STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
P.O. Box 41200 · Olympia, Washington 98504-1200

ISGC – 2005 – 001 – DOB

March 9, 2005

Federal Deposit Insurance Corporation
25 Ecker Street, Suite 2300
San Francisco, CA 94105

And To:

RE: – Exercise of Custodial Powers – Report of Examination dated .

SUBJECT: "Federal Parity" for Washington State-Chartered Commercial Bank (RCW Title 30) with Powers Conferred Upon a Federally Chartered Bank — Title 30, Chapter 4, Section 215, Subsection 3 of Revised Code of Washington [RCW § 30.04.215(3)]

Dear :

Bank has requested, by and through its above-referenced legal counsel, that the Division of Banks of the Washington State Department of Financial Institutions ("DFI") opine on whether it may invoke "federal parity" with the powers conferred upon federally chartered banks to continue its exercise of certain custodial powers referenced in the Report of Examination dated issued by the Division of Supervision of the Federal Deposit Insurance Corporation (hereinafter, "FDIC").

David Kroeger, Director of the Division of Banks, has delegated this matter to me for response in my capacity as DFI Legal Counsel.

The custodial powers in question involve the authority of a national bank, without trust powers, to (1) act as a custodian within a self-directed IRA plan at the direction of its customer to purchase and sell non-traditional assets; and (2) act as custodian to hold stocks, securities and other property in its own name as nominee for the benefit of its customers so long as it does not exercise investment discretion over such assets (hereinafter, "Relevant Custodial Powers").

Barring any unforeseen conditions of and circumstances related to the institution, we conclude that Foundation Bank may invoke the powers and authorities of a national bank in the manner and to the extent set forth in this letter. However, when invoking certain powers and authorities of a national bank, Foundation Bank must rely upon the provisions of RCW § 30.04.215(3).

This is the first time that we have been called to formally interpret RCW § 30.04.215(3) since its recent amendment (Washington State Statutes, 2003, c. 24, §2). Accordingly, we take this opportunity to set forth the position of the DFI as to how a Washington-chartered commercial bank (hereinafter, "Title 30 Bank"), including Bank, may exercise certain powers and authorities of a national bank, including the exercise of the Relevant Custodial Powers outlined by Esq., counsel for Bank, in his letter to the FDIC, dated January 29, 2004.

<u>The Amended Federal Parity Statute — RCW § 30.04.215(3)</u>

<u>Controlling Statute</u>. RCW § 30.04.215(3), as amended and effective as of July 27, 2003, declares as follows:

> (3) ***Notwithstanding any restrictions, limitations, and requirements of law, in addition to all powers, express or implied, that a bank or trust company has under the laws of this state, a bank or trust company shall have the powers and authorities conferred as of August 31, 1994, or a subsequent date not later than July 27, 2003, upon a federally chartered bank doing business in this state***. A bank or trust company may exercise the powers and authorities conferred on a federally chartered bank after July 27, 2003, only if the director finds that the exercise of such powers and authorities:
>
> (a) Serves the convenience and advantage of depositors, borrowers, or the general public; and

> (b) Maintains the fairness of competition and parity between state-chartered banks or trust companies and federally chartered banks.
>
> ***As used in this section, "powers and authorities" include without limitation powers and authorities in*** corporate governance and ***operational matters***.
>
> ***The restrictions, limitations, and requirements applicable to specific powers or authorities of federally chartered banks shall apply to banks or trust companies exercising those powers or authorities permitted under this subsection but only insofar as the restrictions, limitations, and requirements relate to exercising the powers or authorities granted banks or trust companies solely under this subsection.***

[Emphasis added.]

General Interpretation. The DFI's general interpretation of RCW § 30.04.215(3) is that a Washington State Title 30 Bank, in spite of any other restrictions, limitations and requirements of state law to the contrary (and in addition to all powers, express or implied, conferred upon a Title 30 Bank under state law), may, *without prior approval from the Division of Banks*, exercise all the powers and authorities of a federally chartered bank in existence under federal law and regulation as of July 27, 2003.

"Grandfather" Date and "Date Down" to Time of Amendment. One question that has arisen concerns the legislative intent inherent in the following excerpted language of RCW § 30.04.215(3):

> " . . . bank or trust company shall have the powers and authorities conferred ***as of August 31, 1994, or a subsequent date not later than July 27, 2003***, upon a federally chartered bank doing business in this state . . . ."

[Emphasis added.]

August 31, 1994 is the effective date upon which so-called "parity" with federally chartered banks was first granted to Washington State Title 30 Banks. [See Washington State Statutes, 1994, c. 256, § 37, and 1994, c. 92, § 20.] This feature in Washington State law was timed to coincide with the enactment, at the federal level, of the Riegle-Neal Interstate Banking & Branching Act of 1994. [Pub. L. No. 103-328, 108 Stat. 238 (1994).] At that time, "federal parity" for Title 30 Banks was limited solely to federal

law and regulation (and federal agency interpretation thereof) in effect as of August 31, 1994.

Prior to July 27, 2003, in order for a Title 30 Bank, including [redacted] Bank, to exercise the powers and authorities of any federal law or regulation that came into effect after August 31, 1994, a Title 30 Bank would have to apply to and receive a finding from the Division of Banks that the exercise of such powers and authorities (1) served the convenience and advantage of depositors, borrowers, or the general public, and (2) maintained the fairness of competition and parity between state-chartered banks and federally chartered banks.

After July 27, 2003, a Washington State Title 30 Bank *automatically*, without approval of the Division of Banks, may elect to exercise the powers and authorities that a federally chartered bank had as of July 27, 2003, pursuant to applicable federal law and regulation (and federal agency interpretations thereof).

