02-029

CHAPTER 122 (Reg. 22)

SECURITIES ACTIVITIES OF SUBSIDIARIES OF FINANCIAL INSTITUTIONS

SUMMARY: Over the last several years, there have been many changes regarding the securities activities of financial institutions and their subsidiaries, service corporations, and affiliates. The Maine Banking Code grants authority to the Superintendent to authorize by regulation state-chartered financial institutions and service corporations to engage in activities authorized by federal law for institutions chartered or otherwise subject to the jurisdiction of the Federal Government. This regulation provides the framework for financial institutions to engage in certain securities activities either directly or through a service corporation or subsidiary in order to maintain competitive equality between federally-chartered and state-chartered institutions. This regulation is not intended to limit traditional securities activities and investment advisory services already offered by state-chartered financial institutions as expressly authorized under existing law. This includes the marketing of discount brokerage services as now conducted by financial institutions in Maine.

AUTHORITY

- Title 9-B M.R.S.A. Section 111 declares that it is a policy of the State to supervise financial institutions in a manner to assure their strength, stability and efficiency and encourage the development and expansion of financial services advantageous to the public welfare.
- Title 9-B M.R.S.A. Section 131(37) grants to the Superintendent the authority to allow by regulation a service corporation to engage in any activity which has been authorized under federal law for service corporations owned or controlled by federally-chartered savings and loan associations or federally-chartered savings banks.
- Title 9-B M.R.S.A. Section 416 grants to the Superintendent the authority to allow by regulation a financial institution to engage in any activity which has been authorized under federal law for financial institutions.

Chartered by or otherwise subject to the jurisdiction of the Federal Government.

The Federal Home Loan Bank Board (the "Board") by regulation has authorized service corporations of federally-chartered savings and loan associations and savings banks to engage, inter alia, in: (1) "providing liquidity, management, investment, advisory and consulting services" primarily for financial institutions (12 C.F.R. Section 545.74(c)(2)(vii)); (2) "interest rate futures transactions subject to the provisions of Section 563.17-4" (12 C.F.R. Section 545.74(c)(4)(vi)); and (3) "issuing notes, bonds, debentures, or other obligations or securities: (12 C.F.R. Section 545.74(c)(5)(iv)). The FHLBB regulations also allow service corporations to engage in activities "reasonably

incident" to those provided for in the regulations and "such other activities reasonably related to the activities of federal associations that the Board may approve" (12 C.F.R. Section 545.74(c) and (c)(6)). A 1982 resolution by the Board permitted several savings and loan associations to broker securities, as well as offer investment advice (Resolution No. 82-327 - May 6, 1982). In this resolution, the Board approved the application of Coastal Federal Savings and Loan Association, et.al., to form a service corporation (INVEST) which would "(1) execute purchases and sales or redemptions of debt and equity securities and shares in certain mutual funds on behalf of and for the account of others; and (2) provide investment advisory services to customers utilizing the services of a subscribing savings and loan association."

On August 23, 1982, the FDIC Board of Directors issued a Statement of Policy addressing the applicability of the Glass-Steagall Act to securities activities of subsidiaries of insured non-member banks. This statement concluded that the Glass-Steagall Act "does not prohibit an insured non-member bank from establishing an affiliate relationship with, or organizing or acquiring, a subsidiary corporation that engages in the business of issuing, underwriting, selling or distributing at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities."

On November 28, 1984, the Board of Directors of the FDIC issued a rule (12 C.F.R. Section 337.4) effective December 28, 1984, entitled "Securities Activities of Subsidiaries of Insured Nonmember Banks: Bank Transactions with Affiliated Securities Companies." This rule establishes guidelines for banks to affiliate with a securities company or acquire/establish a securities subsidiary. It also places restrictions on underwriting, limits trust department and lending activities with the securities company, sets investment limitations, and imposes notification requirements.

