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## OCC Standardizes Rules for Complex Activities and Updates Licensing Procedures

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In November 2020, the Office of the Comptroller of the Currency released final rules updating:

- the regulations applicable to the **activities and operations** of national banks and Federal savings associations, and
- the **licensing policies and procedures** applicable to national banks and Federal savings associations.

The [Final Activities Rule](#) codifies three major areas of OCC interpretations, also setting out clear procedures for these activities:

- the **derivatives powers** of national banks;
- national banks' and Federal savings associations' **investments in tax equity finance transactions**; and
- national banks' and Federal savings associations' **memberships in payment systems**.

The Final Activities Rule makes a number of additional changes to the existing activities rules, including by allowing national banks to adopt **anti-takeover measures** and expanding the services that national banks can provide at various locations without being required to classify those locations as **branches**. This Alert Memorandum follows up on our [analysis](#) from June 2020 about the proposed rule. The Final Activities Rule is effective as of April 1, 2021.

As with the Final Activities Rule, the OCC explained that the [Final Licensing Procedures](#) are part of its periodic efforts to review existing regulations for opportunities to remove outdated or unnecessary provisions or to provide clarity. The OCC's licensing procedures govern national banks' and Federal savings associations' corporate activities and transactions, including business combinations, investments in operating subsidiaries, dividend issuance, and more. Depending on the nature of the activity and other factors, the licensing procedures generally require a national bank or Federal savings association to obtain the OCC's permission to engage in specified activities or to provide the OCC with notice of these activities. Among other substantive and technical changes, the Final Licensing Procedures create additional flexibility for national banks with respect to their operating subsidiaries and non-controlling investments and provide clarity for the requirements related to subordinated debt. The Final Licensing Procedures generally are effective as of January 1, 2021.

This Alert Memorandum provides an overview of each of the final rules and highlights key takeaways.



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## PART ONE: FINAL ACTIVITIES RULE<sup>1</sup>

### I. DERIVATIVES ACTIVITIES<sup>2</sup>

The Final Activities Rule clarifies and codifies decades of interpretations related to the derivatives powers of national banks.

#### SUMMARY OF FINAL RULE:

- National banks<sup>3</sup> may engage in the following derivatives transactions:
  - On underlying reference assets that a national bank is **permitted to purchase directly** as an investment (including interest rates, foreign exchange and currency, credit, precious metals and investment securities);
  - On any underlying reference asset, in order to **hedge risks** arising from bank-permissible activities;
  - As financial intermediary for any underlying, where the derivatives transaction is **customer-driven**,
    - the transaction is either **cash-settled or physically-settled** (by transitory title transfer or otherwise), and
    - the transaction is either:
      - **perfectly-matched or portfolio-hedged synthetically**; or
      - **physically-hedged** on a portfolio or transaction-by-transaction basis, provided that the **conditions for physical hedging are met**.
- A national bank must **provide notice** to the bank's examiner-in-charge ("EIC") at least 30 days prior to:
  - Engaging in derivatives transactions based on underlying reference assets that a national bank is not permitted to purchase directly as an investment; or
  - Expanding its previously-noticed derivatives activities to include a "new category" of underlying reference assets for derivatives transactions.
- A bank may engage in **physical hedging activities** under the following conditions:
  - The underlying is held solely to hedge risks arising from customer-driven derivatives transactions;
  - Physical hedging offers a cost-effective means to hedge risks;
  - The bank holds no anticipatory or residual positions, except as necessary for the orderly establishment or unwinding of a hedging position;
  - **Equity securities** for hedging purposes do not constitute more than 5% of a class of voting securities of any issuer; and

<sup>1</sup> "Activities and Operations of National Banks and Federal Savings Associations", 85 Fed. Reg. 83686 (Dec. 22, 2020) (the "Final Activities Rule"). The OCC's activities rules are codified at 12 C.F.R. Part 7.

<sup>2</sup> 12 C.F.R. § 7.1030 is a new section created by the Final Activities Rule.

<sup>3</sup> Financial derivatives authority for Federal savings associations is separately addressed in existing regulations. *See* 12 C.F.R. § 163.172. These regulations were unchanged by the Final Activities Rule.

- With respect to **physical hedging involving commodities**:
  - A physical position in a particular commodity (including, as applicable, delivery point, purity, grade, chemical composition, weight, and size) must **not be more than 5%** of the gross notional value of the bank’s derivatives (1) on that particular physical commodity and (2) that allow for physical settlement within 30 days (but commodities acquired and immediately sold through transitory title transfer do not count against this limit);
  - The physical position must more effectively reduce risk than a cash-settled hedge referencing the same commodity;<sup>4</sup>
  - Receipt of physical quantities of the commodity on bank premises is not permitted; and
  - The physical commodity position may only be used to hedge a physically-settled customer-driven derivative transaction or transactions.
- A bank must have an **effective risk management** system to manage the interest rate, credit, liquidity, price, operational, compliance, and strategic risks of its derivatives activities.

#### ANALYSIS AND OBSERVATIONS:

- *Efficiency and flexibility.* The Final Activities Rule is likely to make undertaking derivative activities more efficient and less burdensome:
  - First, the Final Activities Rule puts to rest the ongoing debate as to whether engaging in certain types of derivative activities requires repeated authorization with regard to *legal permissibility*. As the OCC has authorized “any” underlying reference asset, and clearly indicated the conditions under which these transactions may be carried out, there are likely to be far fewer interpretive letters on a reference-asset-by-reference-asset basis and on a hedging-style basis.<sup>5</sup>
  - The OCC appears to view its new regulations for financial intermediation transactions as particularly flexible, and perhaps, somewhat future-proofed. In the preamble to the Final Activities Rule, “[t]he OCC recognizes that financial intermediation in derivatives continues to evolve and that the markets for derivatives on underlyings that the OCC has not previously

<sup>4</sup> The OCC indicated that national banks should treat this requirement as a high hurdle: “[I]f a national bank has a choice between hedging with a cash-settled derivative or a physical commodity, all else being equal, the bank should choose the cash-settled derivative that involves less risk to the bank. . . . [C]ash-settled transactions raise fewer supervisory concerns compared to physically-settled transactions. Accordingly, the final rule continues to require a national bank to utilize cash-settled transactions when such transactions are equally effective as physical hedges.” Final Activities Rule at 83710 (footnotes omitted).

<sup>5</sup> See, e.g., OCC Interpretive Letter No. 1056 (Mar. 29, 2006) (clarifying that (1) linear low density polyethylene and polypropylene are permissible underlying reference assets when OCC Interpretive Letter No. 1039 (Sept. 13, 2005) (“[Interpretive Letter 1039](#)”) had mentioned only high density polyethylene, and (2) frozen orange juice is a permissible underlying reference asset when Interpretive Letter 1039 had mentioned only “orange juice”); OCC Interpretive Letter No. 1060 (Apr. 26, 2006) (permitting portfolio hedging for coal derivatives when prior Interpretive Letters had described only perfectly-matched coal derivatives).

Through 2005’s Interpretive Letter 1039, the OCC commenced a period of significant uncertainty for national banks, as it was not completely clear why small differences in the underlying reference asset mattered for purposes of determining *legal permissibility*, and therefore why separate interpretive or approval letters were needed for each.

addressed through interpretations may have sufficient liquidity and depth to allow a bank to conduct the activity as a financial intermediary,” also noting that the same dynamic may be true for hedging activities.<sup>6</sup>

- Second, the Final Activities Rule makes clear that no derivative activities require *prior approval*—instead, the regulation constitutes prior approval to engage in the activities. The preamble to the Final Activities Rule is unambiguous that any prior notice to the national bank’s EIC is merely a notice and not an approval requirement,<sup>7</sup> and is designed to keep the EIC apprised of the bank’s activities and allow the EIC to incorporate these new activities in the cycle of examinations.<sup>8</sup>
- Related to both these points, the Final Activities Rule should also cure the historical conflation of *legal permissibility* and *risk management*. From time to time, national banks looking for an examiner non-objection (as required by many prior interpretive letters) from a safety and soundness or risk management perspective would be informed that a non-objection also required a legal sign-off, even if a prior interpretive letter was directly on point. The Final Activities Rule specifically provides the legal authorization in the regulatory text, and language in the Activities Rule Proposal specifically indicated that review of a national bank’s risk management with regard to derivatives activity is separate and should be undertaken in the normal exam cycle.<sup>9</sup>

In the Final Activities Rule, the OCC adds an explicit safety and soundness requirement that requires banks to have suitable risk management systems to manage the risks of their derivatives activities, but this provision was merely added for clarity and is consistent with the OCC’s statements regarding legal permissibility.

