

Summary of the Repeal of Existing 3 NYCRR Part 14 and Proposed New 3 NYCRR Part 14 of the General Regulations of the Superintendent (Investments in Operating Subsidiaries and Other Entities)

The Department of Financial Services (“Department”) provides this description of the subject, purpose, and substance of the new version of 3 NYCRR Part 14 proposed by the Department. The full text of the new rule is available at: https://www.dfs.ny.gov/industry_guidance/regulatory_activity/banking under the caption “Proposed Regulations.”

Section 97(4-a) of the New York Banking Law (“BL”) authorizes the Superintendent to adopt regulations to permit banks and trust companies to own or make investments in the stock and other equity of subsidiaries engaged in the transaction of any business in which a bank or trust company may engage directly (defined as “operating subsidiaries,” in the regulation) and to invest in corporations organized pursuant to section 25(a) of the Federal Reserve Act (“Edge Act subsidiaries”). Banks and trust companies may also make investments in the capital stock or other equity interests of other entities if specifically authorized by the Superintendent pursuant to BL section 97(5). Part 14 implements the Superintendent’s authority to authorize investments in operating subsidiaries and Edge Act subsidiaries pursuant to BL section 97(4-a) and to establish the procedures to make applications to invest in the capital stock or other equity interests of other entities pursuant to BL section 97(5).

The following is a summary of the most notable changes from the previous regulation:

a. The following entities are proposed to be excluded from the definition of operating subsidiary for purposes of Part 14 and will not be subject to filings with the Department under Section 14.2 or 14.3 of Part 14. This approach aligns with BL section 97.4-a, current Part 14, and treatment of national banks’ operating subsidiaries.

- i. A subsidiary in which the bank has acquired, in good faith, shares through foreclosure on collateral, by way of compromise of a doubtful claim, or to avoid a loss in connection with a debt previously contracted;
- ii. A trust formed for purposes of securitizing assets held by the bank as part of its banking business and any affiliated entity formed to issue related debt securities or hold the bank's residual interest in the securitization trust;
- iii. A subsidiary formed to hold investments in community development entities or projects that have been approved by the Superintendent (or, if applicable, were self-certified by the bank) pursuant to Section 6.5 of Part 6 of the General Regulations of the Superintendent; and
- iv. A subsidiary formed to own or operate real or personal property for use as bank premises.

For purposes of the proposed Part 14 the term "bank" is defined as a New York state-chartered bank, as defined in BL section 2(1), a New York state-chartered trust company, as defined in BL section 2(2), and a branch or agency of a foreign bank licensed under BL section 201-a.

b. Additional investments in previously approved operating subsidiaries or operating subsidiaries previously reported in a filing under Part 14 would not be notified to the Department. (Section 14.2(c)(1)). A similar approach is taken with respect to additional investments in certain entities other than operating subsidiaries. (Section 14.3(b)).

c. No prior or after-the-fact notice would be required for a well-managed and well-capitalized bank setting up an operating subsidiary that would engage only in activities that the bank has previously reported to the Department in a prior operating subsidiary. (Section 14.2(c)(2)).

d. Only after-the-fact notice would be required for a well-managed and well-capitalized bank setting up an operating subsidiary that would only engage in activities substantively the same as "previously approved

activities.” In proposed Part 14, “previously approved activities” are listed in Section 14.2(b)(2) and for future changes in approved activities, proposed Part 14 would allow the Superintendent to expand “previously approved activities” by updating a list of activities on the Department’s website and notifying regulated entities about the update. (Section 14.1(b)(4)). The Department will not amend the list of approved activities without proposing a formal amendment to Part 14.

To qualify for after-the-fact notice filings, well managed and well capitalized banks would no longer be required to be free of current enforcement orders; instead well managed and well capitalized banks would be required to receive a management rating of 1 or 2 (or risk management rating of 1 or 2 in the case of branches and agencies of foreign banks) as well as a composite rating of 1 or 2 to take advantage of after-the-fact notices. Current Part 14 only looks to the composite rating. In proposing this change, the Department found that a serious enforcement problem would already be reflected in the management and composite ratings, whereas an existence of old enforcement orders may not reflect the current state of the institution. In the Department’s view, the proposed approach strikes the desired supervisory balance.

e. The proposed regulation creates a new Section 14.4 specifically to address tax equity financing (“TEF”). The new Section 14.4 defines tax equity finance transaction as a transaction in which a bank provides equity financing to fund a project or projects that generate(s) tax credits or other tax benefits, and the use of an equity-based structure allows the transfer of those credits and other tax benefits to the bank. TEFs take the form of equity investments for tax purposes but are substantively loans to the facilities.

