

BANKING LEGISLATION

Federal Reserve Bank
of Philadelphia

& Policy

January-March 2000

Volume 19, Number 1

Recent Developments

Abusive Lending Practices Come Under Attack

Responding to the concerns of consumer advocates and community groups, federal regulators and legislators have stepped up their efforts to rein in abusive lending practices. Two practices in particular—payday lending and high-cost mortgages—have come under increased scrutiny. Payday loans are short-term advances secured by a pre-dated check or bank account debit authorization. Although the loans are usually for small amounts—amounts tend to average under \$1000—they may carry annualized interest rates of nearly 1000 percent, making the loans more expensive than risk would dictate. Firms that specialize in these products usually target unsophisticated borrowers like the elderly or working poor. Although most lenders are not depository institutions, banks help fund the practice by making loans to these lenders or purchasing the high-cost mortgage loans in the secondary market.

Several federal banking regulators have taken steps to deal with this problem in recent months. In February of this year, the head of the FDIC spoke out against predatory and abusive lending. The FDIC chairman outlined new steps to reduce banks' involvement by giving heavier scrutiny to bank loan purchases. Purchases of loan pools from low- and moderate-income areas, including loans with predatory terms, would not receive a positive Community Reinvestment Act rating.

Comptroller of the Currency John

CONTENTS

Recent Developments

Abusive Lending Practices Come Under Attack 1

Summary of Federal Legislation

New Legislation

Consumer Credit Fair Dispute Resolution Act of 2000 2

Federal Payday Consumer Protection Amendments of 2000 2

Deposit Insurance Funds Merger Act of 2000 2

State Bank Examination Fee Repeal Act 2

Anti-Predatory Lending Act of 2000 2

Fairness in Credit Card Applications Act of 2000 3

Business Checking Modernization Act 3

Pending Legislation

Bankruptcy Reform Act of 2000 3

Summary of Federal Regulations 3

Summary of Third District Developments 8

Hawke announced several measures to discourage abusive lending practices. First, the OCC is encouraging individuals to report national banks or their affiliates that engage in predatory lending practices. Second, the OCC is preparing to train some of its examiners to look for signs of such practices, such as pricing differences and marketing efforts that steer low-income consumers to high-cost products. Suspected violations would be reported to the Department of Justice. In addition, Comptroller Hawke announced that the OCC is exploring the feasibility of allowing banks to share the risks of lending to low-income areas by forming

joint ventures.

In March, Federal Reserve Board Chairman Alan Greenspan announced the convening of an interagency group to define the range of improper practices that could be considered abusive and to develop methods to combat the practices. One major goal of the group would be to issue an interagency statement that would clarify the distinction between predatory and subprime lending. This would be an important step because at present there are no set operating guidelines that differentiate between the two, making efforts to pass legislation or craft regulations against predatory lending

difficult. In addition to the four federal banking regulators, the interagency group consists of representatives from the Department of Justice, National Credit Union Administration, Department of Housing and Urban Development,

Federal Trade Commission, and the Office of Federal Housing Enterprise and Oversight.

Legislators have begun to take steps to address abusive lending practices. Two bills were introduced this quarter, H.R.

3823 and H.R. 3901. The first bill addresses payday lending and the latter high-cost mortgages. For a detailed summary of these bills, see **Summary of Federal Legislation**, below.

SUMMARY OF FEDERAL LEGISLATION

For more information on legislation, go to [Thomas-US Congress on the Internet](#).

New Legislation

1. Consumer Credit Fair Dispute Resolution Act of 2000 (S. 2117). Introduced by Senator Feingold (D-WI) on February 29, 2000.

Status: Referred to the Committee on the Judiciary.

This bill would prohibit lenders from mandating binding arbitration to settle disputes in consumer credit transactions. Although arbitration provisions in the credit contract would be made unenforceable, the parties involved in a dispute could agree to binding arbitration after a dispute arises.