- *Notice when adding a “new category” of underlying reference assets.* The Final Activities Rule requires a notice to a national bank’s EIC, if the bank proposes to expand certain (previously noticed) derivatives activities “to include any new category of underlyings”. In the preamble to the Final Activities Rule, the OCC did not provide much clarity as to the meaning of “new category”, and we expect this provision to be a source of confusion for national banks and to require both discussions with examiners and potentially OCC legal staff.
  - The OCC did not believe the notice requirement to be a burden, as it was merely a “notice” (and not approval) and should only require “a limited amount of information that should be readily available to the bank”.<sup>10</sup>
  - However, some additional guidance on whether the “categories” of “underlyings” are broad (*e.g.*, “equities”, “non-investment-grade debt”, “commodities” and “real estate”), or more granular (*e.g.*, specific reference-asset-by-reference-asset notice as prior interpretive letters have required) could have been helpful to avoid ambiguity.

<sup>6</sup> Final Activities Rule at 83708.

<sup>7</sup> See Final Activities Rule at 83709.

<sup>8</sup> See OCC Interpretive Letter No. 1160 (Aug. 22, 2018) (providing for EIC notice and ongoing monitoring requirements instead of an EIC prior non-objection determination).

<sup>9</sup> Indeed, in the proposed rulemaking, the OCC noted that the notice to a national bank’s EIC need not reference any OCC interpretive letter as a basis for legal permissibility of the activity. “Activities and Operations of National Banks and Federal Savings Associations”, 85 Fed. Reg. 40794 (July 7, 2020) (the “Activities Rule Proposal”) at 40808.

<sup>10</sup> Final Activities Rule at 83710.

- *Physical hedging authority.* The Final Activities Rule aims to clarify some of the remaining tension with regard to physical hedging with securities or commodities.
  - The Final Activities Rule clarifies that a bank is permitted to physically hedge either a cash-settled or physically-settled transaction with securities, but physical commodities may only be held to hedge physically-settled commodities derivatives. Although the OCC did not share a commenter’s view that past OCC precedent points to physical hedging of cash-settled derivatives *generally* being allowed, the OCC notes that there is precedent for physical hedging of cash-settled *equity* derivatives.<sup>11</sup> All in all, this change should provide banks with more flexibility.
  - In response to a commenter’s question, the OCC clarifies in the preamble that a national bank is permitted to enter into a physically-settled contract, but direct physical settlement toward its affiliate, such that the bank only receives cash settlement.<sup>12</sup>
  - The Final Activities Rule codifies OCC Bulletin 2015-35 (Aug. 4, 2015) wherein the OCC concluded that the value (short or long) of “each commodity” held as a hedge could not be greater than 5% of the gross notional value of the derivatives for which physical settlement in that commodity is permitted over the next 30 days. Therefore:
    - Subject to portfolio hedging potentially requiring a lower amount, a national bank must hedge a significant portion of its physically-settled commodity derivative obligations with either transitory title, back-to-back derivatives or through some other means, and
    - A national bank may not take into account for physical hedge purposes any of its physically settled commodity derivatives that do not mature or require delivery within the next 30 days, thus leaving longer maturity contracts potentially to be hedged in another manner.
- *No liquidity requirement adopted.* The OCC had requested comment on whether any of the physical hedges (commodities or securities) should be subject to a liquidity requirement. Liquidity requirements are inherently subjective and would likely lead to an increase in the number of interpretations requested from the OCC. The OCC declined to adopt liquidity requirements (or any other safety and soundness requirements specifically related to underlyings), pointing to the applicability of general safety and soundness standards as well as the Final Activities Rule’s requirements for physical hedging activities.<sup>13</sup>

## II. TAX EQUITY FINANCE<sup>14</sup>

The Final Activities Rule codifies and makes more flexible a national bank or Federal savings association’s (“FSA”) ability to invest in projects for which investors are expected to receive tax credits. These include tax credits such as the New Markets Tax Credit, Solar Investment Tax Credit, Energy Production Tax Credit and Business Energy Investment Tax Credit, among others.

The Final Activities Rule for Tax Equity Finance (“TEF”) transactions was generally adopted as proposed, but includes revisions and modifications that should increase clarity and flexibility. However, the Final Activities

<sup>11</sup> See Final Activities Rule at 83707-83708.

<sup>12</sup> See Final Activities Rule at 83708 (citing OCC Interpretive Letter No. 949 (Sept. 19, 2002)).

<sup>13</sup> Final Activities Rule at 83708.

<sup>14</sup> 12 C.F.R. § 7.1025 is a new section created by the Final Activities Rule.

Rule also creates a new requirement that the bank obtain a legal opinion or have other good faith, reasoned bases as to the availability of tax credits or other tax benefits.

**SUMMARY OF FINAL RULE:**

- A national bank or FSA may engage in TEF transactions that are the “functional equivalent of a loan”. In these transactions, a bank provides equity financing to fund a project that generates tax credits or other tax benefits, and the use of an equity-based **structure allows the transfer of those tax credits and benefits to the bank**. Under the Final Activities Rule:
  - TEF investments may be made through investment funds.<sup>15</sup>
  - The project must generate tax credits or other tax benefits (instead of the Activities Rule Proposal’s language of tax credits and other tax benefits), given the various forms that tax benefits may take (*e.g.*, deductions).
  - The new rule is distinct from and does not limit other authorities under which banks can make investments (such as community development investments).
- A TEF transaction is the “**functional equivalent of a loan**” if the following conditions are met:
  - The structure of the transaction is necessary for making the tax credits or other tax benefits available to the bank;
  - The transaction is of limited tenure and is not indefinite, including retaining a limited investment interest that is required by law to obtain continuing tax benefits or needed to obtain the expected rate of return;
  - The investment is repaid, and the expected rate of return at the time of underwriting is provided, from the tax benefits and other payments received from the transaction, and the bank does not rely on appreciation of value in the project or property rights underlying the project for repayment;
  - The bank uses approval standards that are substantially equivalent to the underwriting and credit approval criteria and standards used for a traditional commercial loan;
  - The bank is a passive investor in the transaction, unable to direct the affairs of the project;
  - The transaction must be subject to a bank’s legal lending limits and, if applicable, any limits under Sections 23A and 23B of the Federal Reserve Act and Regulation W; and
  - The bank appropriately accounts for the transaction initially and on an ongoing basis and has documented contemporaneously its accounting assessment and conclusion; even though a transaction is the functional equivalent of a loan, it may be accounted for as equity.
- The following **additional requirements** also must be met:
  - The bank cannot control the sale of energy, if any, from the project;
  - The bank limits the **total dollar amount of TEF transactions to no more than 5% of its capital and surplus**, but the bank may request that the OCC approve an amount up to 15% of the bank’s capital and surplus;

<sup>15</sup> See Final Activities Rule at 83695.

- The bank provides **written notification** to the appropriate OCC supervisory office **prior to engaging in each TEF transaction**;
- The bank has appropriate risk management capabilities to identify, measure, monitor, and control the associated risks of its TEF transactions individually and as a whole on an ongoing basis; and
- Before engaging in a TEF transaction, the bank either obtains a **legal opinion** that tax credits or other tax benefits are available or has other good faith, reasoned bases for making such a determination.

#### ANALYSIS AND OBSERVATIONS:

- *Clarifying, and offering more flexibility than, prior interpretations.* By narrowing the conditions to engaging in a TEF transaction to certain essential factors at the core of the OCC’s prior interpretations, the Final Activities Rule standardizes the review by banks of TEF transactions and removes ambiguity generated by differing standards over several prior interpretive letters.
  - In the most clear change from precedent, the OCC permits the total amount of TEF transactions to constitute up to 5% of a bank’s capital and surplus, with the possibility of requesting that the OCC provide a limit up to 15%—a 2013 interpretive letter had placed a 3% cap on TEF transactions.<sup>16</sup>
  - Helpfully, the Final Activities Rule limits the conditions on TEF transactions to only those listed above. Depending on how one reads some of the prior interpretive letters on TEF transactions, a number of “facts” or “representations” provided by the requesting bank could be read as requirements or conditions to the conduct of TEF transactions. For example, in Interpretive Letter 1139, the requesting bank had “represented” that neither it nor any of its U.S. affiliates engaged in electricity or energy trading activities. If read as a requirement, a large number of U.S. banks with affiliates engaged in complementary energy trading activities<sup>17</sup> would not have been permitted to make TEF investments. Other similar examples exist in the prior TEF interpretive letters.<sup>18</sup>
- *Real estate.* Prior interpretive letters<sup>19</sup> provided significant analysis of whether a TEF transaction might result in the ownership of an interest in real estate in contravention of 12 U.S.C. § 29 (limitations on national bank ownership of real estate). The conditions in the Final Activities Rule do not discuss the real estate aspects of TEF transactions. Instead, as proposed, the OCC relies on its past interpretations and states definitively that “wind turbines, solar panels, and other ancillary equipment are not considered real property under 12 U.S.C. 29, and acquisition of interests in real estate incidental to the provision of financing is not inconsistent with 12 U.S.C. 29”.<sup>20</sup> This definitive statement is a signal that the debate

<sup>16</sup> See OCC Interpretive Letter No. 1139 (Nov. 13, 2013) (“[Interpretive Letter 1139](#)”).

