

## **FEDERAL RESERVE SYSTEM**

### **12 CFR Part 208 [Regulation H; Docket No. R-1129]**

Reporting and Disclosure Requirements for State Member Banks With Securities Registered Under the Securities Exchange Act of 1934

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Interim final rule with request for public comment.

**SUMMARY:** The Board has modified its regulations implementing section 12(i) of the Securities Exchange Act of 1934 to reflect the amendments made to section 12(i) by the Sarbanes-Oxley Act of 2002. These amendments vest the Board with the authority to administer and enforce several of the enhanced reporting, disclosure and corporate governance obligations imposed by the Sarbanes-Oxley Act with respect to state member banks that have a class of securities registered under the Securities Exchange Act of 1934. Because some of the relevant provisions of the Sarbanes-Oxley Act to be administered by the Board are effective already, or will become effective shortly, the Board has adopted the rule on an interim basis and made the rule effective immediately. The Board requests comment on all aspects of the interim rule, and will modify the rule as appropriate in light of the comments received.

**DATES:** The interim rule is effective on September 13, 2002. Comments on the rule must be received by October 14, 2002.

**ADDRESSES:** Comments should refer to Docket No. R-1129, and should be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, D.C. 20551 or mailed electronically to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Comments addressed to Ms. Johnson also may be delivered to the Board's mail facility in the west courtyard of the Eccles Building, located on 21st Street between Constitution Avenue and C Street, N.W. Members of the public may inspect comments in Room MP-500 of the Martin Building, between 9:00 a.m. and 5:00 p.m. weekdays, in accordance with the Board's Rules Regarding the Availability of Information (12 CFR part 261).

**FOR FURTHER INFORMATION CONTACT:** Kieran J. Fallon, Senior Counsel (202-452-5270), or Walter R. McEwen, Counsel (202-452-3321), Legal Division; Terrill Garrison, Supervisory Financial Analyst (202-452-2712), Division of Banking Supervision and Regulation. Users of Telecommunication Device for Deaf (TTD) only, call (202) 263-4869.

## **SUPPLEMENTARY INFORMATION:**

### **Background**

Section 12(i) of the Securities Exchange Act (15 U.S.C. 78l(i)) (Exchange Act) vests the Board with the authority to administer and enforce the disclosure and reporting requirements of sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act with respect to state member banks that have a class of securities registered under section 12(b) or 12(g) of the Exchange Act (registered banks).<sup>1</sup> Section 208.36 of the Board's Regulation H (12 CFR part 208.36) implements the reporting and disclosure provisions of sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act for registered banks. As a general matter, Regulation H requires registered banks to comply with the rules, regulations and forms adopted by the Securities and Exchange Commission (SEC) under sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act, but requires registered banks to file any reports or forms required by such regulations with the Board (rather than the SEC) and substitutes the "Board" for the "SEC" each place that term appears in the SEC's rules and forms.

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<sup>1</sup> As of June 30, 2002, 19 state member banks had a class of securities registered under sections 12(b) or 12(g) of the Exchange Act and, thus, are considered registered banks.

## **Description of Interim Rule**

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (occasionally referred to hereafter as the “Act”).<sup>2</sup> Titles III and IV of the Sarbanes-Oxley Act include a number of provisions that are designed to improve the corporate governance and financial disclosures of issuers that have a class of securities registered under sections 12(b) or 12(g) of the Exchange Act, or that are required to file periodic reports with the SEC under section 15(d) of the Exchange Act (public issuers).

The Sarbanes-Oxley Act also amended section 12(i) of the Exchange Act to vest the Board with the authority to administer and enforce several of the Act’s new corporate governance and disclosure requirements with respect to registered banks.<sup>3</sup> In particular, this amendment provides that the Board shall be the appropriate agency to administer and enforce the following sections of the Act with respect to registered banks. (The effective date of the relevant section, as well as any required timeframe for the SEC to adopt implementing rules, are indicated parenthetically.)

