed out that Congress chose not to extend sections 23A and 23B to foreign bank branches when it passed the International Banking Act of 1978.

Commenters also pointed out alleged inconsistencies in the Board's treatment of the U.S. branches and agencies of foreign banks. First, several commenters stated that it is inconsistent and unfair to subject the U.S. branches and agencies of foreign banks to section 23A but then to deny them the benefits of the sister bank exemption. Second, commenters claimed that it is inconsistent to permit a U.S. bank to fund its non-U.S. subsidiaries (generally held through an Edge corporation and often engaged in securities underwriting and dealing) through a non-U.S. branch without complying with section 23A, but to force a non-U.S. bank to fund its U.S. subsidiaries through a U.S. branch in compliance with section 23A. The Canadian Bankers Association noted, for example, that Canada does not apply its transactions-with-affiliates regulations to transactions between Canadian branches of foreign banks and their Canadian nonbank affiliates.

As noted, the proposed rule only applied sections 23A and 23B to transactions between a U.S. branch or agency of a foreign bank and affiliates of the foreign bank engaged in the United States in four new GLB Act activities. Commenters also addressed the proposed rule's selection of activities. The Institute of International Bankers asked the Board to make clear that any activities to be added to the list would be new GLB Act activities and not old section 4(c)(8) activities. The Institute also requested that the Board provide a decisionmaking procedure for supplementing the activity list. The OCC and the Swiss trade associations urged the Board only to add new activities that raise supervisory issues and not to add any activities to the list without going out for public comment. On the other hand, Bank of America believed that Regulation W should be expanded to apply sections 23A and 23B to transactions between a foreign bank's U.S. branch or agency and a U.S. affiliate of the foreign bank engaged in any activities permissible under section 4(c)(8) of the BHC Act but not permissible for banks or their operations subsidiaries (e.g., real estate leasing).

The Institute of International Bankers and the Royal Bank of Canada recommended that the rule grandfather those international banks that commenced insurance underwriting in the United States after passage of the GLB Act but before promulgation of proposed Regulation W. According to Royal Bank of Canada, these banks, including Royal Bank, acquired U.S. insurance underwriters without notice that sections 23A and 23B would apply to these affiliates.

H. Subpart H -- Definitions

Section 223.24 (Definition of affiliate)

The banking agencies made a number of comments on the definition of affiliate under section 23A. The FDIC asked the Board to confirm that a bank's primary federal supervisor (not the Board) may determine the holding period for DPC stock under section 223.24(b)(5) of the proposed rule. The OCC and OTS requested that the rule clarify, perhaps through examples, the applicability of the "sponsored and advised" prong of the affiliate definition. The OTS also asked that the rule (i) confirm that the common ownership prong of the affiliate definition (section 223.24(a)(3) of the proposed rule) covers commonality of ownership even if there is no common purpose among the shareholders; (ii) clarify that majority general partner interlock creates an affiliate; and (iii) clarify the affiliate status of a company that is sponsored and advised by the bank and is also a subsidiary of the bank.

Section 223.24(a)(6) (investment funds)

Proposed Regulation W provided that any investment fund advised by the bank or an affiliate of the bank is itself an affiliate of the bank for section 23A purposes if the bank or an affiliate of the bank owns 5 percent or more of the fund. Five commenters (including the ABA and

SIA) expressed opposition to this provision. According to these commenters, such a rule would violate the careful statutory framework established by Congress for determining which investment funds are affiliates of banks. In addition, these commenters claimed that there is little potential for conflicts of interest, and no evidence of abuse, in transactions between banks and these unregistered funds. NYCHA urged the Board to deem an unregistered investment fund as an affiliate of a bank only if the bank or an affiliate controls the fund.

The proposed rule sought comment on whether portfolio companies controlled by an investment fund affiliate of a bank should be deemed affiliates of the bank. ABA and Morgan Chase objected to this proposal on the grounds that it would have little section 23A benefit and would require the implementation of complex monitoring and aggregation systems.

Section 223.24(a)(10) (general partners)

The proposal deemed partnerships for which the bank (or its operations subsidiary) serves as a general partner to be an affiliate of the bank. Three commenters expressed concern that this change in staff's traditional view would eliminate bank funding of legitimate commercial (e.g., leasing) and community development transactions. The OCC also asked the Board to explain more fully the rationale for this provision.