<sup>17</sup> See, e.g., *Citigroup Inc.*, Federal Reserve Board Order dated Oct. 2, 2003; *The Royal Bank of Scotland Group plc*, Federal Reserve Board Order dated Mar. 27, 2008 (long-term electricity supply contracts).

<sup>18</sup> See, e.g., Interpretive Letter 1139 (the requesting bank represented that “it would not provide financing until the Facility is ready to be ‘placed into service.’ As a result, the Bank would not take on any construction risk.”).

<sup>19</sup> See OCC Interpretive Letter No. 1048 (Dec. 21, 2005); OCC Interpretive Letter No. 1053 (Jan. 31, 2006) (“[Interpretive Letter 1053](#)”); Interpretive Letter 1139.

<sup>20</sup> Final Activities Rule at 83696.



over the real estate elements of these transactions has, from the OCC's perspective, ended.<sup>21</sup>

- *Transactions of limited tenure.* With respect to the requirement that a TEF transaction have a limited tenure and not have an indefinite maturity (the “limited/definite tenure provision”):
  - In response to commenter questions, the OCC confirmed in the preamble that the 15-year holding period for Low-Income Housing Tax Credit (“LIHTC”) investments would not violate the Final Activities Rule’s limited/definite tenure provision.<sup>22</sup>
  - The Final Activities Rule clarifies that the limited/definite tenure provision includes the time that is needed to obtain the expected rate of return (for clarity, the Final Activities Rule also changes the Activities Rule Proposal’s “implied rate of return” to the “expected rate of return”).
  - In the preamble, the OCC clarifies that the transaction may be structured in various ways to meet the requirements of the limited/definite tenure provision, also adding that the bank must not be able to control whether or not it retains the interest indefinitely.<sup>23</sup>
- *Passive investor status.* The OCC clarifies in the preamble that it “does not consider temporary management activities in the context of foreclosure or similar proceedings as violating” the requirement for a bank to be a passive investor, and in response to a comment, notes that it “agrees that customary protective rights and covenants are permitted”.<sup>24</sup> This clarity facilitates compliance with the requirement that a bank’s approval standards for the TEF transaction must be substantially equivalent to the underwriting and credit approval criteria and standards used for a traditional commercial loan.<sup>25</sup>
- *Sales of energy.* As to the requirement that the bank cannot control any sales of energy from the TEF transaction, the preamble clarifies that banks have flexibility as to how they satisfy this requirement, and the examples provided by the Activities Rule Proposal (the use of certain long-term contract or hedging conditions) are merely examples instead of requirements and are not exhaustive.<sup>26</sup> The bank may also place restrictions or other requirements on the TEF project’s sales (such as a condition on the creditworthiness of the purchaser), provided that such conditions are pursuant to prudent underwriting standards and not an attempt to control, influence, or manipulate energy sales.

The OCC confirmed that a bank or the investee project can enter into a contract for the sale of energy with an affiliate of the bank that is participating in the TEF transaction, subject to restrictions on affiliate transactions.<sup>27</sup> However, the bank itself is not permitted to act as the TEF project’s hedging or sales counterparty.<sup>28</sup>

- *Legal opinions.* In a change from the Activities Rule Proposal, before engaging in a TEF transaction, the bank must either obtain a legal opinion that tax credits or other tax benefits are available or it must have

<sup>21</sup> The OCC had spent significant time defending its decision on the real estate elements of TEF and other transactions. See Interpretive Letter 1053.

<sup>22</sup> Final Activities Rule at 83695.

<sup>23</sup> See Final Activities Rule at 83696.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> Final Activities Rule at 83697.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

other good faith, reasoned bases for making this determination. The preamble confirms that the legal opinion does not need to be from outside counsel and, in fact, a legal opinion per se is not required. However, the preamble does caution that a bank “may not rely solely on the assurances of a person or entity promoting a TEF transaction that tax credits will be available”.<sup>29</sup>

- *Emphasis on flexibility.* The Activities Rule Proposal asked commenters whether the OCC should prohibit TEF investments in residential installation projects not involving utility-scale standalone power-generation facilities and whether TEF transactions involving detached single-family residences, multi-family residences, or non-utility commercial buildings should be permitted. Ultimately, the OCC opted for flexibility for TEF transactions, and the Final Activities Rule does not prohibit these smaller scale TEF transactions, based on the conclusion that the legal permissibility of a TEF transaction should not be dependent on the characterization of the end user or the underlying asset.<sup>30</sup>

### III. PAYMENT SYSTEM MEMBERSHIPS<sup>31</sup>

The Final Activities Rule codifies a line of OCC approvals and interpretations regarding the process for national banks and FSAs to join payment systems. The Final Activities Rule was generally adopted as proposed with minor clarifications and revisions, as well as with a new paragraph that adds a nonexhaustive minimum list of factors that national banks and FSAs should consider when evaluating the safety and soundness considerations associated with membership in a payment system.

#### SUMMARY OF FINAL RULE:

- **Payment systems** are defined as “**financial market utilities**”<sup>32</sup> meaning “any [U.S. or non-U.S.] person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person”.
  - U.S. and non-U.S. derivatives clearing organizations and securities clearing agencies are *excluded* from this definition.
- If membership in a payment system would expose a bank to **open-ended liability**, then **prior notice** of 30 days is required; **if not, then after-the-fact notice** within 30 days is required.
  - “**Open-ended liability**” refers to liability for operational losses that is not capped under the rules of the payment system and includes indemnifications of third parties provided as a condition of membership in the payment system.
  - In order to file an after-the-fact notice, the bank must be able to represent that, per the rules of the payment system, either (i) no liability for operational losses is placed upon members or (ii) any potential liability does not exceed the lower of the bank’s lending limit or the limit for the institution set by the OCC.

<sup>29</sup> Final Activities Rule at 83698.

<sup>30</sup> See Final Activities Rule at 83699.

<sup>31</sup> 12 C.F.R. § 7.1026 is a new section created by the Final Activities Rule.

<sup>32</sup> 12 U.S.C. 5462(6).

- **“Operational loss”** means a charge resulting from sources other than defaults by other members of the payment system. The Final Activities Rule adds examples of operational losses to the rule text, such as a loss resulting from information systems failures, security or cybersecurity breaches, or employee misconduct.
- Joining a payment system is subject to other **safety and soundness procedures**.
  - **Prior to and on a continual basis after joining**, the bank must identify and evaluate the risks posed by membership in the payment system (taking into account whether the liability is limited), and measure, monitor, and control those risks.
    - Even if a bank could not represent that the rules of the payment system limited or eliminated its liability for operational losses, for purposes of compliance with the safety and soundness provisions, the bank may (but is not required to) obtain a **legal opinion** that describes how its liability is limited by other factors (such as by local law or by additional agreements). The legal opinion, which must be obtained before the bank joins the payment system, must (i) describe how the payment system allocates liability for operational losses, (ii) contain a conclusion that liability is in fact limited, and (iii) describe how any potential liability does not exceed the lower of the bank’s lending limit or the limit for the institution set by the OCC. To use this option, on an ongoing basis, from the date of the legal opinion, there cannot have been any material changes to the bank’s liability or indemnification requirements. The OCC stated that such an opinion would enable examiners “to verify that the liability of the [bank] is limited *even though* the rules of the payment system do not provide any limits.”<sup>33</sup>
  - **After joining**, the bank must notify the OCC if its ongoing risk management identifies a safety and soundness concern, such as a material change to the bank’s liability or indemnification responsibilities, as soon as that concern is identified, and the bank is required to take appropriate actions to address and remediate the concern.
  - The Final Activities Rule includes a nonexhaustive **list of payment system characteristics that banks should evaluate** as a minimum baseline when undertaking a safety and soundness analysis. The list is written as a list of questions, such as whether the payment system has insurance coverage to cover operational losses and whether the payment system has appropriate admission and continuing participation requirements for system participants.

