THE FEDERAL RESERVE BANK of ST. LOUIS

SUPERVISORY ISSUES

March 1994

Supervisory
News and Views
for the Eighth District

FDIC Rule Limits Activities of State Banks

On November 30, 1993, the Federal Deposit Insurance Corporation (FDIC) approved a final regulation limiting the activities of state chartered banks and their subsidiaries. Under the new regulation, a state bank must obtain the FDIC's prior consent before engaging *as principal*, directly or indirectly through a majority-owned subsidiary, in any activity that is not permissible for a national bank. All activities permitted by Regulation H for state member banks, however, are permissible under the FDIC's new regulation without further application. A bank may engage in an otherwise prohibited activity if it meets, and continues to meet, its minimum capital requirements and the FDIC determines that the activity does not present a significant risk to the deposit insurance fund.

Activities excluded from the regulation

The definition of "as principal" *excludes* agency, brokerage, custodial, advisory and administrative activities, and activities conducted as a trustee. Thus, a state bank may, without prior FDIC consent, operate insurance agencies, securities brokerage firms, real estate agencies, travel agencies, financial planning services and certain other agencies if authorized by state law.

Activities permissible for a national bank

Permissible activities are those expressly recognized as permissible by the Office of the Comptroller of the Currency (OCC) in regulations, official circulars, bulletins, orders or written interpretations. Any interpretation judged valid by the OCC will be considered evidence of permissible activity by a national bank. If a state bank wishes to conduct the

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Checklist Addresses Common FR Y-6 Errors

The Annual Report of Bank Holding Companies (Form FR Y-6) is due no later than March 31 for those whose fiscal year ends on December 31. To assist financial institutions in filing accurate and timely reports, a checklist addressing the most common errors made in preparing Form FR Y-6 reports is presented below. Before mailing your report, review the following items to make sure it is accurate and complete.

- Has each item and sub-item of the report been addressed, including a notation of "NA" for items that are not applicable?
- Have the correct number of copies been filed? Specifically, an original and three copies are needed for institutions with $500 million or more in total assets; an original and two copies for all others.
- Are copies being sent in time for the Reserve Bank to receive them on or before March 31, or no later than 90 days following the organization's fiscal year-end?

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FDIC Rule

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activity without first obtaining the FDIC's consent, it must conduct the activity in the same manner and subject to the same conditions or restrictions applicable to a national bank. In the future, once the FDIC has determined that a particular activity, as authorized by a state, is permissible for a national bank, the activity will generally apply to state banks.

Other authorized activities

Other activities that do not present a significant risk to the insurance fund are permissible if allowed by state law. These include activities determined by the Federal Reserve Board to be "closely related to banking." The FDIC regulation specifically prohibits insurance underwriting that is not permissible for a national bank. A well capitalized state bank that was lawfully providing insurance *as principal* on November 21, 1991, however, may continue to provide the same type of insurance to people residing or employed in the state.

Applications for new or continuing activities

Banks seeking FDIC consent to continue or begin an otherwise prohibited activity must file an application promptly with the appropriate regional office. An institution which has filed an application for consent to continue an ongoing activity may continue to engage in the activity for up to six months from the receipt of the application by the FDIC while the application is pending.