2. Federal Payday Consumer Protection Amendments of 2000 (H.R. 3823). Introduced by Representative LaFalce (D-NY) on March 2, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would amend the Federal Deposit Insurance Act to prohibit insured depository institutions from engaging in payday loan activities. Payday loans are short-term cash advances secured by the borrower's personal check or electronic withdrawal authorization for payment at some future date. Depository institutions would be prohibited from directly making payday loans or making loans to any other entity for the purpose of financing payday loans. The bill would also amend the

Truth in Lending Act (TILA) to prohibit a payday lender from accepting as collateral checks drawn upon an insured depository institution or credit union in addition to increasing a payday lender's civil liability for violations of the TILA.

3. Deposit Insurance Funds Merger Act of 2000 (H.R. 3899). Introduced by Representative Roukema (R-NJ) on March 9, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would amend the Deposit Insurance Funds Act of 1996 by merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF).

Currently, banks and savings associations pay their insurance assessments into separate funds, and the funds provide coverage for depositors depending on the type of institution. The bill would eliminate the barrier between the funds so that all assessments would be paid into the merged fund, which would cover all deposits.

4. State Bank Examination Fee Repeal Act (H.R. 3900). Introduced by Representative Roukema (R-NJ) on March 9, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would amend the Federal Deposit

Insurance Act and the Federal Reserve Act by repealing the two regulators' ability to impose fees upon state-chartered depository institutions for the cost of examining the institution. In practice, regulators seldom impose the fees.

5. Anti-Predatory Lending Act of 2000 (H.R. 3901). Introduced by Representative Schkowsky (D-IL) on March 9, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would amend several consumer protection statutes to help protect consumers from predatory mortgage lending practices. The bill would add provisions to the Home Ownership and Equity Protection Act of 1994 to cover high-cost mortgages. A high-cost mortgage would be defined as a consumer credit transaction secured by the consumer's principal dwelling if either: 1) the APR at origination exceeds the annualized weekly average yield on United States Treasury securities by at least 5 percentage points; 2) the rate is variable, but it can reasonably be expected to exceed this threshold; 3) increases in the rate are controlled by the creditor and are not directly tied to changes in an independent publicly available rate; or 4) the points and fees on the loan cannot be financed. The following practices would be prohibited for high-cost mortgages: 1) call provisions in the terms of the mortgage unrelated to a customer default or sale of

property; 2) fees for deferring payments or for contract modifications; 3) making loans to borrowers who have not completed a certified home ownership counseling course; and 4) mandatory arbitration clauses in the terms of the loan.

Truth in Lending. The bill would also prohibit the following practices for most mortgage loans that conform to the size limits established by Fannie Mae: 1) prepayment penalties; 2) negative amortization terms in the mortgage contract; 3) lending without regard to the realistic ability of the borrower to repay the loan; 4) making a new loan to refinance an existing contract when the new loan has no real tangible benefit to the borrower; 5) encouraging a borrower to default; 6) payments to appraisers; 7) the financing of credit insurance policies by the mortgage lender; 8) blank items in the contract to be filled in after signing; and 9) the securitizing of loans that are not in compliance with the terms of this bill.

Lenders would be required to report the annual percentage rate charged on mortgages and home improvement loans in their Home Mortgage Disclosure Act (HMDA) data. Finally, the bill would prohibit exemptions from HMDA reporting. At present, depository

institutions under \$30 million in assets have the option of not submitting certain HMDA-required disclosures.

6. Fairness in Credit Card Applications Act of 2000 (H.R. 3914). Introduced by Representative Menendez (D-NJ) on March 14, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would amend the Truth in Lending Act by imposing certain disclosure requirements on credit card issuers. First, card issuers would need to get a potential customer's prior agreement to any credit limit. In addition, card issuers would have to disclose to a customer if he or she might be issued a different brand or type of card than that specified in the application, for example, if a gold card might be issued when the customer applied for a platinum card. Customers would have to give prior consent if a different card brand might be substituted. Finally, the solicitation must disclose the terms of any alternative card that the consumer could be issued. These disclosures would apply to telephone solicitations as well as written applications.

7. Business Checking Modernization Act (H.R. 4067). Introduced by Representative Metcalf (R-WA) on March 23, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would legalize the payment of interest on demand deposits by repealing the sections of the Federal Reserve Act, Home Owners Loan Act, and Federal Deposit Insurance Act that currently prohibit the practice. The repeal would take effect three years after the enactment of this bill.