On September 2, 1983, the Comptroller of the Currency concluded that the Glass-Steagall Act did not preclude a national bank (member bank) from engaging in the business of providing investment advice or providing discount brokerage services, and that national banks were authorized to provide the stated services pursuant to the enabling legislation.

The cumulative effect of the federal statutes, opinions and regulations cited above is to permit federally authorized financial institutions, directly or through subsidiaries, to engage in offering discount brokerage services and investment advice. The federal law also permits the creation or acquisition of subsidiaries to provide the additional services described above.

PURPOSE

The purpose of this regulation is to grant the authority to and provide the regulatory framework for banks and savings and loan associations to engage in certain securities brokerage activities so as to:

- Bring about the greatest possible uniformity and encourage parity between federally-chartered and state-chartered financial institutions;
- Provide a wider variety of financial services to customers of state-chartered banks and savings and loan associations; and
- Assure uniformity in registration and reporting requirements among all participating financial institutions.

DEFINITIONS

For purposes of this regulation, the following terms have the following meanings:

- Control - The power to exercise a controlling influence over the management and policies of a company, as further defined in Title 9-B M.R.S.A. Section 1011(4).
- Discount Brokerage Services - Buying and selling securities, solely as agent, on the order and for the account of customers. Discount brokerage services do not include providing investment advice or buying or selling for the account of the financial institution, or the issuing, underwriting or distributing of securities or any public sale of securities which may be prohibited by §378(a)(1).
- Extension of Credit - The making or renewal of any loan, a draw upon a line of credit, or an extending of credit in any manner whatsoever and includes, but is not limited to:
    - A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;
    - An advance by means of an overdraft, cash item, or otherwise;
    - Issuance of a standby letter of credit (or other similar arrangement regardless of name or description);
    - An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;
    - A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;
    - An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (A) accrued interest or (B) taxes, insurance, or other expenses incidental to the existing indebtedness; or
    - Any other transaction as a result of which a natural person or company becomes obligated to pay money (or its equivalent to a bank, whether the obligation arises directly or indirectly, or because

of an endorsement on an obligation or otherwise, or by any means whatsoever.

- Investment Quality Debt Security - A marketable bond, note or debenture that is rated in the top four rating categories by a nationally recognized rating service which has the characteristics of such top-rated obligation.
- Investment Quality Equity Security - A marketable common stock or preferred corporate stock that is ranked or graded in the top four categories or equivalent categories by a nationally recognized rating service, or a marketable preferred corporate stock that has the characteristics of such a top-rated issue.
- Subsidiary - A service corporation authorized by and subject to the provisions of Title 9-B M.R.S.A. Section 445 and which may engage in activities pursuant to Title 9-B M.R.S.A. Section 131(37), or any other corporation controlled by a financial institution.
- Securities - The term "securities" as used in this rule shall be defined by Title 32 M.R.S.A.

PROVISIONS OF THE REGULATION

- Subject to the restrictions and limitations set forth in this regulation, financial institutions are hereby authorized, directly or through subsidiaries, to engage in the activities enumerated below:
    - Discount brokerage services;
    - Investment advisory services; and
    - Activities reasonably incident to those listed in 1 through 2 above, as determined by the Superintendent.
- Subject to the restrictions and limitations set forth in this regulation, financial institutions are authorized to engage in the activities enumerated below, solely through subsidiaries:
    - Providing liquidity, management, investment, advisory and consulting services for financial institutions;
    - Conducting interest rate futures transactions, subject to the provisions of 12 C.F.R. § 563.17-4 and the Statement of Policy issued by the Federal Deposit Insurance Corporation, where applicable;
    - Issuing notes, bonds, debentures, or other obligations or securities, except those of the financial institution; and
    - Engaging in activities reasonably incident to those listed in 1 through 3 above, as determined by the Superintendent.