Special purpose vehicles

The proposed rule sought comment on whether the Board should treat special purpose securitization vehicles ("SPVs") as affiliates of their associated bank. Sixteen commenters (including the OCC, ABA, and FSR) registered opposition to this proposal. Their principal arguments were: (i) FAS 140 requires that an SPV be demonstrably distinct from the transferor, limits an SPV's activities, asset holdings, and methods for disposing of non-cash assets, and provides that assets transferred to an SPV are not consolidated on the books of the transferor; (ii) the banking agencies' risk-based capital guidelines and FFIEC supervisory guidance comprehensively deal with securitizations, including credit enhancements provided by a bank to a securitization vehicle; (iii) SPVs are established for the benefit of the bank (to assist the bank in selling its assets or accomplishing its risk management goals) or the bank's nonaffiliated customers and treating SPVs as affiliates would severely limit a bank's ability to securitize assets or service securitized assets; (iv) treating SPVs as affiliates will interfere with the socially beneficial securitization process by limiting the amount of credit enhancements that a bank can provide to an SPV and requiring collateral to be provided to the bank; and (v) SPVs have separate corporate status, equity ownership, and management from their sponsor.

Bank of America contended that securitization SPVs do not meet the "sponsored and advised" prong of the affiliate definition in section 23A because the bank does not generally pick the trustees of the SPV, and the SPV generally does not have a name similar to that of the bank. Bank of America also represented that banks generally would not experience a material adverse reputational effect if an SPV fails because several parties are usually associated with the SPV.

Four commenters expressed the view that SPVs should be dealt with on a case-by-case basis because they significantly vary in structure from deal to deal. Another commenter believed that the Board should generally exempt transactions with "qualifying SPEs" (as defined in FAS 140) or SPEs that are wholly owned by the bank and bankruptcy-remote.

The OCC and Merrill Lynch contended that securitization SPVs should generally not be treated as affiliates because they are a way for a bank to reconfigure its own assets. These two commenters acknowledged, however, that transactions with SPVs that contain assets originated by an affiliate of the bank (e.g., a bank's purchase of interests in such an SPV) should in some cases be covered transactions. Merrill Lynch advised that the Board should exempt even these transactions where the bank only purchases investment grade interests in the SPV, or where the bank limits its purchase to less than 50 percent of any tranche of SPV interests, or where the affiliate's assets represent less than 50 percent of the SPV's assets.

Section 223.24(b) (bank subsidiaries)

Section 23A and the proposed rule provide that a subsidiary of a bank (other than a depository institution subsidiary or a financial subsidiary) is not an affiliate of the bank. Two commenters recommended expanding this subsidiary exception to the definition of affiliate. MBNA urged the Board not to include as an affiliate a wholly owned foreign bank subsidiary of a bank. ABA and FSR stated that the rule should not include as an affiliate of a bank an uninsured depository institution subsidiary of the bank. According to ABA and FSR, such uninsured depository institution subsidiaries should be treated like all other uninsured operations subsidiaries of a bank.

ESOPs

The proposed rule contained provisions ensuring that most employee stock option plans of a bank or an affiliate of the bank would be considered affiliates of the bank. ICBA supported the Regulation W approach to ESOPs. Several commenters (including the ABA) objected to this approach. They principally argued that (i) bank loans to an associated

ESOP do not pose risk to the bank; (ii) ESOPs are regulated (including their related-party transactions) by the Department of Labor and transactions between a bank and an associated ESOP are adequately governed by ERISA; (iii) Congress has expressed support for ESOPs; (iv) regulating bank-ESOP transactions under section 23A would prevent banks from effectively using ESOPs to compensate employees and would put banks at a competitive disadvantage to nonbank firms; (v) bank ESOPs generally are controlled by the bank because the bank can appoint the trustees and, hence, ESOPs generally are subsidiaries and not affiliates of the bank under section 23A; and (vi) treating ESOPs as affiliates of their associated bank may prevent some banks from establishing ESOPs because third-party lenders to an ESOP generally require the employer to guarantee the loan and ESOPs often would have no collateral to pledge for the bank guarantee other than unacceptable affiliate-issued securities.