Pending Legislation

1. Bankruptcy Reform Act of 2000 (H.R. 833). Introduced by Representative Gekas (R-PA) on February 24, 1999. Related Bills: S. 625.

Status: Passed in the House of Representatives on May 6, 1999. Senate substituted language of S. 625 into H.R. 833 and passed it on February 2, 2000. Currently in conference. (See *Banking Legislation and Policy*, First Quarter 1999, for a summary of H.R. 833 as introduced.)

SUMMARY OF FEDERAL REGULATIONS

For more information on regulations, go to [Federal Regulations Online](#).

Board of Governors of the Federal Reserve System

Financial Holding Companies (1/25/2000)
Issued an interim rule, along with a request for comment, codifying provisions of the Gramm-Leach-Bliley Act. The interim rule addresses the guidelines that a bank holding company (BHC) or a foreign bank must follow in order to become a financial holding company (FHC) and, as such, be allowed to engage in securities and insurance activities.

Each depository institution of a BHC must be well capitalized, well managed, and have received at least a satisfactory rating on its most recent Community Reinvestment Act examination in order for the BHC to become an FHC. Qualifying BHCs would need to file a written declaration to the Board stating the BHC's intention to become an FHC. After 31 days the BHC would be designated an FHC, unless otherwise notified by the Board.

An FHC whose depository institutions are not both well capitalized and well

managed would receive written notice from the Board and would be given 180 days to bring its depository institutions back into compliance. However, if the institutions remain in noncompliance, the Board may order the FHC to divest its subsidiary depository institutions. Alternatively, the FHC could cease activities impermissible for BHCs. FHCs that have subsidiary depository institutions with a CRA rating below Satisfactory would be prohibited from commencing new financial activities or

purchasing firms that engage in such activities until all the FHC's depository institutions received a rating of at least Satisfactory. Comments were due March 27, 2000. For more information, see 65 *Federal Register*, pp. 3785-94. (Regulation Y).

Tying Restrictions (2/11/2000)

Gave advanced notice of proposed rulemaking that would allow banks to offer their customers private-label credit cards. Any product or service able to be purchased using the private-label card must be available for purchase using a different payment medium—such as cash or a third-party credit card—at the same price charged to the private-label card holder. The issuing bank would also be prohibited from offering credit terms through the private-label credit card not available to its general issue customers.

Current Board regulations generally prohibit a bank from tying the availability or price of a product or service to the purchase by a customer of another product or service offered by the bank or any of its affiliates. Comments were due March 13, 2000. For further information, see 65 *Federal Register*, pp. 6924-5. (Regulation Y).

Nonbanking Activities (3/17/2000)

In consultation with the Department of the Treasury, issued an interim rule that: 1) lists the activities in which a financial holding company (FHC) may engage; 2) sets forth the procedures for engaging in the listed activities; and 3) establishes procedures for requesting that an activity be determined financial in nature or complementary to a financial activity.

The interim rule provides a detailed listing of activities that FHCs are permitted to engage in. Examples of these activities include management consulting, securities underwriting, property leasing, mutual fund underwriting, insurance activities, and merchant banking. FHCs wishing to engage in these activities would need to notify the Board within 30 days of commencement of the activity. The written notice, sent to the appropriate

Reserve Bank, would need to describe the activity and subsidiary engaged in the activity or the company acquired.

Any interested person may request that an activity be designated financial in nature. The request must describe the activity in detail. Within 60 days the Board, in consultation with the Treasury, would be required to make a decision on the request.