#### ANALYSIS AND OBSERVATIONS:

- *Payment systems definition.* As proposed, the definition of “payment systems” excludes U.S. and non-U.S. derivatives clearing organizations and securities clearing agencies. In the preamble, the OCC notes that the distinction that it draws between (i) payment system memberships and (ii) derivatives clearing organizations and securities clearing agencies is consistent with OCC precedent, noting that banks seeking to join derivatives clearing organizations and securities clearing agencies should follow existing precedent on these topics.<sup>34</sup> Generally, existing precedent for derivatives and securities clearing organizations requires, primarily for risk exposure reasons, a no-objection determination from a bank’s EIC.

<sup>33</sup> Final Activities Rule at 83702 (emphasis added).

<sup>34</sup> Final Rule at 83700. *See also, e.g.*, OCC Interpretive Letter No. 929 (Feb. 11, 2002) (“Interpretive Letter 929”) (London branch membership in LCH SwapClear); OCC Interpretive Letter No. 1014 (Jan. 10, 2005) (membership in

- *Operational losses vs. credit risk.* The Final Activities Rule provides for authority to become a member of a payment system, even if there is open-ended liability for operational losses. While the Final Activities Rule states that “OCC legal precedent only has addressed whether a national bank may assume open-ended liability for operational losses at the payment system”,<sup>35</sup> the OCC has a number of significant and important precedents where banks have been permitted to join clearinghouses even if the rules of the clearinghouse would impose potential liability for the credit risk and default of other members. However, the Final Activities Rule did not provide a standardized process for clearinghouses that may subject a bank to such liability. Similar to the conclusion on derivatives and securities clearing organizations, it appears that OCC precedent likely requires EIC non-objection if liability for other than operational losses may be open-ended.
  - Banking Circular 235,<sup>36</sup> as early as 1989, indicated that banks participating in payment systems must control for the credit, counterparty and settlement risks inherent in these systems, including through potential default of other members.
  - A series of OCC precedents regarding membership in derivatives or securities clearinghouses specifically took on the questions of both theoretically limited<sup>37</sup> and open-ended/unlimited<sup>38</sup> liability allocated by the clearinghouse in the event of a default of another member, and approved both subject to EIC non-objection and the ability to monitor the risks of the clearinghouse to keep projected liability within a bank’s legal lending limit.
- *List of safety and soundness factors.* The Final Activities Rule adds a nonexhaustive list of payment system characteristics that banks should evaluate as a minimum baseline when undertaking a safety and soundness analysis. The list is written as a list of questions and stems from Interpretive Letter 1140 and commenters’ views that adding in these factors would increase clarity.<sup>39</sup>

#### IV. BRANCHING

The Final Activities Rule adopts as proposed the provisions that expand the kinds of services that national banks can provide at various locations without being required to characterize those locations as branches.

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loss allocation system of the Government Securities Division of the Fixed Income Clearing Corporation); OCC Interpretive Letter No. 1071 (Sept. 6, 2006) (membership in independent system operators or regional transmission organizations for physical and derivative electricity trading); OCC Interpretive Letter No. 1102 (Oct. 14, 2008) (“Interpretive Letter 1102”) (membership in an India securities clearinghouse); OCC Interpretive Letter No. 1113 (March 4, 2009) (membership in ICE Trust credit derivative clearinghouse); OCC Interpretive Letter No. 1122 (July 30, 2009) (membership in ICE Clear Europe derivative clearinghouse).

<sup>35</sup> Final Activities Rule at 83700.

<sup>36</sup> OCC Banking Circular BC-235, “International Payment Systems Risks” (May 10, 1989) (“Banking Circular 235”).

<sup>37</sup> See, e.g., Interpretive Letter 929 (theoretical cap on liability because bank may resign membership and limit its loss allocation to its original default fund contribution).

<sup>38</sup> See, e.g., Interpretive Letter 1102. Indeed, in footnote 2 of Interpretive Letter 1102, the OCC contrasted the required procedure for clearinghouses with theoretically limited liability (certification to the EIC that liability is limited and is within the bank’s legal lending limit) and situations with potential allocation of unlimited liability from defaulting members (EIC non-objection and continuous review and monitoring of exposure to ensure that projected exposure is within the bank’s legal lending limit).

<sup>39</sup> Final Activities Rule at 83701 and OCC Interpretive Letter No. 1140 (Jan. 13, 2014).

**SUMMARY OF FINAL RULE:**

- The Final Activities Rule codifies an OCC interpretation<sup>40</sup> that a national bank may **distribute loan proceeds** directly to a borrower in person **at an office of an operating subsidiary**, without turning that office into a branch, if the operating subsidiary provides similar services on substantially similar terms and conditions to customers of unaffiliated entities, including unaffiliated banks.<sup>41</sup> Under these circumstances “money” is not be deemed to be “lent” from that office. The OCC declined to extend this concept to offices of the national bank itself.
- The Final Activities Rule codifies the interpretation that “**remote service units**” (“**RSUs**”) also include non-automated and unstaffed facilities, such as drop-boxes for payments or deposits.<sup>42</sup> RSUs are not treated as branches.<sup>43</sup> A location at which a bank operates a combined loan production office, deposit production office and an RSU continues to not be treated as a “branch”, and the rule text stipulates that an RSU at a combined location “must be primarily operated by the customer with at most delimited assistance from bank personnel”.<sup>44</sup>
- The Final Activities Rule streamlines the **loan production office** interpretations, and clarifies that a national bank may, at its own office or an office of an operating subsidiary, solicit loan customers, market loan products, assist potential borrowers in completing documentation, make credit decisions and offer other loan information such as applications, provided that (1) “money” is not “lent” at that site and (2) the office does not accept deposits or pay withdrawals.<sup>45</sup>
- The Final Activities Rule codifies an OCC interpretation<sup>46</sup> regarding when **premises of a third party** at which a national bank participates in a **financial literacy program** is not a branch.<sup>47</sup> The existing requirement that a bank not “establish and operate” the premises or facility remains unchanged – as does the OCC’s ability to review these programs and their premises on a case-by-case basis – but under the Final Activities Rule, a safe harbor used for third-party messenger services<sup>48</sup> would also apply to financial literacy program locations. Generally, the safe harbor should be met if a bank’s participation is limited to managing or conducting activities, while the third-party organization retains control over the program and the premises or facilities.

<sup>40</sup> OCC Interpretive Letter No. 814 (Nov. 3, 1997).

<sup>41</sup> 12 C.F.R. § 7.1003.

<sup>42</sup> 12 C.F.R. § 7.1027 is a new section created by the Final Activities Rule, which will replace the current section 12 C.F.R. § 7.4003. *See also* OCC Interpretive Letter No. 1165 (June 28, 2019) (“[Interpretive Letter 1165](#)”).

<sup>43</sup> 12 U.S.C. § 36(j).

<sup>44</sup> 12 C.F.R. § 7.1029 is a new section created by the Final Activities Rule, which will replace the current section 12 C.F.R. § 7.4005. *See also* OCC Interpretive Letter No. 1165 and OCC Conditional Approval No. 313 (July 9, 1999) (Bank personnel who are physically present will not be considered to be staffing the facility provided that “withdrawals undertaken . . . will be accomplished by depositors, not by bank personnel” and bank personnel “cannot operate the [facility] on behalf of a [c]ustomer.”).

<sup>45</sup> 12 C.F.R. § 7.1004.

<sup>46</sup> OCC Interpretive Letter No. 839 (Aug. 3, 1998).

<sup>47</sup> 12 C.F.R. § 7.1021.

<sup>48</sup> *See* 12 C.F.R. § 7.1012(c)(2).

- Furthermore, under the Final Activities Rule, a national bank can participate in educational financial literacy programs run by organizations other than schools (*e.g.*, nonprofit organizations).
- In addition, while it remains in the definition of “financial literacy program”, the concept that the “principal purpose” of the program be educational is no longer part of the determination of permissibility of the location and whether the premises or facility is a branch.