Other commenters requested that the Board modify its approach to bank-associated ESOPs in various ways. The ABA requested that the rule clarify that defined benefit and defined contribution plans are not affiliates. Bank One stated that ESOPs of affiliates of a bank should not be deemed affiliates of the bank, especially since bank holding companies may have no practical way of knowing whether a merchant banking portfolio company affiliate has an ESOP. Other commenters noted that there are material differences among the various kinds of ESOPs and recommended that, if the Board is concerned about a bank using loans to an ESOP to fund the bank's holding company, the Board should attack these abuses in the supervisory process.

Joint venture subsidiaries

The proposed rule provided that a subsidiary of a bank that is also more than 25 percent owned by an affiliate of the bank is itself an affiliate of the bank. The ICBA wrote in support of this provision. The ABA objected to this provision because such joint venture companies and their investors are already supervised by federal bank regulators.

Other commenters recommended restricting the scope of this provision. Citigroup and Capital One stated that the rule should not define as an affiliate a subsidiary of a bank of which affiliates of the bank own more than 25 percent if the bank owns more than 50 percent of the voting securities of the joint venture. These commenters explained that, in such case, the bank controls the joint venture and the bank's primary federal supervisor will examine the joint venture. Citigroup also asked that the rule be amended so as to apply only if an affiliate owns more than 25 percent of the voting securities of the joint venture (and not if an affiliate owns more than 25 percent of the nonvoting equity interests of the joint venture). Morgan Chase expressed its view that the proposed rule should be modified to provide that a company owned partly by a bank and partly by an affiliate of the bank is not an affiliate of the bank unless the affiliate directly owns 25 percent or more of the company. For example, Morgan Chase believed that a company should not be deemed an affiliate of a bank if, for example, the bank owns 24.9 percent of the company and the bank's holding company owns 0.1 percent of the company. Another commenter suggested that the rule should not make a joint venture an affiliate if the joint venture is only engaged in agency activities.

Section 223.25 (Covered transactions)

Numerous commenters expressed views on the rule's definition of covered transaction. The FDIC requested that the rule provide that bank deposits in an affiliated bank are not covered transactions (regardless of whether there is a correspondent banking relationship). The OTS asked for clarification as to whether (i) a bank's retention of a residual interest in a securitization SPV could be deemed a guarantee on behalf of an affiliate if an affiliate invests in the SPV; and (ii) interest rate swaps are covered transactions. Shearman & Sterling requested clarification that a covered transaction does not occur when a bank participates out an unfunded loan to an affiliate (despite the fact that the bank becomes exposed to the credit risk of the affiliate). Wells Fargo asked the Board to make clear that certain confirmations of a documentary letter of credit are not covered transactions, as per staff's traditional position.

Repurchase agreements/securities lending

Five commenters (including the OCC and OTS) asked the Board to clarify the treatment of repurchase agreements and securities lending and borrowing transactions under section 23A. Citigroup and the Bond Market Association urged the Board to state that securities borrowing transactions and reverse repurchase agreements are not covered transactions (or are exempt transactions) regardless of the fact that the bank posts cash or other collateral with the affiliate. These commenters defended their position by arguing that these transactions (i) have been recognized by the Board as adding value to the financial system; (ii) are motivated by a need of the bank to obtain securities -- not a need of the affiliate for cash; and (iii) may qualify for the (d)(4) or (d)(6) exemptions in section 23A. The OCC, NYCHA, and Citigroup also sought Board confirmation that indemnities relating to "securities lending as conduit" activities are not covered transactions except to the extent that the indemnity is unsecured at a point in time.

<u>Collateral for debt securities</u>

The proposed rule provided that a bank must satisfy the collateral requirements of section 23A in connection with a purchase of debt securities issued by an affiliate. The proposal also sought public comment on whether the collateral requirements should be waived when a bank purchases an affiliate's debt securities (i) from a third party in a bona fide secondary market transaction; or (ii) pursuant to an offering in which the affiliate receives significant participation by third parties. Seven commenters (including ABA, FSR, and SIA) registered opposition to imposing the collateral requirements on any purchase of affiliate debt securities by a bank. They argued that (i) section 23A and its legislative history provide no support for this position; (ii) it will often not be feasible or possible (due to negative pledge covenants) for the bank to obtain collateral for the security after the terms of the security are fixed at inception; (iii) requiring collateral for purchases of debt securities but not for purchases of equity securities is perverse; and (iv) the proposal is a departure from past staff guidance and current market practice. Morgan Chase and National City specifically noted, however, that the Board did have legal authority to take this position.