The interim rule requires that an FHC wishing to engage in an activity considered complementary to a financial activity receive permission from the Board before engaging in the activity. The application notice must detail the scope and relative size of the activity and identify the financial activity to which the proposed activity is complementary. The notice must also address safety and soundness concerns, including measures to be taken to minimize risks. This interim rule became effective March 17, 2000. Comments must be received by May 12, 2000. For further information, see 65 *Federal Register*, pp. 14433-40. (Regulation Y)

Transactions Between Affiliates (3/17/2000)

Issued an interim rule imposing two requirements for an FHC's transactions with its financial subsidiary that is engaged in securities underwriting, dealing, or market-making activities. The first requirement is that any intra-day extension of credit by a subsidiary bank, thrift, or U.S. branch or agency of a foreign bank to its affiliated securities firm be done on prevailing market terms consistent with section 23B of the Federal Reserve Act. The interim rule also requires a subsidiary depository institution to adhere to sections 23A and 23B of the Federal Reserve Act when it extends credit to or purchases securities from an affiliate acting as lead underwriter. Sections 23A and 23B of the Federal Reserve Act limit credit and other transactions between a bank and its affiliate and so help to limit the risk that losses at the nonbank affiliate will be transferred to the depository institution. This rule became effective March 11, 2000. Comments must be

received by May 12, 2000. For further information, see 65 *Federal Register*, pp. 14440-2. (Regulation Y).

Operating Subsidiaries (3/20/2000)

Issued an interim rule, with request for comment, that codifies the affiliation provisions of the Gramm-Leach-Bliley Act for state-chartered institutions. State member banks would be eligible to invest in or control a financial subsidiary if: 1) the bank and each of its depository institution affiliates are well capitalized and well managed; 2) the total assets of the bank's financial subsidiaries do not exceed the lesser of 45 percent of the bank's total assets or \$50 billion; and 3) a state member bank that is one of the largest 50 insured banks must have at least one issue of outstanding debt rated in one of the three highest investment grades by a nationally known rating agency. If the bank falls within the 51 to 100 range, it may meet this debt rating criterion to an alternate guideline (see *Financial Subsidiaries*, below). If eligible, the bank must gain the approval of both the Federal Reserve and its appropriate state supervisory authority.

To gain approval from the Federal Reserve, the bank must file a notice with the appropriate Reserve Bank detailing the existing and proposed activities of the financial subsidiary and in the case of a subsidiary involved in insurance activities, the states where the subsidiary holds an insurance license. Unless notified by the Reserve Bank, such notices are automatically deemed approved after 15 days.

State member banks with financial subsidiaries would need to deduct from the bank's total assets and tangible equity the total outstanding equity investment in all financial subsidiaries, when calculating their capital ratios. The bank would also be required to establish policies and procedures to manage the financial and operational risks resulting from the financial subsidiary. A bank or any of its affiliates that fail to remain well capitalized and well managed or that exceed the asset

cap would need to execute an agreement with the Board and the appropriate functional regulator detailing a plan to return to compliance. Noncompliance that exceeds 180 days may result in forced divestiture of the financial subsidiaries. A bank that does not meet its debt-rating requirement would be barred from acquiring any additional capital of a financial subsidiary until the debt rating is made compliant.

A state member bank would be barred from further acquisitions of financial subsidiaries if the bank or any of its insured depository institution affiliates received a less than Satisfactory rating as of its most recent CRA examination. This prohibition would also prevent a financial subsidiary from acquiring control of another company by acquiring the assets of the company. This interim rule became effective March 11, 2000. Comments must be received by May 12, 2000. For further information, see 65 *Federal Register*, pp. 14810-6. (Regulation H).

The FDIC issued a similar rule for state nonmember banks on March 23, 2000. The FDIC's interim rule became effective March 11, 2000. Comments on it must be received by May 22, 2000. For further information, see 65 *Federal Register*, pp. 15526-31. The OCC also issued a parallel rule applicable to national banks on March 10, 2000. The OCC's rule became effective March 11, 2000. For further information, see 65 *Federal Register*, pp. 12905-16.

Financial Subsidiaries (3/20/2000)

Together with the Department of the Treasury, issued a joint interim rule setting alternative ratings requirements for certain banks that wish to own a financial subsidiary. The Gramm-Leach-Bliley Act requires that banks falling in the top 100 by asset size have outstanding debt rated in one of the three highest investment grades by a nationally recognized rating agency. Banks ranked between 51 and 100 on this list could meet this requirement by complying with an alternative criterion set forth by the Board and Treasury. This interim rule states that a bank may meet

the alternative guideline by having a current long-term issuer credit rating in the top three investment grade categories from a nationally recognized rating agency, for example, Moody's or Standard and Poor's.