- Section 301, which establishes certain oversight, independence, funding and other requirements for the audit committees of public issuers, and

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<sup>2</sup> Pub. L. No. 102-204 (2002).

<sup>3</sup> See Sarbanes-Oxley Act at § 3(b)(4) (amending 15 U.S.C. 78l(i)).

requires the SEC to issue rules that prohibit any national securities exchange or national securities association from listing the securities of an issuer that fails to comply with these audit committee requirements. (The SEC must adopt rules implementing the listing prohibition by April 26, 2003.)<sup>4</sup>

○ Section 302, which mandates that the SEC adopt rules that require the principal executive officer(s) and principal financial officer(s) of public issuers to include certain certifications in the issuer's annual and quarterly reports filed under the Exchange Act. (The SEC issued final rules implementing this section on August 28, 2002.)<sup>5</sup>

○ Section 303, which requires the SEC to issue rules prohibiting the officers and directors of public issuers, and persons acting under their direction, from fraudulently influencing, coercing, manipulating, or misleading the issuer's independent auditor for purposes of rendering the issuer's financial statements materially misleading. (The SEC must issue proposed rules

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<sup>4</sup> These audit committee and listing requirements were enacted as a new subsection (m) to section 10A of the Exchange Act. See 15 U.S.C. 78f(m).

<sup>5</sup> See Exchange Act Rel. No. 34-46427 (Aug. 28, 2002), available at [www.sec.gov/rules/final.shtml](http://www.sec.gov/rules/final.shtml). Section 906 of the Sarbanes-Oxley Act includes another certification requirement that is separate from the certification requirements of section 302. Section 906 provides that all periodic reports that contain financial statements and that are filed by public issuers under sections 13(a) or 15(d) of the Exchange Act must include a written certification by the chief executive officer and chief financial officer (or equivalent) that (1) the report complies with the requirements of section 13(a) or 15(d) of the Exchange Act, and (2) the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer. Section 906 became effective on July 30, 2002, and persons who knowingly or willfully violate section 906 are subject to specified criminal penalties. See 18 U.S.C. 1350.

implementing section 303 by October 28, 2002, and must adopt final rules implementing this section by April 26, 2003.)

- Section 304, which requires the chief executive officer and chief financial officer of public issuers to reimburse the issuer for certain compensation and profits received if the issuer is required to restate its financial reports due to material noncompliance, as a result of misconduct, with the Federal securities laws. (The requirements of section 304 became effective on July 30, 2002.)

- Section 306(a), which prohibits the directors and executive officers of any public issuer of equity securities from purchasing, selling or transferring any equity security acquired by the director or executive officer in connection with his or her service as a director or executive officer during any “blackout period” with respect to the security. (The provisions of section 306(a) will become effective on January 26, 2003.)

- Section 401(b), which requires the SEC to issue rules that prohibit issuers from including misleading pro forma financial information in their filings with the SEC or in any public release, and that require issuers to reconcile any pro forma financial information included in such filings or public releases with the issuer’s financial statements prepared in accordance with

generally accepted accounting principles (GAAP). (The SEC must issue final rules implementing section 401(b) by January 26, 2003.)

- Section 404, which mandates that the SEC issue rules that require all annual reports filed under section 13(a) or 15(d) of the Exchange Act to include certain statements and assessments related to the issuer's internal control structures and procedures for financial reporting.<sup>6</sup> (The Act does not establish a date by which the SEC must issue rules implementing the requirements of section 404.)

- Section 406, which mandates that the SEC adopt rules that require public issuers to (1) disclose in their periodic reports filed under the Exchange Act whether the issuer has adopted a code of ethics for its senior financial officers and, if not, the reasons why such a code has not been adopted; and (2) promptly disclose on Form 8-K any change to, or waiver of, the issuer's code of ethics. (The SEC must issue proposed rules implementing section 406 by October 28, 2002, and must adopt final rules implementing the section by January 26, 2003.)