#### ANALYSIS AND OBSERVATIONS:

- The above provisions, finalized as proposed, should provide banks with additional flexibility and certainty. Because establishing a new branch requires OCC approval, this aspect of the Final Activities Rule is likely to reduce administrative burdens associated with expansion and, when combined with an updated set of digital activity regulations, potentially allow greater delivery of services electronically even at brick-and-mortar non-branch locations.
- In June 2020, contemporaneously with the Activities Rule Proposal, the OCC also published an Advanced Notice of Proposed Rulemaking requesting ideas related to the digital activities of national banks and FSAs (the “ANPR”).<sup>49</sup> The OCC has not yet released a proposal stemming from the ANPR. Nevertheless, the OCC has been working on digital activity issues in recent months through interpretive releases.<sup>50</sup>

## V. CORPORATE GOVERNANCE

The Final Activities Rule largely adopts the Activities Rule Proposal’s corporate governance changes as proposed.

The analysis below focuses on the OCC’s revisions to: (1) a national bank’s or FSA’s ability to elect certain State law corporate governance procedures and (2) a national bank’s ability to adopt anti-takeover measures. We also address other corporate governance items in the Final Activities Rule likely to be of interest to national banks, including the codification of a Covid-era interim final rule addressing telephonic and electronic participation at all board of directors, shareholder, and member meetings.

#### SUMMARY OF FINAL RULE:

- As proposed, the Final Activities Rule widens the scope of State law **corporate governance provisions** available to a national bank<sup>51</sup> or FSA.<sup>52</sup>
  - Currently, a national bank can elect the corporate governance provisions of the law of the State in which the main office of the bank is located, the law of the State in which the holding company of the bank is incorporated, Delaware General Corporate Law, or the Model Business Corporation Act.

<sup>49</sup> “National Bank and Federal Savings Association Digital Activities”, 85 Fed. Reg. 40827 (July 7, 2020).

<sup>50</sup> See OCC Interpretive Letter No. 1172 (September 21, 2020) (authority to hold stablecoin reserves) and OCC Interpretive Letter No. 1170 (July 22, 2020) (authority to provide cryptocurrency custody services for customers).

<sup>51</sup> 12 C.F.R. §7.2000.

<sup>52</sup> 12 C.F.R. § 5.21 (mutual savings association) and § 5.22 (stock savings association).

Federal stock savings associations have similar choices for corporate governance provisions, while Federal mutual savings associations may elect the corporate governance provisions of the home office's state.<sup>53</sup>

- Under the Final Activities Rule, national banks **can choose from the following sources of law**, in addition to those noted above:
  - any State in which any branch of the bank is located;
  - a State where any holding company of the bank is incorporated; or
  - the State where its holding company is incorporated even if (i) the holding company is later eliminated or no longer controls the bank and (ii) the national bank is not located in that State.
- These elections are permitted to the extent they are not inconsistent with Federal law and bank safety and soundness. A national bank may not mix the provision of several different sources, but may only choose one of the permissible sources.
- The Final Activities Rule provides similar flexibility for Federal stock savings associations and Federal mutual savings associations.<sup>54</sup>
- The Final Activities Rule provides a national bank with the ability to **adopt anti-takeover measures**.<sup>55</sup>
  - The OCC added an entirely new section to its rules to provide that a national bank can adopt State corporate governance law anti-takeover measures, provided that these measures are not inconsistent with Federal banking statutes or regulations and are not inconsistent with safety and soundness.
  - The rule text explicitly enumerates (i) which anti-takeover provisions are not inconsistent with Federal banking statutes or regulations (and thus permissible for a bank to adopt) and (ii) which anti-takeover provisions *are* inconsistent with Federal banking statutes and regulations (and thus impermissible for a bank to adopt).
    - A bank may adopt:
      - certain restrictions on business combinations with interested shareholders;
      - poison pills;
      - requirements for all shareholder actions to be taken at a meeting (as opposed to by written consent);
      - limits on shareholders' ability to call special meetings; or
      - shareholders' removal of directors only for cause.
    - A bank may *not* adopt:
      - supermajority voting requirements, or
      - restrictions on a shareholder's right to vote all of the shares that it owns.

<sup>53</sup> See Final Activities Rule at 83712.

<sup>54</sup> *Id.*

<sup>55</sup> 12 C.F.R. §7.2001 is a new section created by the Final Activities Rule.

- The Final Activities Rule also sets forth the kinds of anti-takeover provisions that are inconsistent with bank safety and soundness (and thus impermissible for a bank to adopt, subject to certain exceptions). These restrictions are grounded primarily in the condition of an individual bank and secondarily in the kind of activity being restricted.
  - If (i) the bank is less than adequately capitalized; (ii) the bank is in troubled condition; (iii) the grounds for the appointment of a receiver are present, as determined by the OCC; or (iv) the bank is otherwise in less than a satisfactory condition, as determined by the OCC, then certain State corporate governance provisions (including anti-takeover provisions that may otherwise be permissible) are inconsistent with safety and soundness.
 

Such State corporate governance provisions are those that that would render more difficult or discourage a capital injection by purchase of bank stock, a merger, the acquisition of the bank, a tender offer, a proxy contest, the assumption of control by a holder of a large block of the bank's stock, or the removal of the incumbent board of directors or management.
  - However, a bank that adopts an anti-takeover measure is not in violation (i) if it is not subject to any of the conditions mentioned above when it adopts the provision and (ii) in adopting the anti-takeover provision, it includes a limitation that the provision is not effective if one or more of the foregoing conditions occur or if the OCC otherwise directs the bank not to follow the provision for supervisory reasons.
- On a case-by-case basis, the OCC can object to a national bank adopting one of these measures as inconsistent with Federal banking law or safety and soundness. A bank also can request that the OCC review the permissibility of a State anti-takeover provision.
- The Final Activities Rule also prescribes specific procedures and requirements for a national bank's adoption of State anti-takeover provisions into its articles of association or bylaws. For example, banks must hold a shareholder vote to incorporate anti-takeover provisions into its articles of association, even if State law does not contain this requirement.
- The regulations for stock FSAs currently address the adoption of anti-takeover provisions<sup>56</sup> and no changes were proposed for these regulations.<sup>57</sup>
- Additional corporate governance items of interest to national banks:
  - The Final Activities Rule adopted as proposed the requirement that the person with the **function of the president** (regardless of title) of a national bank must be a member of its board of directors, but need not be chairman of the board.<sup>58</sup>
  - As proposed, the Final Activities Rule also clarifies that a national bank or FSA may **indemnify an institution-affiliated party** (“IAP”) in accordance with the State law it has chosen to apply to its corporate governance procedures.<sup>59</sup> Per the Final Activities Rule, the IAP is required to reimburse the bank for any portion of the bank's advancement of funds that the IAP is not entitled to, except to the

<sup>56</sup> 12 C.F.R. § 5.22(g)(7), (h) and (j)(2)(i)(A).

<sup>57</sup> See Final Activities Rule at 83713.

<sup>58</sup> 12 C.F.R. § 7.2012.

<sup>59</sup> 12 C.F.R. § 7.2014. The Final Activities Rule eliminates the IAP indemnification rule currently applicable to FSAs and applies 12 C.F.R. § 7.2014 to both national banks and FSAs.



extent the bank is reimbursed by insurance or a fidelity bond. The bank must obtain a written agreement to this effect before advancing funds to the IAP.

- The Final Activities Rule codifies and makes permanent an interim final rule that became effective on May 28, 2020,<sup>60</sup> which explicitly permitted national banks and FSAs to **hold director, shareholder and member meetings via electronic or telephonic participation** (*i.e.*, participants can attend remotely). The OCC initially made this clarification in response to the logistical obstacles posed by the Covid-19 pandemic.

#### ANALYSIS AND OBSERVATIONS:

- *National banks without a holding company.* National banks that are the top-tier entity within a group (or are considering a restructuring to shed their holding company) receive the greatest potential benefits from the corporate governance-related changes in the Final Activities Rule.
  - These national banks have new flexibility to choose to adopt the corporate governance law of the State in which branches may be concentrated (if different from the State of the “main” office) or a State with well-developed corporate governance law (in addition to Delaware law, which national banks may choose under current OCC rules).
  - A national bank considering whether to shed its holding company also receives marginal benefits through the permission to retain the law of its former holding company, thereby potentially avoiding disruption to previous corporate governance choices of the bank and bank holding company. This aspect of the Final Activities Rule may make the OCC a more attractive primary federal regulator and may signal the OCC’s willingness to continue granting approvals for this type of restructuring.<sup>61</sup> While national banks of all sizes could realize managerial, operational and administrative benefits by streamlining their corporate structures,<sup>62</sup> recent forms of relief by the OCC and the other banking agencies (*i.e.*, increasing the thresholds at which the Federal Reserve’s enhanced prudential standards apply) may obviate some of the regulatory benefits that had previously motivated at least one larger banking organization to pursue this course.
  - On the other hand, most national banks *are* subsidiaries of holding companies, for historical bank regulatory, securities law and corporate governance reasons. We therefore expect most national banks will continue with their current choice of corporate governance law, which is often that of the state of incorporation of its holding company
- *Anti-takeover defenses.* Although national banks are often subsidiaries of publicly traded holding companies, the OCC has recognized that the value of the national bank charter could be enhanced with greater flexibility to adopt anti-takeover defenses—thus, allowing national banks to consider

<sup>60</sup> “Director, Shareholder, and Member Meetings”, 85 Fed. Reg. 31943 (May 28, 2020).