A long-term issuer rating is one that assesses the bank's overall capacity and willingness to pay its unsecured financial obligations on a timely basis. This interim rule became effective March 14, 2000. Comments must be received by May 15, 2000. For further information, see 65 *Federal Register*, pp. 15049-52. (Regulation H).

Foreign FHCs (3/21/2000)

Issued an interim rule making changes to the current process for foreign banks' applying for designation as a financial holding company (FHC). To make the application procedure for foreign banks more parallel to the procedure for domestic banks, the interim rule states that elections by foreign banks will become effective on the 31st day after filing unless the Board has objections or an agreement is made to extend the review process.

The new rule also seeks to harmonize the treatment of domestic bank holding companies and foreign banks. The interim rule issued on January 19 required that a foreign bank and its U.S. branches, agencies, and commercial lending subsidiaries be well capitalized and well managed in order to be eligible for FHC designation. This rule clarifies that all U.S. depository institution subsidiaries of the foreign bank—including thrifts and nonbank trust companies—must be well capitalized and well managed.

In addition, this rule amends the January 19 rule to encourage a foreign bank chartered in a country from which no other bank has been reviewed for comprehensive consolidated supervision to use the pre-clearance process. Under this process, a foreign bank may file a request for review of its capital and management qualifications to be treated as an FHC. The Board will usually act on such requests within 30 days. These amendments became effective March 15,

2000. Comments were due April 17, 2000. For further information, see 65 *Federal Register*, pp. 15053-7. (Regulation Y).

Merchant Banking (3/28/2000)

Together with the Secretary of the Treasury, issued an interim rule providing guidelines for the merchant banking activities of financial holding companies. Merchant banking refers to the temporary taking of equity positions in nonfinancial firms. The interim rule would allow a financial holding company (FHC) to make direct or indirect merchant banking investments only through a securities affiliate or through an insurance affiliate that has an investment advisor. The rule defines a securities affiliate to include any broker or dealer registered with the SEC. Under this definition, almost any FHC would be able to engage in merchant banking activities.

The FHC would need to file notice with the Board within 30 days of making a merchant banking investment if: 1) the acquisition represents in excess of 5 percent of the voting shares, assets, or ownership interests of the company; and 2) the costs of the investment exceeds the lesser of 5 percent of the FHC's Tier 1 capital or \$200 million.

The interim rule would generally discourage an FHC from routinely managing a portfolio company. Routine management is presumed if any director, officer, employee, or agent of the financial holding company serves as an officer or employee of the portfolio company. Routine management would also be presumed if the FHC were actively involved in the day-to-day management of the portfolio company. Under limited circumstances, such as a loss of senior management or catastrophic threat to the value of a portfolio company, an FHC would be permitted to actively manage the portfolio company. In general, such intervention would be limited to six months, with Board approval for an extended period. Under no circumstances would an FHC's depository institution or its subsidiary be permitted to actively

manage the portfolio company.

Merchant banking investments would generally have to adhere to a 10-year term, with interests in private equity funds limited to 15 years. A venture capital fund is an example of a private equity fund. FHCs wishing to extend the term would need to request permission from the Board at least one year prior to the normal holding period expiration date. In addition to any further restrictions mandated by the Board, FHCs receiving extensions would be required to deduct 100 percent of that investment's carrying value from their Tier 1 capital and would also be prohibited from including any unrealized gains on the investment in their Tier 2 capital for regulatory purposes.

The rule would also place aggregate limits on merchant banking investments. Total merchant banking investments could not exceed the lesser of 30 percent of the FHC's Tier 1 capital or \$6 billion. In addition, after investments made in private equity funds are excluded, merchant banking investments must not exceed the lesser of 20 percent of the FHC's Tier 1 capital or \$4 billion.

Finally, the interim rule requires FHCs to have explicit risk management systems for their merchant banking investments. FHCs would need to be able to adequately assess the value of individual investments, the value of the aggregate portfolio, and the total exposure of the FHC to merchant banking investments. In addition, systems must adequately maintain corporate separateness and shield the FHC from the legal and financial liabilities of portfolio companies.