RESTRICTIONS AND LIMITATIONS

- Prior written approval of the Superintendent is required for a financial institution or a subsidiary thereof to engage in, or invest in a company

engaged in, each activity which can be permitted pursuant to this regulation. An application for prior approval shall include, but not be limited to, discussion of the general business plan, initial capital needs, and the prospective risks involved in the proposed activity.

The restrictions and limitations contained in this regulation are based on the assumption that both IV.A. and IV.B. activities will be generally conducted by subsidiaries of financial institutions. If a financial institution seeks to directly engage in activities permitted by Section IV.A. of this regulation, the restrictions and limitations set forth in Section V will apply, to the fullest extent possible, notwithstanding the use of the word "subsidiary" in subsection V(2).

In addition to satisfying the decision-making criteria found in Title 9-B M.R.S.A. Section 252, any application that provides for the conduct of the activities enumerated in Section IV.A. directly by a financial institution rather than a subsidiary thereof, shall bear a heavy burden in demonstrating that such activities: (1) do not raise unnecessary risks to the financial institution or its customers; (2) are conducted in accordance with the restrictions and limitations set forth in this regulation to the fullest extent possible; (3) avoid all problems of conflict of interest, breach of fiduciary duty and the appearance of impropriety.

- Whenever a subsidiary is formed or acquired to engage in a permitted activity, the subsidiary shall be a separate corporation from the financial institution(s) controlling it and shall comply with all related securities laws.
    - The facilities utilized in providing the activities enumerated in Section IV of this regulation must be distinctly separated from those of the financial institution;
    - The subsidiary must maintain separate accounting and other corporate records.
    - The subsidiary may not share any common officers with the financial institution and must maintain a separate board of directors, the majority of whom are neither directors nor officers of the financial institution;
    - Any advertising or promotional activity must make clear that the subsidiary and not the financial institution, is offering brokerage services, and the customer shall acknowledge in writing that he or she understands this fact;
    - Individuals acting as dual employees of the financial institution and subsidiary shall be prohibited from receiving any transaction-related compensation that is directly derived from the securities activities; and

- Recognizing the risks inherent in securities activities, the aggregate investment in subsidiaries engaging in activities pursuant to this regulation shall not exceed 20% of the institution's total capital and reserves or surplus account without the express permission of the Superintendent. Also, these investments shall be included in determining compliance with the aggregate limitations prescribed in Title 9-B M.R.S.a. Section 445 and 446.

- **Underwriting**
  - A subsidiary that engages in brokerage services pursuant to subsection IV.B. of this regulation may only underwrite the following:
    - Investment quality debt securities;
    - Investment quality equity securities; and
    - Investment companies with not more than 25% of its investments consisting of other than: i) investment quality debt securities; ii) investment quality equity securities; iii) obligations of the United State Government and Agencies, including repurchase agreements of such obligations; and iv) other similar investments normally associated with a money market fund.
  - Paragraph A. of this section notwithstanding, a subsidiary of a financial institution may engage in underwriting activities other than as limited thereby provided that the following conditions are met:
    - The subsidiary is a member in good standing of the National Association of Securities Dealers ("NASD");
    - The subsidiary has been in continuous operation for the five year period preceding notice to the year period preceding notice to the Bureau of Banking as required by this rule;
    - No director, officer, general partner, employee or 10% shareholder of any class of voting securities of the subsidiary has been convicted, within five years of the notice required by this rule, of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of a false filing with the Securities and Exchange Commission or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment advisor;
    - Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10% shareholders of any class of voting securities of the subsidiary is or has been subject to any state or federal administrative order or court order, judgment, or decree entered, within five years of the

notice required by this rule, temporarily or preliminarily enjoining or restraining such person or the subsidiary from engaging in, or continuing, any conduct or practice in connection with the purchase or sale of any security involving the making of a false filing with the SecuritNovember 8, 2018 business of an underwriter, broker, dealer, municipal securities dealer, or investment advisor;

- None of the subsidiary's directors, officers, general partners, employees, or 10% shareholders of any class of voting securities of the subsidiary are or have been subject to an order entered, within five years of the notice required by this rule, of the Securities and Exchange Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 780, 780-4) or section 203(c) of (f) of the Investment Advisor Act of 1940 (15 U.S.C. 80b-3(c), and (f)); and
- All officers of the subsidiary who have supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.