- Section 407, which mandates that the SEC adopt rules that require public issuers to disclose in their periodic reports filed under the Exchange Act

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<sup>6</sup> Section 404 also requires the registered public accounting firm that prepares or issues the audit report for the issuer's annual report to attest to, and report on, the issuer's assessment of its internal control structures and procedures for financial reporting.

whether the audit committee of the issuer includes at least one “financial expert” and, if not, the reasons why the audit committee does not include such an expert. (The SEC must issue proposed rules implementing section 407 by October 28, 2002, and must adopt final rules implementing the section by January 26, 2003.)

In light of the foregoing, the Board has amended section 208.36(a) of Regulation H to reflect the fact that the Board will administer and enforce the above-described sections of the Sarbanes-Oxley Act with respect to registered banks. As noted above, Regulation H currently requires registered banks to comply generally with the rules, regulations and forms adopted by the SEC under sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act. The interim rule similarly requires registered banks to comply with any rules, regulations and forms that the SEC adopts under section 10A(m) of the Exchange Act (as added by section 301 of the Sarbanes-Oxley Act), or sections 302, 303, 304, 306(a), 401(b), 404, 406 and 407 of the Sarbanes-Oxley Act. Registered banks should monitor the SEC’s web site ([www.sec.gov](http://www.sec.gov)), the Federal Register, or other appropriate publications to remain informed about any rules or regulations issued by the SEC under these sections of the Sarbanes-Oxley Act.<sup>7</sup> If the rules or forms issued by

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<sup>7</sup> As noted above, the SEC already has adopted a final rule to implement the certification requirements of section 302 of the Act. See Exchange Act Release No. 34-46427 (Aug. 28, 2002).

the SEC under these sections require issuers to file documents with the SEC, registered banks must make such filings with the Board (rather than the SEC) in accordance with the provisions of section 208.36.

### **Effective Date of Rule**

Some of the provisions of the Sarbanes-Oxley Act to be administered and enforced by the Board became effective immediately upon enactment of the Act (July 30, 2002), or became effective on August 29, 2002.<sup>8</sup> In light of these statutory deadlines, the Board has adopted the modifications to section 208.36(a) of Regulation H on an interim basis without first reviewing public comments, and has made the rule effective immediately upon its publication in the Federal Register. Pursuant to 5 U.S.C. 553, the Board finds that it is impracticable to review public comments prior to the effective date of the interim rule, and that there is good cause, for the reasons discussed above, to make the interim rule effective on [INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]. The Board also finds, pursuant to 12 U.S.C. 4802(b)(1), that there is good cause to make the rule effective prior to the first day of the first calendar quarter that begins after publication of the rule.

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<sup>8</sup> See Sarbanes-Oxley Act, sections 302 and 304.

## **Request for Comments**

The Board requests comment on all aspects of the interim rule. The interim rule generally requires registered banks to comply with the rules, regulations and forms adopted by the SEC under the sections of the Exchange Act and the Sarbanes-Oxley Act listed in the rule. The Board notes that section 12(i) permits the Board to modify the requirements of these SEC rules, regulations and forms for registered banks if the Board (1) determines that the SEC's rules, regulations or forms are not necessary or appropriate in the public interest or for the protection of investors, and (2) publishes such findings (and the reasons supporting such findings) in the Federal Register.<sup>9</sup>

The Board intends to monitor the rules, regulations and forms adopted by the SEC to implement the provisions of the Sarbanes-Oxley Act that will be administered and enforced by the Board with respect to registered banks, and to consider whether any modifications to such rules, regulations or forms would be appropriate or necessary for registered banks. The Board requests comment on whether it would be appropriate at this time to modify any of the rules, regulations or forms adopted by the SEC to implement the provisions of the Sarbanes-Oxley Act referenced in section 12(i) of the Exchange Act. Commenters supporting any modifications to the SEC's rules, regulations or forms should discuss why

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<sup>9</sup> See 15 U.S.C. 78l(i)(4).

compliance with the SEC's rules would be impracticable or unduly burdensome for registered banks, and how the proposed modification would be consistent with the standards set forth in section 12(i) of the Exchange Act.