Capital Regulations for Merchant Banking. In addition to the joint interim rule on merchant banking guidelines, the Board gave notice of proposed rulemaking that would require a financial holding company to deduct from its Tier 1 capital an amount equal to 50 percent of the total value of all merchant banking investments held by the FHC. The merchant banking investments would be valued according to their carrying value on the consolidated financial statements of the holding

company. The capital charge would apply to all equity investments in portfolio companies as well as debt instruments that are convertible into equity.

The proposal would explicitly exempt certain types of loans from the capital charge. Short-term secured loans to the portfolio company for working capital purposes would not be subject to the capital charge. Other loans explicitly exempted include loans guaranteed by the U.S. government and collateralized loans made by a subsidiary depository institution. The interim rule became effective March 17, 2000. Comments on both the joint interim rule and the Board's proposal must be received by May 22, 2000. For further information, see 65 *Federal Register*, pp. 16459-79 and pp. 16480-3. (Regulation Y).

Truth in Lending (3/31/2000)

Issued a final rule clarifying that payday loans, or similar transactions in which there is an agreement to defer payment of a debt, are considered credit and are subject to all requirements under the Truth in Lending Act. This rule became effective March 24, 2000. For further information, see 65 *Federal Register*, pp. 17129-32. (Regulation Z)

Federal Deposit Insurance Corporation

Privacy of Consumer Financial Information (2/22/2000)

Together with the Office of the Comptroller of the Currency, Office of Thrift Supervision, and the Federal Reserve System, gave joint notice of a proposed rule addressing consumer financial information privacy. The proposed rule requires financial institutions to disclose their privacy policies and practices to consumers; sets forth the conditions under which a financial institution may disclose confidential information to a nonaffiliated third party; and gives consumers the right to "opt out" of information-sharing arrangements between the financial institution and

nonaffiliated third parties. Specifically, providers of financial services would be subject to disclosure and opt out requirements for any private information that identifies the customer individually. The fact that an individual is a customer, or has applied to purchase a financial product, would be considered private information.

The regulators are seeking comment on what type of customer information should be deemed public and therefore be put outside the reach of privacy protection. For example, while spending habits and credit limits are information that is relatively more difficult to come by, addresses and phone numbers are readily available from many sources. Two approaches have been proposed. One, only information actually collected from a public source would be deemed public. Or two, any information that might have been collected from a public source would be deemed public.

The proposed rule would require a financial institution to provide a clear notice of its privacy policies to customers at the outset of the relationship and at least once annually thereafter. For consumers, the notice must be provided prior to the disclosure of nonpublic personal information to a nonaffiliated third party. Notices must be sent in such a way as to reasonably ensure receipt by the consumer. The posting of the policy in the lobby or an oral notice would be permissible but not sufficient to satisfy the rule. Notice-delivery methods (such as mailings, hand-delivery, or email) are encouraged.

The notices should contain information about: 1) the categories of nonpublic personal information that the financial institution may collect; 2) the categories of nonpublic personal information that the financial institution may disclose to both affiliates or nonaffiliated third parties; 3) the type of affiliates and nonaffiliated third parties that may receive information; 4) the policies regarding the sharing of financial information of former customers; 5) the disclosure policy regarding nonaffiliated third-party service providers; 6) the consumer's right to opt out of most

nonaffiliated third-party information transfers; 7) disclosures made under the Fair Credit Reporting Act; and 8) security and confidentiality policies in place to protect the security of the customer's information. Comments were due March 31, 2000. For further information, see 65 *Federal Register*, pp. 8770-816.

Risk-Based Capital Standards (3/8/2000)

Together with the Office of the Comptroller of the Currency, Office of Thrift Supervision, and the Federal Reserve System, gave joint notice of a proposed rulemaking addressing capital standards applicable to recourse obligations, direct credit substitutes, and certain securitized transactions. Recourse refers to the risk of credit loss that a banking organization retains in connection with a transfer of its assets; for example, when a bank provides a guarantee against losses to the purchaser of a loan originated by the bank. A direct credit substitute refers to an arrangement in which a bank bears risk of credit loss for an asset originated by a third party; for example, if a bank guarantees a loan originated by another bank.