- **Extensions of Credit**

  A financial institution which has a subsidiary that engages in brokerage services pursuant to this regulation shall not:

  - Extend credit to any investment company whose securities are currently underwritten or distributed by its subsidiary, unless such securities qualify as investment quality debt securities or investment quality equity securities;
  - Extend credit where the purpose is to acquire any security issued or currently underwritten or distributed by its subsidiary, or issued by an investment company advised by the subsidiary, unless the credit extensions are to employees of the subsidiary for acquiring shares through an adopted employee stock bonus or stock purchase plan;
  - Condition any extension of credit to any company on the requirement that the company contract with the financial institution's subsidiary to underwrite or distribute the company's securities; and
  - Condition any extension of credit to any person on the requirement that that person purchase any security currently underwritten or distributed by its subsidiary.

- **Trust Department**

A financial institution which has a subsidiary that engages in brokerage service pursuant to this regulation shall not:

- Transact business through its trust department with its subsidiary unless such transactions are conducted on a basis at least comparable with transactions between the trust department and a securities company that is not a subsidiary of the financial institution; and
- Purchase as fiduciary or co-fiduciary any security currently distributed, underwritten, or issued by its subsidiary or any investment company advised by such subsidiary, unless the purchase is: i) expressly authorized by the trust instrument, court order, local law, or specific authority is obtained from all interested parties after full disclosure; ii) otherwise consistent with the financial institution's fiduciary obligation; or iii) permissible under applicable federal and/or state statute or regulation.

- **Federal Regulations**

  It is recognized that the Federal Home Loan Bank Board, through the Federal Savings and Loan Insurance Corporation and the Federal Deposit Insurance Corporation, have promulgated regulations controlling the manner in which they will permit financial institutions they insure to engage in securities activities. It is further recognized that there may exist differences in scope and coverage between this regulation and those promulgated by the said federal insuring agencies. It is not the intent of this regulation to permit any practice which is not permitted by the appropriate federal agency. To the contrary, besides any other restriction or limitation stated herein, each financial institution must comply with the regulations of the applicable federal insuring agency.

BASIS STATEMENT: Over the last several years, the Federal Home Loan Bank Board, through the Federal Savings and Loan Insurance Corporation as well as the Federal Deposit Insurance Corporation, have promulgated regulations allowing financial institutions they insure to engage in securities activities pursuant to certain restrictions and limitations. The Maine Banking Code grants authority to the Superintendent of the Bureau of Banking (Superintendent) to authorize, by regulation, state-chartered financial institutions and service corporations to engage in activities authorized by federal law for institutions chartered by or otherwise subject to the jurisdiction of the federal government. It is the policy of this State to supervise financial institutions in a manner which will insure their strength, stability and efficiency, while at the same time, encouraging the expansion of the financial services they offer to the public. In order to effectuate this policy, the Superintendent, on or about December 19, 1984, promulgated Chapter 122 (Reg. 22). Chapter 122 permits subsidiaries of financial institutions to engage in securities activities subject to certain stated restrictions and limitations.

These regulations are intended to expand the powers of state-chartered financial institutions. They are not intended to limit traditional securities activities and investment advisory services presently offered by such institutions.

Pursuant to the provisions of Maine's Administrative Procedure Act, a draft of Chapter 122 (Reg. 22) was promulgated by the Superintendent on or about December 19, 1984 and comment thereupon were solicited for a period extending until February 4, 1985. The only comment received during the comment period was a letter dated February 1, 1985 and signed by Michael T. Healy, Esq. Mr. Healy's comments will be discussed below in the order set forth in his letter.