### **Other Sarbanes-Oxley Act Issues Relevant to Registered Banks**

Besides the provisions discussed above, the Sarbanes-Oxley Act also includes a variety of other provisions that will affect all issuers of public securities, including state member banks that report to the Board under the Exchange Act. For example, the Act includes important changes relating to the independence of outside auditors, the services that audit firms may provide to their audit clients, and the composition and duties of audit committees of public issuers.

In addition, the Sarbanes-Oxley Act made several amendments to sections 13 and 16 of the Exchange Act which relate to the financial disclosures of public issuers, lending by public issuers to their directors and executive officers, and the timeframe for officers, directors and principal shareholders of public issuers to report trades in the equity securities of the issuer.<sup>10</sup> Because these amendments were made to sections 13 and 16 of the Exchange Act, the Board is the agency responsible for administering and enforcing these provisions with respect to registered banks.<sup>11</sup> Moreover, because section 208.36 of Regulation H

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<sup>10</sup> See Sarbanes-Oxley Act, sections 401(a), 402, 403 and 409 (to be codified at 15 U.S.C. 78m(i), (j), (k) and (l), and 78p(a)).

<sup>11</sup> See 15 U.S.C. 78l(i).

already requires registered banks to comply with any rules, regulations and forms adopted by the SEC under sections 13 and 16 of the Exchange Act, registered banks must comply with any rules issued by the SEC to implement the amendments made by the Sarbanes-Oxley Act to sections 13 and 16 of the Exchange Act, unless these rules are modified by the Board.

Accordingly, registered banks are encouraged to review the Sarbanes-Oxley Act and to discuss the Act's requirements with their directors, outside auditors, audit committees and counsel as appropriate. Registered banks also are encouraged to monitor the SEC's web site ([www.sec.gov](http://www.sec.gov)) or other appropriate publications to keep abreast of actions taken by the SEC to implement the provisions of the Sarbanes-Oxley Act relating to public issuers and their officers, directors and auditors. The Board notes, for example, that the SEC has adopted a final rule implementing the amendments made by the Sarbanes-Oxley Act to the insider transaction reporting requirements of section 16 of the Exchange Act.<sup>12</sup> The Board also intends to monitor developments in this area and may issue supervisory guidance in the future to assist registered banks and other banking organizations supervised by the Federal Reserve in understanding and complying with the requirements of the Sarbanes-Oxley Act.

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<sup>12</sup> See Exchange Act Rel. No. 34-46421 (Aug. 27, 2002), which is available on the Internet at <http://www.sec.gov/rules/final.shtml>.

## **Plain Language**

Section 722 of the Gramm-Leach-Bliley Act (12 U.S.C. 4809) requires the Board to use “plain language” in all rules published in the Federal Register after January 1, 2000. The Board believes the interim rule is presented in a simple and straightforward manner, and invites comment on whether there are additional steps that the Board could take to make the interim rule easier to understand.

## **Regulatory Flexibility Act**

Pursuant to section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a)), the Board must publish an initial regulatory flexibility analysis with this interim rule. The rule implements for registered banks several of the new reporting and disclosure obligations imposed by the Sarbanes-Oxley Act on public issuers of securities. Consistent with section 12(i) of the Exchange Act, the interim rule requires registered banks to comply with any rules, regulations or forms that the SEC may issue under the relevant provisions of the Sarbanes-Oxley Act. By incorporating the SEC’s rules, regulations and forms by reference, the interim rule seeks to minimize the potential conflict between the interim rule and the corresponding SEC rules and, thus, reduce the potential burden associated with complying with the Board’s rule. The Board also has requested comment on whether any of the SEC’s rules incorporated by reference into the Board’s rules would impose undue burdens on registered banks.