Ten commenters (including the OCC, ABA, FSR, and NYCHA) supported including in the final rule a provision stating that a bank is not required to collateralize a purchase of a debt security issued by an affiliate if the purchase is on market terms and is a bona fide purchase in the secondary market from a third party. Only two commenters (including the SIA) explicitly supported the second proposed exemption that would exempt purchases that are on market terms and are purchases in an offering with third party participation. Moreover, the OCC specifically objected to granting the second proposed exemption.

Other commenters proposed alternative exemptions. SIA and Bank One suggested that the rule should not require a bank to collateralize a purchase of a debt security issued by an affiliate if the purchase is on market terms and is a purchase of a marketable debt security. U.S. Bancorp stated that the rule should not require a bank to collateralize a purchase of an investment-grade debt security issued by an affiliate. Merrill Lynch contended that the rule should not require a bank to collateralize a purchase of a debt security issued by an affiliate if the purchase is an indirect purchase of affiliate-issued debt securities (i.e., through purchases of a mutual fund or other pass-through entity). Merrill Lynch also asked the Board to provide a special grandfather provision for this aspect of Regulation W.

Cross-affiliate netting arrangements (CANAs)

The preamble to the proposed rule indicated the Board's view that certain cross-affiliate netting arrangements ("CANAs") effectively were guarantees on behalf of an affiliate for purposes of section 23A. The Bond Market Association encouraged the Board to clarify that CANAs that do not make the bank liable for the obligations of its affiliates or otherwise cause any detriment to the bank are not covered transactions. The Bond Market Association also provided several examples of CANAs that should not be deemed covered transactions. Citigroup also indicated that certain CANAs should be treated as covered transactions; namely, CANAs that contain cross-collateralization provisions in which the bank potentially benefits from a pool of excess collateral that a third party has posted with its affiliates. Both the Bond Market Association and Citigroup urged the Board to withhold judgment on CANAs until standardized documentation is developed by the industry. Shearman & Sterling advised that CANAs are of many types and, therefore, the Board should not adopt a fixed rule for all CANAs.

Citigroup also requested clarification that cross-default arrangements in which a bank is deemed to have defaulted on a contract with a third party if an affiliate of the bank has defaulted on another contract are not covered transactions. According to Citigroup, banks only agree to these cross-defaults in order to get a similar cross-default from the third party.

Section 223.26 (Other definitions)

Control

Several commenters asked for additional guidance on how the Board interprets the control provisions of section 23A. The FDIC requested that the Board acknowledge that the FDIC has the right to make control determinations regarding state nonmember banks. The FDIC also desired clarification of how the control definition applies to LLCs and to companies that do not issue voting securities.

Four commenters addressed the issue of how convertible securities and warrants fit into section 23A's control framework. NYCHA and Citigroup stated that the rule should provide that calculation of percentage ownership should be done on a fully diluted basis. SIA contended that only convertible securities that are immediately convertible into underlying voting securities should be presumed to be a holding of the underlying securities and that this presumption should be rebuttable. Shearman & Sterling directed the Board's attention to the SEC's rules on convertible securities, which treat convertible securities as a holding of the underlying securities if the convertible securities are convertible within 60 days.

Low-quality asset

Four commenters also commented on the proposed regulatory definition of low-quality asset. SIA objected to the Board's position that non-investment grade debt securities are ipso facto low-quality assets and noted that much riskier assets can be pledged to meet section 23A's collateral requirements. Citigroup, KeyCorp and Shearman & Sterling objected to the provision of the proposed rule that defined low-quality asset to include any asset classified in the internal classification system of a bank. According to these commenters, the statute was careful in its definition of low-quality asset, and the Board should not penalize banks with careful internal classification systems. They also contended that such an approach creates perverse incentives for banks and allows the definition of low-quality asset to vary from bank to bank. In addition, Citigroup argued that "other real estate owned" should not be considered a low-quality asset. Citigroup represented that OREO is often good collateral collected from a bad borrower and stated that a bank should be allowed to purchase OREO from an affiliate if the bank uses the OREO as premises.