Y-6 Checklist

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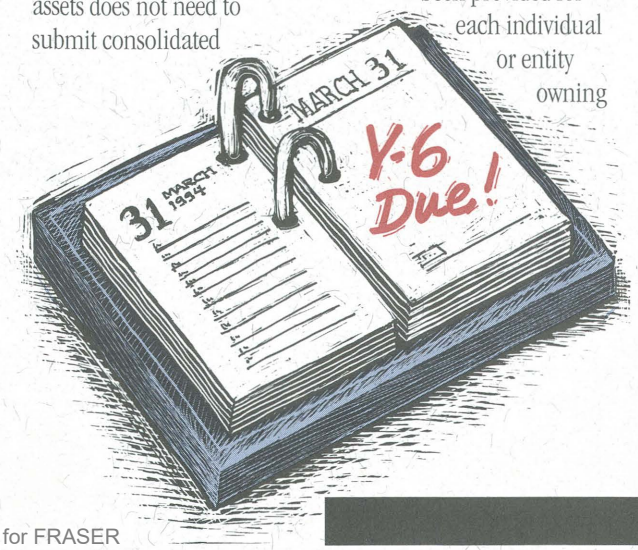
- Is the report signed by either a holding company officer who is also a director or by the chairperson of the board?
- Have the most recent two-year comparative consolidated and parent-company-only financial statements, including a balance sheet, income statement, statement of changes in stockholders' equity, and a cash flow statement, been submitted?
- Has an independent public accountant audited the financial statements if consolidated assets are $150 million or more? A company with only one subsidiary bank and less than $150 million in total consolidated assets does not need to submit consolidated statements unless the statements are prepared in the usual course of business.
- Have two-year comparative financial statements, including balance sheets, income statements and statements of changes in stockholders' equity, been submitted for all nonbank subsidiaries?
- Has an organization chart showing the percentage of direct and indirect ownership or control of all subsidiaries been included?
- Are certified copies of amendments to organizational documents, charters, and bylaws, etc., included with the report if they were not previously submitted?
- Has all required information been provided for each individual or entity owning or controlling 5 percent or more of any class of the company's stock at year-end *and* for those with 5 percent or more at some point during the year?
- Has all required information for every officer, director, principal shareholder, trustee, partner or any person exercising a similar function, regardless of title, been submitted? Responses to this question most commonly omit the number and percentage of shares owned or controlled in any other business when the ownership or control represents at least a 25 percent interest.
- Has all required information been provided for the trustee(s) if a trust owns 5 percent or more of the outstanding shares, or is a principal shareholder?
- Has all required information been disclosed regarding loans, which equal more than 10 percent of consolidated capital accounts, that have been made by the *holding company or nonbank subsidiary* (not the bank) to insiders and their interests?
- Has the confirmation statement been signed, indicating that all required FR Y-6A forms have been filed?

For questions regarding the Annual Report of Bank Holding Companies (FR Y-6), call Rita J. Rauba at (314) 444-8850.



Guidelines to Ensure Timeliness

Reports will be considered timely provided the following guidelines are met:

- *U. S. Mail, Express Mail or Priority Mail.* Allow at least three calendar days for the reports to reach the Federal Reserve Bank.
- *Overnight Delivery Service.* Place reports with the overnight service no later than the day before they are due.
- *Electronic Filing.* Transmit by 5 p.m. on the due date.

Examiners Answer Questions on Common Violations

Examiners generally note the same Regulation B violations from one examination to the next. The following questions and answers were developed to address the most common violations and assist bankers with future compliance.

When is a written application required?

A creditor is required to take a written application for a loan to purchase or refinance a dwelling which is or will be the applicant's principal residence if the extension of credit will be secured by the dwelling. Under Regulation B, creditors do not have to take written applications for loans to finance homes that are not principal residences, such as vacation homes or rental properties. Such loans might, however, be covered by the Home Mortgage Disclosure Act (HMDA) provisions in Regulation C. §202.5(e), §202.13(a)

Must a creditor require a written application on a request to refinance a loan on the applicant's principal dwelling for which the creditor already has a mortgage or deed of trust?

Yes. Where the dwelling will secure the loan, a creditor must require a written application for a loan to refinance a principal residence. The creditor who receives an application to change the terms and conditions of an existing extension of credit may request the required monitoring information, but does not have to if this information was obtained in the earlier transaction. §202.5(e), §202.13(a)

When must a creditor notify a loan applicant of its credit decision?

A creditor is required to notify an applicant of action taken on a credit application within:

- 30 days after receiving a completed application concerning the approval of, counteroffer to or adverse action on the application;
- 30 days after receiving an incomplete application by providing a notice of incompleteness or advising the applicant of its approval of, counteroffer to or adverse action (for reasons other than incompleteness);
- 30 days after taking adverse action on an incomplete application for the reason of incompleteness;
- 30 days after taking adverse action on an existing account; or
- 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered. §202.9(a)(1)

How should an applicant be notified of the credit decision?

If adverse action is taken, a written notice must be provided to help the applicant understand why the application was denied and what the applicant's rights are if the applicant believes the denial was based on a prohibited basis.