- Summary. Mr. Healy requested that the SUMMARY of Chapter 122 include a statement that this regulation is not intended to limit traditional securities activities and investment advisory services already offered by state-chartered financial institutions. The SUMMARY of Chapter 122 (Reg. 22) has been revised to incorporate language addressing Mr. Healy's comment.
- Section III - Definitions. Mr. Healy suggested that the definition of "extension of credit" set forth in Section III of the draft regulations was not sufficiently inclusive since this definition was not co-extensive with the definition of the same term contained in the FDIC regulation on securities activities, 12 C.F.R. sec. 3374.(a)(5). The definition of extension of credit in Chapter 122 has been revised to be identical to that set forth in 12 C.F.R. sec. 3374.(a)(5).
- Section IV. Mr. Healy suggested that the five subcategories of Section IV of Chapter 122 be rearranged in a six category arrangement wherein securities brokerage services and investment advisory services were listed separately. This change has been accomplished in Section IV.A. of the revised regulations. In addition, Section IV of Chapter 122 has been amended to address comment no. 6 in Mr. Healy's letter of February 1, 1985. Mr. Healy's comment no. 6 was that section 225.22(d)(2) of the Bank Holding Company Act Regulations (Reg. Y) only permitted state-chartered banks to enter the securities business through subsidiaries if the parent bank is permitted to engage in those activities directly. Mr. Healy, therefore, suggested that Section IV be amended to permit financial institutions directly to engage in the activities enumerated below.

  For purposes of conformance with section 225.22(d)(2), Section IV has been revised to permit financial institutions directly to engage in the activities enumerated in Section IV.A., these being the only activities permitted by federal law absent a subsidiary. Section IV.B. has been added to permit financial institutions to engage in certain other activities through subsidiaries. Any application submitted by a financial institution

to directly engage in Section IV.A. securities activities must bear a heavy burden in demonstrating that such activities do not raise unnecessary risks to the financial institution or its customers and are conducted in accordance with the safeguards set forth in the regulation.

- Section IV - General. Mr. Healy suggested that the proposed restrictions set forth in the draft under "General (1)-(6)" are too restrictive when applied to securities activities which the bank itself could not conduct. Mr. Healy cites, by way of example of such activities, the activities permitted by 12 U.S.C. Section 24 as well as the approval by the Comptroller of Currency of an application by a national bank to establish a subsidiary to provide "canned" investment advice. As noted above at "1". SUMMARY, the SUMMARY has been revised to make explicit that nothing in these regulations is intended to limit traditional securities activities or investment advisory services presently offered by state-chartered financial institutions.

  Mr. Healy also suggested some specific comments to the restrictions listed under Section V "General (1) to (6)". We need not further address those comments because, as Mr. Healy correctly noted, the restrictions listed at "General (1) to (6)" closely follow the FDIC final regulation governing bank securities activities (49 Fed. Reg. 230 Nov. 28, 1984) and are, therefore, required whether or not they are in this regulation. We would expect that any definitional questions regarding, for example, what constitutes "distinctly separated facilities", one of the above-referenced restrictions, would follow the interpretation of the federal regulations.

- Section V - Underwriting. This section which, in essence, constitutes an additional restriction or limitation on conducting securities activities, has been renumbered under the Restriction and Limitations Section. In addition, in response to Mr. Healy's comments, the list of permissible underwriting activities has been expanded to become co-extensive with those permitted pursuant to 12 C.F.R. section 337.4(b)(2)(i) to (vi).

  Besides the above changes, the only other changes to Chapter 122 (Reg. 22) have been stylistic and grammatical and have affected no substantive modification. Even with regard to the above changes, since they do not, individually, or cumulatively, substantially alter the scope or impact of Chapter 122 (Reg. 22) the Superintendent sees no need for an additional comment period.

AUTHORITY: Title 9-B M.R.S.A. Sections 11, 131(37) and 416

EFFECTIVE DATE: June 18, 1985