Securities

The OTS asked for clarification as to whether annuities issued by an affiliate are "securities" for purposes of section 23A.

APPENDIX A

Members of Congress

1. Barney Frank
2. Edward M. Kennedy and John F. Kerry

Other Federal Banking Agencies:

3. Federal Deposit Insurance Corporation, Washington, D.C.
4. Office of the Comptroller of the Currency, Washington, D.C.
5. Office of Thrift Supervision, Washington, D.C.

Other Public Commenters:

6. American Bankers Association/ABA Securities Association, Washington, D.C.
7. American Bar Association (Banking Law Committee of the Business Law Section), Washington, D.C.
8. ABN Amro North America, Inc., Chicago, Illinois
9. America's Community Bankers, Washington, D.C.
10. American Financial Services Association, Washington, D.C.
11. Arkansas State Banking Department, Little Rock, Arkansas
12. Asian American Bank & Trust Company, Boston, Massachusetts
13. Athol Savings Bank, Athol, Massachusetts
14. Avon Co-operative Bank, Avon, Massachusetts
15. Bank of America Corporation, Charlotte, North Carolina
16. Bank One Corporation, Chicago, Illinois
17. Bank of Montreal Group of Companies, Chicago, Illinois
18. Barre Savings Bank, Barre, Massachusetts
19. Berkshire Bank, Pittsfield, Massachusetts
20. Beverly Cooperative Bank, Beverly, Massachusetts
21. The Bond Market Association, New York, New York
22. Bridgewater Savings Bank, Raynham, Massachusetts
23. California Federal Bank, San Francisco, California
24. Cambridge Savings Bank, Cambridge, Massachusetts
25. Cambridgeport Bank, Cambridge, Massachusetts
26. Canadian Bankers Association, Toronto, Canada
27. Canadian Department of Finance, Ottawa, Canada
28. Cape Cod Cooperative Bank, Yarmouth Port, Massachusetts
29. Cape Cod Five Cents Savings Bank, Orleans, Massachusetts
30. Capital One Financial Corporation, Falls Church, Virginia

31. Chevron Credit Bank, N.A., Concord, California
32. Chelsea-Provident Co-operative Bank, Chelsea, Massachusetts
33. Citigroup Inc., New York, New York
34. Citizens-Union Savings Bank, Fall River, Massachusetts
35. The Connecticut Bankers Association, Hartford, Connecticut
36. The Co-operative Central Bank, Boston, Massachusetts
37. Credit First National Association, Brook Park, Ohio
    DSRM National Bank, Albuquerque, New Mexico
    FDS Bank, Mason, Ohio
    First North American National Bank, Kennesaw, Georgia
    Granite National Bank, Bowling Green, Ohio
    National Bank of the Great Lakes; Elmhurst, Illinois
    Retailers National Bank, Sioux Falls, South Dakota
38. Conference of State Bank Supervisors, Washington, D.C.
39. Deustche Bank AG, New York, New York
40. Discover Bank, Greenwood, Delaware
41. Doral Financial Corporation, Puerto Nuevo, Puerto Rico
42. East Boston Savings Bank, East Boston, Massachusetts
43. East Cambridge Savings Bank, Cambridge, Massachusetts
44. Eastern Bank Corporation, Lynn, Massachusetts
45. Easthampton Savings Bank, Easthampton, Massachusetts
46. Equitable Co-operative Bank, Lynn, Massachusetts
47. Financial Institutions Insurance Association, Corte Madera, California
48. The Financial Services Roundtable, Washington, D.C.
49. 1st Bank Holding Company of Colorado, Lakewood, Colorado
50. First Electronic Bank, Draper, Utah
51. First Investors Federal Savings Bank, Woodbridge, New Jersey
52. FleetBoston Financial Corporation, Boston, Massachusetts
53. Foley & Lardner, Chicago, Illinois
54. Goulston & Storrs, P.C., Boston, Massachusetts
55. Granite Savings Bank, Rockport, Massachusetts
56. Greenfield Savings Bank, Greenfield, Massachusetts
57. Household International, Inc., Prospect Heights, Illinois
58. Hudson Savings Bank, Hudson, Massachusetts
59. Hyde Park Savings Bank, Boston, Massachusetts
60. Iberville Bank, Plaquemine, Louisiana
61. Independent Bank Corp., Rockland, Massachusetts
62. Independent Community Bankers of America, Washington, D.C.