<sup>61</sup> See OCC Conditional Approval No. 1200 (July 6, 2018) (merger of Zions Bancorporation, a holding company, down into its subsidiary national bank to create Zions Bancorporation, N.A.).

<sup>62</sup> See Bank of the Ozarks, Annual Report (Form 10-K) (Mar. 1, 2017); Zions Bancorporation, N.A. “2018 Year in Review” (no date) (“It had become increasingly evident in recent years that, given the increased powers available under our national bank charter, and considering the straight-forward traditional banking business we conduct, the need for a bank holding company had become superfluous. Virtually every aspect of our business was conducted — and could be conducted — with a national bank charter alone, without the need for a holding company.”).

independence from a holding company and to maintain that independence. In conjunction with the greater flexibility offered by the Final Activities Rule with regard to banking activities and with the potential for expansion of digital activities under the ANPR, there may be further opportunities for non-traditional bankers to establish a national bank as a platform for financial services.

## VI. ELECTRONIC ACTIVITIES AND SBICS

### SUMMARY

The Activities Rule Proposal put forth several miscellaneous clarifications and revisions that should provide national banks and FSAs with greater flexibility. The Final Activities Rule adopts these amendments largely as proposed.

#### ▪ *Electronic activities.*

- The current regulations contain two separate rules regarding “**finder**” activities: one that includes a non-exclusive list of permissible general finder activities, and another that includes a list of permissible electronic finder activities. As proposed, the Final Activities Rule cross references the electronic activities list in the general activities list, thus clarifying the broad scope of this useful authority.<sup>63</sup>
- As proposed, the OCC also modified its rule for **determining permissible activities** generally, by clarifying that the same criteria apply to digital and electronic activities as apply to other activities. The current rule and the Final Activities Rule contain an illustrative list of electronic activities that are incidental to the business of banking.<sup>64</sup> The Final Activities Rule creates a cross-reference from this list to a newly created general permissibility regulation that delineates the criteria under which an activity is part of or incidental to the business of banking; this new regulation is drawn from the existing electronic activities regulation.<sup>65</sup>
- As previously noted, the OCC has not yet released a rule proposal stemming from the **ANPR on the digital activities** of national banks and FSAs. However, in the preamble to the Final Activities Rule, the OCC notes that it is reviewing the electronic activities list in the context of reviewing the ANPR; the same is true of the electronic finder activities list.<sup>66</sup>

#### ▪ *Small Business Investment Company (“**SBIC**”).*<sup>67</sup>

- The Final Activities Rule codifies interpretations that a national bank or FSA may invest in an already organized SBIC or one that is **in the process of organization**.
- As an addition to the proposed codifications, the Final Activities Rule also explicitly permits a national bank to retain its interest in an SBIC that is **in a wind-down phase** (*i.e.*, the entity has surrendered its SBIC license), provided that the SBIC does not make any new investments other than

<sup>63</sup> 12 C.F.R. § 7.1002 and § 7.5002.

<sup>64</sup> 12 C.F.R. § 7.5001.

<sup>65</sup> 12 C.F.R. § 7.1000 is a new section created by the Final Activities Rule; current 12 C.F.R. § 7.1000 has been redesignated to 12 C.F.R. § 7.1024.

<sup>66</sup> Final Activities Rule at 83687.

<sup>67</sup> 12 C.F.R. § 7.1015.

investments in cash equivalents. The OCC notes that in addition to providing investors with certainty, this change creates consistency with a recent amendment to the Volcker Rule regulations.<sup>68</sup> The Volcker Rule amendment similarly clarifies that investments in SBICs still qualify for the exclusion from the definition of “covered fund”, even when these entities are winding down.<sup>69</sup>

## PART TWO: FINAL LICENSING PROCEDURES<sup>70</sup>

Below we highlight the ten most important takeaways from the Final Licensing Procedures. The Final Licensing Procedures are effective on January 1, 2021, although one technical change became effective when the Final Licensing Procedures were published in the Federal Register.<sup>71</sup>

### I. BRANCHES<sup>72</sup>

The Final Licensing Procedures specify that the definition of “branch” does not include RSUs as well as certain other types of offices. This change clarifies that, consistent with a recent interpretive letter from the OCC,<sup>73</sup> a national bank’s establishing an “interactive ATM” is not equivalent to the national bank establishing a branch, provided that the interactive ATM meets certain conditions.<sup>74</sup>

In response to a commenter’s suggestion, the OCC also clarifies in the rule text that a “mobile branch” of a bank – essentially, a branch of a bank that is transported by a vehicle to different sites – can be located in one place for four months before it needs to apply for status as a temporary branch. The OCC views this as a change conducive to unusual circumstances such as the Covid-19 pandemic or weather-related emergencies, although it notes that State statutes regarding mobile branches apply to national banks and may override the OCC’s regulations.

### II. OPERATING SUBSIDIARIES<sup>75</sup>

The OCC’s licensing procedures require national banks to obtain approval from or provide notice to the OCC (i) about the acquisition or establishment of an operating subsidiary or (ii) to undertake new activities within an operating subsidiary.

<sup>68</sup> Final Activities Rule at 83692.

<sup>69</sup> 12 C.F.R. § 44.10(c)(11)(i).

<sup>70</sup> “Licensing Amendments”, 85 Fed. Reg. 80404 (Dec. 11, 2020) (the “Final Licensing Procedures”). The OCC’s licensing procedures are codified at 12 C.F.R. Part 5.

<sup>71</sup> This technical change is to reflect the removal of 12 C.F.R. Part 195 from the Code of Federal Regulations (the Community Reinvestment Act rule for FSAs), as 12 C.F.R. Part 25 has been amended to include FSAs.

<sup>72</sup> 12 C.F.R. § 5.30.

<sup>73</sup> Final Licensing Procedures at 80412; OCC Interpretive Letter No. 1165 (June 28, 2019).

<sup>74</sup> However, we note that, for FSAs, the Final Licensing Procedures codify the OCC’s interpretation that if an FSA wishes to establish an ATM in Washington, D.C., that ATM constitutes a branch requiring appropriate approval. *See* Final Licensing Procedures at 80413.

<sup>75</sup> 12 C.F.R. § 5.34. The Final Licensing Procedures also make similar changes to the rules for the operating subsidiaries of FSAs (12 C.F.R. § 5.38). *See* Final Licensing Procedures at 80423.

The Final Licensing Procedures provide a helpful clarification that securitization trusts are not considered to be operating subsidiaries. Securitization trusts are used to securitize assets that a bank holds as a result of its banking business. As the OCC explains in the preamble, banks do not have the kind of voting power or control over securitization trusts that they normally would have with respect to a typical equity investment, and securitization trusts “are generally structured simply as a set of instructions for administering the securitization that are difficult to change”.<sup>76</sup>

For certain new activities – whether in existing subsidiaries or in operating subsidiaries that are to be established – well capitalized and well managed banks can provide notice to the OCC up to ten days *after the fact* instead of filing an application, subject to various conditions. Activities currently eligible for notice include, in addition to many others:<sup>77</sup> holding and managing assets acquired by the parent bank or its operating subsidiaries; providing securities brokerage activities or acting as a futures commission merchant; and making loans or other extensions of credit.

The Final Licensing Procedures expand the availability of the notice procedure (*i.e.*, rather than the application procedure) for any activity that is substantively the same as a “previously approved activity” and will be conducted under the same terms and conditions that pertain to that previously approved activity.<sup>78</sup> As highlighted below, the definition of “previously approved activity” includes any activity approved in published OCC precedent for (i) a national bank, (ii) an operating subsidiary of a national bank, or (iii) a non-controlling investment of a national bank.