The proposal would, in general, treat both types of credit enhancements symmetrically when calculating regulatory capital requirements. A bank's required capital would depend on the bank's exposure and the risk of the underlying asset. Under current capital regulations, essentially identical credit risks can lead to different capital requirements, depending on whether the bank provides a recourse agreement or a direct credit substitute. The proposal would vary the capital requirement for a traded securitized asset according to its rating by one of the nationally recognized agencies, such as Moody's. Nontraded credit enhancements would be eligible for the ratings-based approach only if: 1) the qualifying ratings came from two different rating agencies; 2) they were

publicly available; and 3) the rating criteria did not deviate from the criteria used to rate securities sold to the public.

The proposal would also permit a banking organization to use an internal risk-rating system for nontraded credit enhancements. Eligible internal rating systems would have to meet several criteria. For example, the banking organization's internal model would need to classify assets into risk grades by clear and explicit criteria. The organization would also need to link its ratings to measurable outcomes, such as the probability that a position will experience a loss. Internal models would also be required to make credit risk grading assumptions consistent or more conservative than the assumptions made by the rating agencies. The bank's internal ratings system would have to be certified by regulators.

Finally, the proposal would address risk attributable to the early amortization feature of securitized assets by requiring a banking organization's securitized receivables to be included in weighted assets when determining risk-based capital requirements. These off-balance-sheet receivables would be assigned to the 20 percent risk category, resulting in a 1.6 percent risk-based capital charge. Comments must be received by June 7, 2000. For further information, see 65 *Federal Register*, pp. 12320-52. (Regulations H and Y).

Office of the Comptroller of the Currency

Assessment of Fees (3/21/2000)

Gave notice of proposed rulemaking that would revise the formula used by the agency in assessing the amount charged to independent trust banks (ITBs) for supervision. The assessment amount is based on many factors, including the size of the bank, its condition, and whether the institution is the "lead" bank among national banks in a holding company. An

independent trust bank is a national bank that: 1) has trust powers; 2) does not primarily offer full-service banking; and 3) is not affiliated with a full-service national bank.

The proposal would group ITBs in two categories: those with assets of at least \$1 billion, or those with assets below \$1 billion. Those ITBs with assets of at least \$1 billion would pay an additional managed assets fee calculated by multiplying the amount of assets under management by a factor to be determined by the OCC. The proposal would incorporate a marginal assessment rate on assets—with one rate on assets between \$1 billion and \$10 billion, and a lower rate on assets over \$10 billion. The proposal would assess those ITBs with managed assets under \$1 billion a flat fee, in addition to the assessment the bank would pay based on its balance-sheet assets. Comments were due by April 20, 2000. For further information, see 65 *Federal Register*, pp. 15111-3.

Office of Thrift Supervision

Transfer and Repurchase of Government Securities (3/28/2000)

Issued a direct final rule with request for comment repealing the prohibition against a savings association's entering into a repurchase agreement with a denomination under \$100,000 and with a maturity of at least 90 days unless the other party in the contract was an FDIC-insured institution or an SEC-registered broker or dealer. The original purpose of the rule was to remove the possibility of savings associations using repurchase agreements as a way to pay interest on deposit accounts. While paying interest on demand deposits is still illegal, the use of sweep accounts has made the earlier prohibition unnecessary. This rule will become effective May 30, 2000. Comments were due by April 27, 2000. For further information, see 65 *Federal Register*, pp. 16302-5.

SUMMARY OF THIRD DISTRICT DEVELOPMENTS

New Jersey

On January 11, 2000, Representative Zecker and Representative Blee introduced A.B. 742, titled the "Ethical ATM Act." The bill would prohibit ATM

owners from assessing fees on consumers who use their ATMs to access an account not held with the ATM owner. Other states and municipalities have enacted similar laws, but federal regulators and

courts have not permitted them to be applied to national banks, thus negating their effectiveness. (See *Banking Legislation and Policy*, Third Quarter 1999.)

Return to page 1.

