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DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 545, 559, 560, 563, 567, 571

[No. 96-119]

RIN 1550-AA88

Subsidiaries and Equity Investments

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS or agency) is today issuing a final rule updating and substantially streamlining its regulations and policy statements concerning subsidiaries and other subordinate organizations in which savings associations have ownership interests (including operating subsidiaries and service corporations) and equity investments (including pass-through investments). These amendments are being made pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review (Reinvention Initiative) and section 303 of the Community Development and Regulatory Improvement Act of 1994 (CDRIA), which requires OTS and other federal banking agencies to review, streamline, and modify regulations and policies to improve efficiency, reduce unnecessary costs, and remove inconsistent, outmoded and duplicative requirements.

EFFECTIVE DATE: January 1, 1997.

FOR FURTHER INFORMATION CONTACT: Deborah Merkle, Project Manager, Supervision Policy, (202) 906-5688; Donna Deale, Manager,

Supervision Policy, (202) 906-7488; Susan Miles, Senior Attorney, Regulations and Legislation Division, (202) 906-6798; Dean Shahinian, Senior Counsel for Corporate Activities, Business Transactions Division, (202) 906-7289; or Deborah Dakin, Deputy Chief Counsel, (202) 906-6445, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

TABLE OF CONTENTS

I. Background

Pursuant to section 303 of the CDRIA[1] and the Administration's Reinvention Initiative, OTS began a comprehensive review of its regulations in the spring of 1995. Early in that process, OTS identified its regulations governing operating subsidiaries, service corporations and other equity investments as one of the most important areas for updating and streamlining. Each regulation in this area was reviewed to determine whether it was current and understandable; imposed the least possible burden consistent with safety and soundness and statutory requirements; addressed subject matter more suited for handbook guidance; and was written in a clear, straightforward manner. OTS also sought industry input regarding staff's initial recommendations through an industry focus group consisting of thrift representatives, an industry trade association, and OTS staff. The consensus that emerged from this process was that regulatory burden could be reduced primarily by enhancing flexibility and clarifying investment options available to savings associations, including operating subsidiaries, service corporations, and pass-through investments.

As a result of this review, OTS identified a number of ways in which its regulations could be revised to reduce regulatory burden. On June 13, 1996, OTS issued a notice of proposed rulemaking.[2] The proposal reorganized some regulations into a chart to facilitate comparisons of the different types of subordinate organizations; replaced several application procedures with more

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1 12 U.S.C. 4803(a)(1).

2 61 FR 29976 (June 13, 1996).

streamlined notice requirements; standardized the requirements applicable to pass-through investments; revised the list of activities preapproved for thrift service corporations; removed regulations dealing with finance subsidiaries (which have largely been replaced by operating subsidiaries); and restated the regulations in plain language.

Today's final rule is substantially similar to the June proposal, but incorporates several changes and clarifications in response to comments received.

II. Summary of Comments and Description of the Final Rule

A. General Discussion of the Comments

The public comment period on the proposal closed on August 12, 1996. Ten commenters, including six federal savings associations, three trade associations, and one mortgage guaranty insurance corporation, submitted comments.

Eight of the ten commenters supported OTS efforts to clarify, consolidate, and reorganize these regulations. They agreed that the proposed regulatory changes will make it easier to make investments in subordinate organizations. Several commenters specifically supported the plain language drafting and accompanying chart, stating that these changes will be useful and will reduce the burden of compliance with the regulations. Most commenters who supported the proposal also made suggestions for clarifications and modifications, which are discussed in the section-by-section analysis. Two commenters, representing current or potential competitors of savings associations or their service corporations, urged OTS not to adopt, or to proceed more slowly with, changes that would expand the list of preapproved activities for service corporations of federal savings associations.