The Department has not previously adopted regulations specifically addressing TEF. To minimize regulatory burdens, establish clear expectations, and to maintain competitiveness of state-chartered and licensed entities, the Department’s practice has been to follow the parameters codified in the regulations adopted by the Office of the Comptroller of the Currency (the “OCC”) at 12 C.F.R. § 7.1025 in considering applications by the

Department's regulatees to engage in TEF. Section 14.4 of the proposed regulations codifies the Department's existing practices.

f. The proposed regulation also codifies two guidance letters issued by the New York State Banking Department, predecessor of the Department. The Guidance Letter dated June 4, 2001 (Foreign Branches and Agencies Establishing Operating Subsidiaries) states that Part 14 applies to operating subsidiaries of licensed New York branches and agencies of foreign banks. The Guidance Letter dated June 16, 2003 (Clarification of Part 14 Notification and Filings), clarifies that Part 14 applies to investments in various legal persons, such as limited liability companies and business trusts, among others, and not just to subsidiaries organized as corporations.

Section 14.1 sets forth the purpose of the new regulation and provides a list of definitions.

Section 14.2 establishes prior approval and after-the-fact notice procedures for banks seeking to establish or acquire an operating subsidiary or Edge Act subsidiary.

Section 14.2(b)(4) provides a list of 33 activities that qualify for after-the-fact notice procedure. The list of 33 activities is based on the current Part 14 and incorporates additional activities from the OCC's current list of approved activities. The proposed regulations provide that once the Superintendent has authorized a previously approved activity and published that activity on the Department's website, the Superintendent will not remove that particular activity from the authorized list or make substantial changes to the content or description of that activity, except through public notice with the opportunity to comment.

Section 14.2(c) provides that a bank making an additional investment of the book value no more than 1% of the bank's capital and surplus in an operating subsidiary previously approved by the Superintendent or reported to the Superintendent by the bank in a filing under Part 14 is not required to seek prior approval of such additional investment or provide after-the-fact notice of such additional investment, provided there is no change in the activities of the operating subsidiary. A well-capitalized and well-managed bank may acquire or establish

a new operating subsidiary, make an additional investment of the book value no more than 1% of the bank's capital and surplus in such an operating subsidiary, or perform a new activity in an existing operating subsidiary without prior approval or after-the-fact notice if it meets the enumerated requirements.

Section 14.3 provides that a bank making equity investments in entities other than operating subsidiaries and Edge Act subsidiaries is required to submit a written notice to the Superintendent no later than 10 days after making the investment if the bank can make the representations and the certifications required by the section. A bank is required to seek the Superintendent's approval or a waiver if it is unable to make some of the required representations or the certifications in Section 14.3(a)(1). A bank making additional investments in an entity already approved by the Superintendent in a prior application is not required to seek a prior approval of such additional investment or provide after-the-fact notice of such investment provided the additional investment's book value does not exceed 1% of the bank's capital and surplus and the bank can meet the enumerated requirements. This section codifies the Department's established practice and closely tracks the same requirements imposed on national banks for non-controlling investments.

Section 14.4 adopts new provisions covering tax equity financings ("TEF"). The new Section 14.4 defines tax equity finance transaction as a transaction in which a bank provides equity financing to fund a project or projects that generate(s) tax credits or other tax benefits, and the use of an equity-based structure allows the transfer of those credits and other tax benefits to the bank. TEFs take the form of equity investments for tax purposes but are substantively loans to the facilities. If a financing qualifies under the terms of Section 14.4, then a prior approval under Part 14 is required only for the first transaction of a particular type done by a bank. Subsequent transactions of a similar type will only need to be notified to the Department. Section 14.4 (b) defines terms only applicable to tax equity financings and not to other parts of the proposed regulation.

Section 14.5 outlines the informational requirements for prior review applications and most after-the-fact notices.