63. Independent Insurance Agents of America, Alexandria, Virginia
National Association of Insurance and Financial Advisors, Falls Church, Virginia
National Association of Professional Insurance Agents, Alexandria, Virginia
64. Institute of International Bankers, New York, New York
65. Ipswich Co-operative Bank, Ipswich, Massachusetts
66. International Swaps and Derivatives Association, Inc., New York, New York
67. J.P. Morgan Chase & Co., New York, New York
68. KeyCorp, Cleveland, Ohio
69. Lawrence Savings Bank, North Andover, Massachusetts
70. Manufacturers and Traders Trust Company, Buffalo, New York
71. Massachusetts Bank Insurance Association, Boston, Massachusetts
72. Massachusetts Bankers Association, Boston, Massachusetts
73. Massachusetts Co-operative Bank, Quincy, Massachusetts
74. Massachusetts Division of Banks, Boston, Massachusetts
75. Mayer, Brown & Platt, Washington, D.C.
Alston & Bird LLP, Atlanta, Georgia
Bank of America Corporation, Charlotte, North Carolina
Citigroup Inc., New York, New York
Deutsche Banc Alex. Brown Inc., Baltimore, Maryland
1st Financial Bank USA, Dakota Dunes, South Dakota
FleetBoston Financial Corporation, Boston, Massachusetts
J.P. Morgan Chase & Co., New York, New York
MBNA Corporation, Wilmington, Delaware
National City Corporation, Cleveland, Ohio
Orrick, Herrington, Sutcliffe LLP, San Francisco, California
Providian Financial Corporation, San Francisco, California
Wells Fargo & Company, Minneapolis, Minnesota
World Financial Network National Bank, Gahanna, Ohio
76. Mayflower Bank, Middleboro, Massachusetts
77. MBNA Corporation, Wilmington, Delaware
78. Mellon Financial Corporation, Pittsburgh, Pennsylvania
79. Mercantile Bank and Trust Company, Boston, Massachusetts
80. Merrill Lynch Bank USA, Plainsboro, New Jersey
81. Muldoon, Murphy & Faucette LLP, Washington, D.C.
82. National Bank of the Great Lakes, Elmhurst, Illinois
83. National City Corporation, Cleveland, Ohio

84. National Retail Federation, Washington, D.C.
85. New York Clearing House Association L.L.C., New York, New York
86. Northern Bank and Trust Company, Woburn, Massachusetts
87. Northern Trust Corporation, Chicago, Illinois
88. Northmark Bank, North Andover, Massachusetts
89. North Brookfield Savings Bank, North Brookfield, Massachusetts
90. Pentucket Bank, Haverhill, Massachusetts
91. PNC Financial Services Group, Inc., Pittsburgh, Pennsylvania
92. Principal Bank, Des Moines, Iowa
93. Royal Bank of Canada, Montreal, Canada
94. Ms. Dorothy Savarese
95. U.S. Small Business Administration, Office of Advocacy, Washington, D.C.
96. Shearman & Sterling, New York, New York
97. Securities Industry Association, Washington, D.C.
98. Sidley Austin Brown & Wood LLP, New York, New York
99. South Shore Co-operative Bank, Boston, Massachusetts
100. Spirit of America National Bank, Milford, Ohio
101. State Street Corporation, Boston, Massachusetts
102. Strata Bank, Medway, Massachusetts
103. Swiss Bankers Association, Basel, Switzerland
     Swiss Association of Insurers, Switzerland
104. The Savings Bank, Wakefield, Massachusetts
105. UniBank For Savings, Whitinsville, Massachusetts
106. Union Bank of California, N.A., San Francisco, California
107. U.S. Bancorp, Minneapolis, Minnesota
108. Volkswagen Bank USA, Salt Lake City, Utah
109. Warren Five Cents Savings Bank, Peabody, Massachusetts
110. Wells Fargo & Company, Minneapolis, Minnesota
111. Westborough Bank, Westborough, Massachusetts