**We highlight the new definition of “previously approved activity”:**

*Previously approved activity* means:

- (1) In the case of a national bank, any activity approved in published OCC precedent for a national bank, an operating subsidiary of a national bank, or a non-controlling investment of a national bank; and
- (2) In the case of a Federal savings association, any activity approved in published OCC or OTS precedent for a Federal savings association, an operating subsidiary of a Federal savings association, or a pass-through investment of a Federal savings association.

Together with the Final Activities Rule, this clarification should resolve the question of whether a national bank or FSA requires a specific activity approval for itself, instead determining that any approved activity in any published precedent can be relied upon by any national bank or FSA.

<sup>76</sup> Final Licensing Procedures at 80419.

<sup>77</sup> These activities are currently specified in 12 C.F.R. § 5.34(e)(5)(v) and will be specified in § 5.34(f)(5).

<sup>78</sup> However, a scenario nevertheless requiring an application instead of a notice is if a “State has or will charter or license the proposed operating subsidiary as a bank, trust company, or savings association.” See 5.34(f)(2)(ii) in Final Licensing Procedures.

However, the Final Licensing Procedures do not adopt an alternative suggested in the Licensing Procedures Proposal<sup>79</sup> whereby a national bank, subject to certain conditions, would not have even needed to notify the OCC for a new operating subsidiary or a new activity in an existing subsidiary. The OCC rejected this alternative so that it can gain experience with the expansion of the notice-only requirement for “previously approved activities” described above.

Under the current licensing procedures, filings related to a national bank’s investments in operating subsidiaries are exempt from certain rules of general applicability, namely § 5.8 (Public Notice), § 5.10 (Comments), and § 5.11 (Hearings and Other Meetings). The Final Licensing Procedures modify this exemption to give the OCC the flexibility to determine that any or all of the relevant provisions apply upon the OCC’s determination “that an application presents significant or novel policy, supervisory, or legal issues”. The Final Licensing Procedures make similar changes<sup>80</sup> to the rules of general applicability that pertain to a bank’s investments in non-controlling subsidiaries, which are addressed in the next section.

In the Final Licensing Procedures, the OCC also has eliminated the requirement for national banks to provide an annual report about operating subsidiaries that transact directly with consumers as this report is duplicative of other requirements.

**Revisions to the licensing procedures’ regulations for *financial* subsidiaries<sup>81</sup> formally implement a Dodd-Frank Act change that has been in force since 2012.<sup>82</sup>** Prior to Dodd-Frank, a national bank’s transactions with a financial subsidiary were excluded from the requirement that transactions with a single affiliate not exceed ten percent of the national bank’s capital stock and surplus. Dodd-Frank eliminated this exclusion. The Final Licensing Procedures also contain other clarifying and technical changes related to the approval process for financial subsidiary activities.

### III. NON-CONTROLLING INVESTMENTS<sup>83</sup>

In § 5.36 of the current licensing procedures, the OCC prescribes rules and procedures pertaining to national banks’ equity investments, with an emphasis on notice or application procedures for non-controlling investments. The Final Licensing Procedures clarify the meaning of “non-controlling investment,” which is an equity investment made under 12 U.S.C. § 24(Seventh) that is not subject to another OCC rule. Consistent with the OCC’s existing views, the Final Licensing Procedures also specify that the definition of a non-controlling investment does not include a national bank’s interest in a securitization trust or in a trust that was formed to hold multiple legal titles of motor vehicles or equipment in connection with lease financing transactions.

<sup>79</sup> “Licensing Amendments”, 85 Fed. Reg. 18728 (Apr. 12, 2020) (the “Licensing Procedures Proposal”).

<sup>80</sup> The rules pertaining to non-controlling investments also include § 5.9 (Public Availability) among the available exemptions.

<sup>81</sup> 12 C.F.R. § 5.39.

<sup>82</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 311 and 609.

<sup>83</sup> 12 C.F.R. § 5.36.

The Final Licensing Procedures make a number of other clarifications and substantive changes that should provide national banks with greater flexibility when it comes to non-controlling investments (the Final Licensing Procedures also make similar changes to the rules relating to the pass-through investments of FSAs):<sup>84</sup>

- More activities eligible for notice instead of application: A national bank or its operating subsidiary is currently eligible to provide notice (instead of filing an application) to make a non-controlling investment in an enterprise that engages in certain kinds of activities, which are the same as the operating subsidiary activities eligible for notice, as described above. Similar to the changes in the rules for operating subsidiaries, the Final Licensing Procedures make available for notice any “previously approved activity”.

As with operating subsidiaries, the OCC rejected a proposed alternative change that – if the target enterprise was engaged in activities permissible for national banks – would have permitted a national bank to make non-controlling investments *without* providing notice.

- Exception from filing requirement: Under the Final Licensing Procedures, a national bank does not need to make a filing with the OCC if the non-controlling investment is limited to an enterprise with activities that are the same as the activities of other non-controlling investments that the national bank has made, subject to certain other parameters. As the OCC notes in the preamble, this change is similar to an existing provision for investments in operating subsidiaries.

**The OCC believes that one of the changes to the licensing procedures regarding non-controlling investments should make it easier for national banks to invest in fintech companies.** Currently, when a national bank makes a non-controlling investment in an enterprise, the enterprise must agree to OCC supervision and examination, which may not be an appealing proposition for fintech and other companies. The Final Licensing Procedures remove this requirement, allowing national banks to apply to make non-controlling investments in enterprises that have not agreed to OCC supervision and enforcement.

The Final Licensing Procedures even provide for an expedited process whereby the application will be deemed to be approved in ten days if the following conditions are met: (i) the enterprise must engage in activities that are eligible for the notice-only procedure described above, including “previously approved activities”; (ii) the national bank must be well managed and well capitalized; (iii) the book value of the national bank’s non-controlling investment must be no more than one percent of the bank’s capital and surplus; (iv) no more than 50 percent of the enterprise may be owned/controlled by banks, savings associations, or credit unions that are subject to examination by a Federal banking agency or insured by the National Credit Union Association, as applicable; and (v) the bank has not received notice from the OCC that the OCC has removed the application from expedited review or extended the expedited review timeframe.

#### IV. SUBORDINATED DEBT<sup>85</sup>

The licensing procedures contain various requirements for subordinated debt issued by a national bank, including requirements for subordinated debt notes; the process for OCC approval of the issuance or prepayment of subordinated debt; and the requirements for national banks to be able to include subordinated debt in Tier 2

<sup>84</sup> See Final Licensing Procedures at 80429; 12 C.F.R. § 5.58.

<sup>85</sup> 12 C.F.R. §5.47.

capital. The Final Licensing Procedures make a number of revisions to these requirements. The Final Licensing Procedures:

- Explicitly require national banks to provide the disclosure in the subordinated debt note itself that “the obligation may be fully subordinated to interests held by the U.S. government in the event that the national bank enters into a receivership, insolvency, liquidation, or similar proceeding”, which echoes a requirement already in effect for advanced approaches banks.
- Provide explicit regulatory authority for banks’ practices of confirming with the OCC prior to issuance that subordinated debt will qualify as Tier 2 capital.
- Establish a single procedure for national banks to receive approval to prepay subordinated debt (as opposed to separate procedures for prepayment and prepayment in the form of a call option).
- Make explicit the requirement that a national bank obtain OCC approval before making a material change to a subordinated debt document if the bank would have needed approval to issue the subordinated debt in the first place or to include it in Tier 2 capital. In the preamble, the OCC notes that it “would consider a change to be material if it pertains to subjects covered by the OCC regulatory requirements at 12 C.F.R. 3.20 [the rules for capital components and eligibility criteria for regulatory capital instruments] and 12 C.F.R. 5.47 [the licensing procedures’ rules for subordinated debt], such as pricing and maturity, rights and obligations of the lender and borrowers, and required regulatory disclosures”.<sup>86</sup> The OCC also adds that purely technical and administrative changes are not considered to be material.