The objectives and legal basis for the interim rule are discussed in the supplementary information set forth above. As of June 30, 2002, 19 state member banks had a class of securities registered under sections 12(b) or 12(g) of the Exchange Act and, thus, would be subject to the rule. As of the same date, only eight of these institutions have assets of less than \$100 million and are considered small entities for purposes of the Regulatory Flexibility Act. See 5 U.S.C. 601; 13 CFR 121.201.

### **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A), the Board has reviewed this interim rule under the authority delegated to the Board by the Office of Management and Budget. Consistent with the requirements of section 12(i) of the Exchange Act, the interim rule requires registered banks to abide by any collection of information requirements adopted by the SEC under sections 301, 302, 303, 304, 306(a), 401(b), 404, 406 and 407 of the Sarbanes-Oxley Act of 2002. As of June 30, 2002, there were 19 registered banks that will be subject to the interim rule. Registered banks may request confidential treatment of any information submitted to the Board under the interim rule in the manner described in section 208.36(d) of the Board's Regulation H (12 CFR 208.36(d)).

Because the SEC has not yet adopted many of the rules necessary to implement the sections of the Sarbanes-Oxley Act referenced above, the Board is unable at this time to estimate the annual burden registered banks will incur in complying with the interim rule. The Board notes that the SEC must consider the paperwork burden imposed by its rules in connection with its rulemaking process, and provide an estimate of the number of hours persons subject to the rule would spend each year in complying with any collections of information imposed by the SEC's rule. Registered banks and other persons interested in the potential paperwork burden imposed by the interim rule are encouraged to monitor the SEC's rulemaking process under the Sarbanes-Oxley Act.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless the Board has displayed a currently valid OMB control number. The OMB control number for the information collections required by the interim rule is 7100-0091. Comments on the collections of information required by the interim rule may be sent to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503, with copies of the comments sent to Mary M. West, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 41, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

## **List of Subjects in 12 CFR Part 208**

Accounting, Banks, banking, Reporting and recordkeeping requirements, Securities.

### **Authority and Issuance**

For the reasons set forth in the preamble, the Board of Governors of the Federal Reserve System amends part 208 of chapter II of title 12 of the Code of Federal Regulations as follows:

#### **PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for part 208 continues to read as follows:

**Authority:** 12 U.S.C. 24, 24a, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1843(*l*), 1882, 2901-2907, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. Section 208.36(a) is revised to read as follows:

**§ 208.36 Reporting requirements for State member banks subject to the Securities Exchange Act of 1934.**

(a) Filing, disclosure and other requirements--(1) General. Except as otherwise provided in this section, a member bank whose securities are subject to registration pursuant to section 12(b) or section 12(g) of the Securities Exchange Act of 1934 (the 1934 Act) (15 U.S.C. 78l(b) and (g)) shall comply with the rules, regulations and forms adopted by the Securities and Exchange Commission (Commission) pursuant to—

(i) Sections 10A(m), 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act (15 U.S.C. 78f(m), 78l, 78m, 78n(a), (c), (d) and (f), and 78p); and

(ii) Sections 302, 303, 304, 306, 401(b), 404, 406 and 407 of the Sarbanes-Oxley Act of 2002 (codified at 15 U.S.C. 7241, 7242, 7243, 7244, 7261, 7262, 7264 and 7265).

(2) References to the Commission. Any references to the “Securities and Exchange Commission” or the “Commission” in the rules, regulations and forms described in paragraph (a)(1) of this section shall with respect to securities issued by member banks be deemed to refer to the Board unless the context otherwise requires.

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By order of the Board of Governors of the Federal Reserve System,  
September 9, 2002.

          signed            
Jennifer J. Johnson  
Secretary of the Board