A favorable credit decision does not have to be communicated in writing, but may be communicated, for example, in a telephone conversation or by issuing a requested credit card or loan proceeds. §202.9(a)(2)

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When making a counteroffer, what notification is a creditor required to provide an applicant?

The creditor must notify the applicant of a counteroffer within 30 days after receiving the completed application. If the applicant does not use or expressly accept the counteroffer within 90 days, the creditor then must send an adverse action notification.

To avoid sending two notices, the creditor may elect to send within 30 days a combined counteroffer and notification of adverse action. §202.9(a)(1)

Are business loans subject to the notification requirements?

Yes. Creditors may use the notification rules for consumer credit or follow the rules established in the regulation for business credit. §202.9(a)(3)

How can a creditor satisfy the written application rule?

A written application must contain both the credit information normally required to make a credit decision and monitoring information. The applicant must be informed that disclosure of monitoring information is optional, and that the federal government requests the information to monitor compliance with federal discrimination laws. §202.5(e), §202.13

May a creditor accept a telephone application for credit when a written application is required?

Yes. A creditor may complete the application on behalf of an applicant without requiring the applicant to sign the application. Therefore, telephone applications in which the application information is written by the creditor qualify as written applications. If an applicant does not apply in person, a creditor does not have to request the monitoring information or complete that portion of the application. If it is not evident on the application that it was received by telephone, the creditor should indicate how it was received. §202.5(e), §202.13(b)

A question and answer booklet, covering all aspects of Regulation B, is currently being developed by this Reserve Bank. Notification of its completion and information for ordering copies will be published in an upcoming issue of *Supervisory Issues*.

Fair Lending Affects Expansion Proposal

The importance of fair lending compliance was evident in the Board of Governors' denial of a regional bank holding company's acquisition proposal.

On the application by Shawmut National Corporation, the Board, for the first time, denied an expansionary proposal solely on fair lending grounds. The Board noted that Shawmut, through its mortgage company subsidiary, may have engaged in discriminatory treatment in violation of the Equal Credit Opportunity Act (ECOA). The Board also noted that data reported by Shawmut's mortgage company, as required by the Home Mortgage Disclosure Act (HMDA), contained numerous inaccuracies.

In denying the application, the Board recognized that Shawmut had recently taken positive steps to improve its lending record, to address concerns related to past lending practices and to report accurate HMDA data. These steps, however, were considered too new to allow an adequate evaluation of the overall effectiveness of Shawmut's actions.

Agencies Consider Effect of FASB 115 on Capital Rules

The Federal Reserve and other federal banking agencies have announced that banking organizations should continue to calculate regulatory capital in accordance with current guidelines.

Last August, the agencies adopted FASB No. 115 effective with the March 31, 1994, reporting period. FASB No. 115 prescribes accounting standards for certain debt and equity securities and establishes a new equity account reflecting unrealized gains and losses on "available-for-sale" securities.

The agencies have not yet determined, however, whether this new equity account will be included in regulatory capital. On December 20, 1993, the agencies requested comment on a proposal to include this new account in calculating regulatory capital. Until these comments are evaluated and a final amendment is issued, banking organizations should continue to calculate regulatory capital according to current guidelines.

BANK PERFORMANCE

Use of Derivative Products Limited in Eighth District

Federal banking supervisors are increasing their surveillance of the industry's use of financial derivative products. A few large banks that serve as intermediaries account for the vast majority of derivatives volume. A growing number of banks, however, use derivatives as a risk management tool; for example, a properly executed interest rate swap can reduce the risk to earnings from a mismatched interest rate gap.

Banks are required to disclose the values (notional or par) of interest rate swaps, futures and forwards contracts, options contracts, and similar contracts involving commodities and equities on Schedule RC-L of the call report. Condition reports for the September 1993 period reflect limited use of derivatives by Eighth District banks. Of banks with assets less than $1 billion, fewer than ten report any derivative instruments. The majority of these products are held by larger institutions, with six banks accounting for over 90 percent of the total.