The Final Licensing Procedures made similar changes to the requirements for FSAs that address the inclusion of subordinated debt in Tier 2 capital<sup>87</sup>; specifically, the OCC adopted as proposed the disclosure requirement mentioned above and the streamlined procedure regarding the prepayment of subordinated debt.<sup>88</sup>

## **V. BOARD OF DIRECTORS<sup>89</sup>**

For national bank boards of directors, there are statutory requirements that require (i) every bank director to be a U.S. citizen and (ii) a majority of directors to either reside in the national bank’s State/Territory/District or reside within 100 miles of the bank’s office location. The OCC also has the statutory discretion to waive the citizenship requirement for up to a minority of directors and to waive the residency requirement. At present, the OCC’s waiver process is found in the *Comptroller’s Licensing Manual*. In a new section of the licensing procedures, the Final Licensing Procedures codify the waiver process and provide additional clarification. In brief:

- With respect to waiver of the residency requirement, a national bank can file an application with the OCC to request a waiver. The OCC may grant this for a designated number of the board’s directors (existing practice) or to specific individuals (something that the Final Licensing Procedures have added to increase flexibility).
- With respect to waiver of the citizenship requirement, a national bank can file an application with the OCC. The OCC notes that its practice is to grant these waivers on an individual basis rather than for a designated number of directors. The individual who is the subject of a citizenship waiver request must submit the

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<sup>86</sup> Final Licensing Procedures at 80427.

<sup>87</sup> 12 C.F.R. § 5.56.

<sup>88</sup> Final Licensing Procedures at 80429.

<sup>89</sup> 12 C.F.R. § 5.43 is a new section created by the Final Licensing Procedures.

information required by the Interagency Biographical and Financial Report (“IBFR”); however, the OCC can waive information requirements consistent with public interest.

- The Final Licensing Procedures also delineate the process under which the OCC can revoke a citizenship/residency waiver and the process for appealing such a waiver.

In the rule text, the OCC clarifies that waivers granted as of the Final Licensing Procedures’ January 1, 2021 effective date remain in force unless otherwise revoked.

## VI. TROUBLED CONDITION<sup>90</sup>

National banks and FSAs that are in “troubled condition” must notify the OCC of any additions to their boards of directors or to their ranks of senior executive officers. The current definition of “troubled condition” contains three disjunctive prongs that form the definition of “troubled condition”, and the Final Licensing Procedures clarify one of the prongs. Consistent with the OCC’s existing practice as well as with Federal Reserve Board regulations and Federal Deposit Insurance Corporation regulations, the Final Licensing Procedures clarify that a cease and desist order, a consent order, or a formal written agreement between the OCC and national bank/FSA must require the national bank/FSA to improve its financial condition in order to be considered “in troubled condition.” Other orders or agreements that do not include a financial condition improvement requirement will not, by themselves, place a national bank or FSA into the troubled condition category.

The Final Licensing Procedures also add the chief risk officer position to the list of senior executive officer positions that require notice to the OCC. This role has grown more prevalent in many organizations as a result of regulatory change in recent years, and the OCC has included this position in the notification process for “troubled banks” to reflect this development.

## VII. APPLICATIONS

Non-substantive Comments:<sup>91</sup> To better reflect OCC policy, the Final Licensing Procedures codify the OCC’s position that “non-substantive comments” on a filer’s proposal are not something that would prevent the OCC’s expedited review of an application from proceeding. A non-substantive comment is “a generalized opinion that a filing should or should not be approved or a conclusory statement, lacking factual or analytical support”.<sup>92</sup> Non-substantive comments join an existing list of enumerated factors that will not prevent expedited review, including, “Adverse comments that the OCC determines do not raise a significant supervisory, CRA [Community Reinvestment Act] (if applicable), or compliance concern, or a significant legal or policy issue, or are frivolous, filed primarily as a means of delaying action on the filing, or that raise a CRA concern that the OCC determines has been satisfactorily resolved”.<sup>93</sup>

<sup>90</sup> 12 C.F.R. §5.51.

<sup>91</sup> 12 C.F.R. § 5.13.

<sup>92</sup> 12 C.F.R. §5.13(a)(2)(ii) (as reflected in the Final Licensing Procedures).

<sup>93</sup> 12 C.F.R. §5.13(a)(2)(ii).



Prefiling Meetings:<sup>94</sup> The Final Licensing Procedures provide additional guidance as to when filers should approach the OCC for a prefiling meeting. The rule text explicitly states that a filer with a “novel, complex, or unique proposal” should contact the OCC early in a proposal’s development.

Nullification or Modification of Decisions:<sup>95</sup> The Final Licensing Procedures clarify that the OCC can nullify a decision on a filing before or after the consummation of a transaction. Nullification may be based on material representations or omissions in the filing materials or may occur if the OCC’s decision is contrary to law/regulation/policy or if the decision was granted by mistake. In comparison, the OCC can modify, suspend or rescind a decision on the basis of changes in facts and circumstances that occur *after* the OCC’s decision was made but before the consummation of a transaction.<sup>96</sup>

## VIII. COMMUNITY REINVESTMENT ACT AND BUSINESS COMBINATIONS<sup>97</sup>

The Final Licensing Procedures revise the OCC’s existing procedures for evaluating an insured national bank’s or an FSA’s Community Reinvestment Act (“CRA”) record:

- The Final Licensing Procedures clarify that in evaluating a business combination, the OCC will take into account the filer’s CRA performance record and that the OCC evaluates CRA performance in light of the application as a whole. The OCC explains in the preamble that this language better encapsulates the statutory requirements and the OCC’s process.
- In a change from existing practice, the Final Licensing Procedures require national banks or FSAs to disclose whether or not they have entered into and disclosed “a covered agreement”.<sup>98</sup> In the preamble, the OCC notes, “[r]equiring disclosure of any covered agreements will better permit the OCC to review the filer’s CRA record and any CRA-related comments on the filing”, but also adds, “a bank’s compliance with these agreements should not be a factor in the OCC’s decision on an application”, given regulators’ long-held position that CRA agreements are private agreements.<sup>99</sup>
- In addition, the Final Licensing Procedures require national banks and FSAs to include summaries of substantive conversations related to the development of covered agreements disclosed under the new requirement mentioned above. This information includes names of participants, dates, and a synopsis of what was discussed.
- As noted in the previous section, the current licensing rules contain a list of factors that will not prevent an application’s expedited review. These factors include a “satisfactorily resolved” CRA comment in cases where the OCC has previously reviewed a comment that is substantially the same. The Final Licensing Procedures expand the examples as to when a comment may have been “previously reviewed” to include “an examination, other supervisory activity, or a prior filing made by the current filer.”

<sup>94</sup> 12 C.F.R. § 5.4.

<sup>95</sup> 12 C.F.R. § 5.13.

<sup>96</sup> See Final Licensing Procedures at 80409.

<sup>97</sup> 12 C.F.R. § 5.33.

<sup>98</sup> As defined in 12 C.F.R. § 35.2 and in accordance with 12 C.F.R. §§ 35.6 and 35.7.

<sup>99</sup> Final Licensing Procedures at 80414.

## IX. BUSINESS COMBINATION PROCEDURES<sup>100</sup>

The Final Licensing Procedures provide national banks and FSAs with more flexibility when it comes to the procedures for certain types of business combinations. Under the Final Licensing Procedures, in addition to the option of following OCC procedures, national banks and FSAs that are involved in business combinations for which there are not statutory procedural requirements may choose to follow procedures promulgated by the State of the national bank's main office or the FSA's home office (*i.e.*, procedures that would apply to a State bank or State savings association). The filings related to these State requirements would be submitted to the OCC, unless otherwise specified. An election to use State law procedures could obviate the need to apply certain Federal law conditions that had been previously applied.

The Final Licensing Procedures also provide that, in certain circumstances and subject to certain conditions, shareholders of a national bank or Federal stock savings association do not need to vote to authorize a merger or consolidation. Conditions include the requirement that the national bank's articles of association or the Federal stock savings association's charter remain unchanged as well as various conditions related to the issuance of stock. This exception is similar to an existing exception applicable to FSAs.

## X. OTHER CLARIFICATIONS

The Final Licensing Procedures create new definitions and revise existing definitions in ways that should enhance clarity throughout the licensing procedures. Among other changes, the Final Licensing Procedures provide a single definition for each of "well managed" and "well capitalized" – standardizing the different versions currently found in the licensing procedures – and create new definitions for "nonconforming assets," "nonconforming activities," "previously approved activity," and more.

One technical change of note is that, for filings currently described as "notices" but that nevertheless require the OCC's prior approval, the term "notice" in general has been replaced with the term "application." The term "notice" continues to be used in connection with other kinds of filings (*e.g.*, filings that are merely informational and that do not require approval of the OCC).

In a further clarification, the OCC codifies its practice of collecting fingerprints from filers and other relevant individuals for background check purposes and highlights those situations in which it collects fingerprints.

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<sup>100</sup> 12 C.F.R. § 5.33.

## Contacts

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