B. Section-by-Section Analysis

New Part 559-Subordinate Organizations

OTS proposed to adopt a new Part 559, Subsidiaries, that would include all of the agency's regulations affecting thrift subsidiaries. Commenters generally agreed with OTS's view that this reorganization will make it much easier for savings associations to find and use these regulations. OTS has retitled this part as "Subordinate Organizations" in order to avoid potential confusion arising from the use of the term "subsidiary" both as a generic term for a business organization in which a savings association has an ownership interest and as a more specific term used to describe a narrower category of companies in which the savings association's ownership interest is significant enough to give it direct or indirect control. A federal savings association's ownership interest in a service corporation may not be large enough to make that service corporation a "subsidiary" of the thrift, but the service corporation is still subject to federal regulation under this part because the savings association is an owner of the service corporation.

Section 559.1 What does this part cover?

This section explains the scope of new Part 559 and sets forth OTS's basic statutory authority over subordinate organizations. No commenters addressed this section, which is adopted as proposed, with minor technical corrections.

Section 559.2 Definitions (new)

As OTS reviewed the comments received on the proposal, it became clear that adding a definitional section to Part 559 would help users to identify more readily what types of entities are affected by the various regulatory provisions. New § 559.2 gathers in one location definitions of key terms describing different types of entities in which savings associations may invest. These definitions are derived in large part from existing regulatory definitions. The term "subordinate organization" encompasses all business organizations in which a savings association has a direct or indirect ownership interest except where that ownership interest has been acquired through the use of the savings association's pass-through investment authority (discussed below). "Subsidiary" is defined using language taken from the Federal Deposit Insurance Corporation's regulations governing notices filed for savings association subsidiaries, 12 CFR 303.13(a)(1996). This definition turns primarily on whether an association has control of the entity in which it invests. For these purposes, OTS will use its standard definition of "control," which appears in its change-of-control regulations, 12 CFR Part 574. "Operating subsidiary" is defined as any entity that satisfies the operating subsidiary requirements of new § 559.3 and is designated as an operating subsidiary by the investing association. There are three basic characteristics of an operating subsidiary: (a) a majority of its voting shares must be owned by the investing association; (b) it must be controlled by the association; and (c) it may engage only in activities that are permissible for the association. "Service corporation" is defined as any entity that satisfies the service corporation requirements of new § 559.3 and the authorizing statute, 12 U.S.C. 1464(c)(4)(B), and is designated as a service corporation by the investing association. Service corporations may engage in activities reasonably related to the operation of a financial institution. However, the amount of funds a federal savings association may invest in service corporations is limited (as discussed below). "Lower-tier entity," a new term, includes all business organizations in which an operating subsidiary, service corporation, or other subordinate organization has an ownership interest. It includes entities often commonly referred to as "second-tier service corporations" or "service corporation subsidiaries." "GAAP-consolidated subsidiary" is a newly defined term that describes all operating subsidiaries and any service corporations or lower-tier entities that are consolidated with a savings association for purposes of filing reports in accordance with Generally Accepted Accounting Principles (GAAP).

Section 559.3 What are the characteristics of, and what requirements apply to, subordinate organizations of federal savings associations?

Section 559.3 (proposed as § 559.2) authorizes federal savings associations to establish or acquire operating subsidiaries and service corporations. Most of this section takes the form of a chart that lists and compares the different characteristics of, and requirements that apply to, operating subsidiaries and service corporations (including lower-tier entities in which these companies invest). The chart is derived in large part from the current regulations at 12 CFR 545.74 (service corporations) and 545.81 (operating subsidiaries). Where appropriate, and for ease of reference, it cross-references other applicable OTS regulations that have been the subject of frequent questions to the agency. The chart reiterates that, in addition to preapproved service corporation activities, a federal thrift may continue to apply to OTS for case-by-case approval for a service corporation to engage in any activity that is reasonably related to the operation of a financial institution.

Commenters thought the chart would be a comprehensive and concise reference source that would make it easier to compare these two structures and determine which best fits the association's needs.

Commenters addressed several substantive areas covered by the chart:

ATTACHMENT IS AVAILABLE UPON REQUEST

WRITE US AT:

DISSEMINATION BRANCH
OFFICE OF THRIFT SUPERVISION
1700 G STREET, NW
WASHINGTON, DC 20552

FAX US AT:

202/906-7755

E-MAIL US AT:

PUBLIC.INFO@OTS.TREAS.GOV