Volume of Derivative Products
Expressed in Billions (9/30/93)

Type	U.S. Banks	District Banks
Interest Rate Contracts	$7,005.0	$8.2
Foreign Exchange Contracts	$4,790.6	$1.4

Although derivatives activity among District banks appears to be nominal, quarterly call reports indicate that participation in the derivative markets increased during 1993. As shown on the chart above, both nationally and within the District, interest rate contracts comprise the largest segment of derivative contracts.

Banks considering the use of derivative instruments must have the ability to assess accurately the many risks associated with these instruments and have in place sound risk management systems. Federal banking regulators will be reviewing the models and procedures banks use to measure the risks of derivatives. In December 1993, the Federal Reserve and the Office of the Comptroller of the Currency issued written guidance on internal controls for banks using derivative instruments. Future supervisory attention will focus on disclosure, investor protection and risk management.

New Criminal Referral Forms Delayed

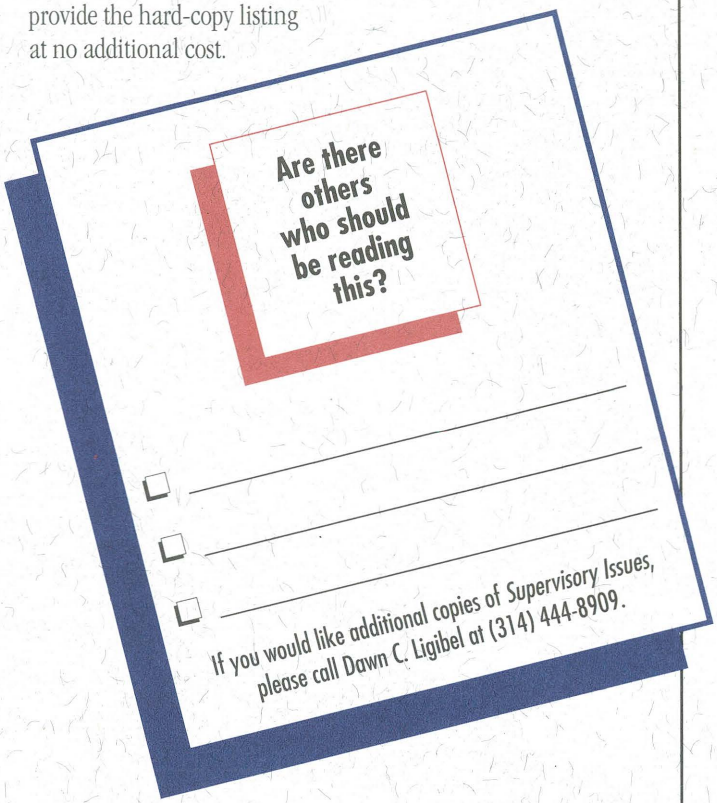
Pending development of computer software, the new uniform criminal referral form, as designed by the five federal banking agencies, will not be distributed for at least two more months. Therefore, institutions should continue to report suspected criminal offenses on the existing criminal referral form. This will satisfy compliance with the banking agencies' regulations until the new forms are distributed.

The computer software being developed will facilitate preparation of the form. Distribution of the new form without the software, however, would create a potential burden to many financial institutions.

Census Data is Available

Lending institutions may purchase on magnetic tape for $250 the census data that the FFIEC will use to prepare 1994 Home Mortgage Disclosure Act (HMDA) reports. Although institutions do not need the file to prepare their HMDA-LAR for submission, they may choose to obtain the data to conduct statistical analyses examining the demographics of the census tracts in which they make loans. A HMDA data order form can be obtained by calling the Federal Reserve Board's automated answering system at (202) 452-2016.

Currently, the tape does not contain HUD income estimates used to group loans and applications based on the income of borrowers and applicants relative to median family income for their metropolitan statistical area (MSA). The HUD data are expected by the second quarter and will be added to the tape at that time. Purchasers may wait to order until the tape is complete or may request on the order form that a hard copy of the listing be mailed to them when available. The FFIEC will provide the hard-copy listing at no additional cost.



CTR Filing Deadlines

The Department of the Treasury reminds banks that the 25-day allowance for filing Currency Transaction Reports (CTRs) applies only to CTRs that are filed magnetically.

If, for any reason, a bank withdraws from the magnetic tape program or files a paper CTR, it must do so within 15 days following the reportable transaction.

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