It is important, here, to explain the statutory intent implicit in the sentence construction of the above-referenced excerpt of RCW § 30.04.215(3). The Washington State Legislature arguably lacks the authority to confer upon state-chartered institutions the powers and authorities that the U.S. Congress, after the enactment of state law, may later confer upon federally chartered institutions. Accordingly, the Washington State Legislature amended RCW 30.04.215(3) in 1994 to read *only* as follows:

> ". . . bank or trust company shall have the powers and authorities conferred ***as of August 31, 1994,*** upon a federally chartered bank doing business in this state . . ."

[Emphasis added.]

It was then only in 2003 that the July 27, 2003 "date down" clause was added, reflecting the effective date of the statutory amendment, as follows:

> ". . . bank or trust company shall have the powers and authorities conferred as of August 31, 1994, ***or a subsequent date not later than July 27, 2003***, upon a federally chartered bank doing business in this state . . . ."

[Emphasis added.]

Seen in historical context, then, the intent of the above-referenced excerpt of RCW 30.04.215(3) becomes obvious.

<u>"Powers and Authorities" Defined</u>. Pursuant to § RCW 30.04.215(3) —

> *". . . , **'powers and authorities' include without limitation powers and authorities in*** corporate governance and ***operational matters***."

[Emphasis added.]

Based upon the breadth of the definition above, the exercise by ████ Bank of the Relevant Custodial Powers referenced in the Report of Examination dated ████ issued by the Division of Supervision of the FDIC, is within the coverage contemplated by the Washington State Legislature pursuant to § RCW 30.04.215(3).

<u>The Implications of the Amended Federal Parity Statute for ████ Bank</u>

████ Bank seeks to invoke "federal parity" pursuant to RCW § 30.04.215(3) in order to gain acceptance of the Relevant Custodial Powers to which the FDIC has taken exception in its most recent examination.

In strict terms and by admission of ████ Bank's own legal counsel, Peter Mucklestone (see letter dated January 29, 2004, at Pages 4-5) —

> "the power of a national bank not exercising trust powers to act as a custodian was addressed in ***1996, when the Office of the Comptroller of the Currency (the 'OCC') revised 12 C.F.R. 9 ('Rule 9') in its entirety.*** In revised Rule 9, the definition of 'fiduciary capacity' was amended . . . .
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> . . .
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> "Thus, under revised Rule 9, the definition of 'fiduciary capacity' turns on whether the national bank possesses investment discretion on behalf of another. In the Notice of Proposed Rulemaking dated ***December 21, 1995***, 60 FR 66163, the OCC explained its approach . . . ."

[Emphasis added.]

Thus, the type of custodial powers, which ████ Bank seeks to invoke by reason of "federal parity," were not even proposed until *after* August 31, 1994 — the effective date of first enactment of the "federal parity" provision of RCW § 30.04.215(3). Moreover, the type of custodial powers sought by ████ Bank pursuant to federal law and regulation were not adopted as a final rule by the OCC until 1996.

It appears to the Division of Banks, then, that for the relevant period of examination evidenced by the Report of Examination dated September 15, 2003 (hereinafter, "Relevant Examination Period"), [redacted] Bank was engaged in the exercise of the Relevant Custodial Powers, which were only permissible under *federal* law and regulation and, absent the proper invocation of "federal parity," not otherwise permitted under governing Washington State law (RCW § 30.08.140).

Under a correct interpretation of the "federal parity" statute [RCW § 30.04.215(3)] set forth above, [redacted] Bank did not have *automatic* authority during the Relevant Examination Period to exercise the Relevant Custodial Powers.

Such exercise of custodial power only became permissible, without a *prior* finding (approval) from the Division of Banks, *after* July 27, 2003, which was a date subsequent to the Relevant Examination Period.

Therefore, while we conclude that [redacted] Bank's conduct in question became permissible *after* July 27, 2003, [redacted] Bank did not obtain the requisite finding of permissibility from the Division of Banks pursuant to "federal parity" for all or most of the Relevant Examination Period.

Just how long the exercise of the Relevant Custodial Powers was taking place at [redacted] Bank prior to July 27, 2003 − the effective date of "grandfathering" of "OCC's Rule 9" within the powers and authorities conferred by RCW § 30.04.215(3) − is uncertain. However, it seems only to have been an exception identified in the most recent Examination Report covering the Relevant Examination Period. Therefore, the Division of Banks can only consider the conduct in question *as if* it had occurred only during the Relevant Examination Period (i.e., a period beginning [redacted], and ending [redacted]).

Normally, the Division of Banks would be obliged, prior to permitting the exercise of the Relevant Custodial Powers by [redacted] Bank, to make a finding that such power and authority (1) serves the convenience and advantage of depositors, borrowers, or the general public, and (2) maintains the fairness of competition and parity between state-chartered banks and federally chartered banks. Moreover, given the *sensitive nature of fiduciary obligations* sought to be exercised by [redacted] Bank without also applying to the Division of Banks for trust powers, we would likely have insisted on a review of the activity in question before making a finding that the conduct (1) served the convenience and advantage of depositors, borrowers, or the general public, and (2) maintained the fairness of competition and parity between state-chartered banks and federally chartered banks.

Unfortunately, at this juncture, all Washington State Title 30 Banks now may exercise the Relevant Custodial Powers without obtaining prior permission from the Division of Banks.

Given the short duration of known conduct and the ability to now exercise the Relevant Custodial Powers automatically, the Division of Banks has determined that it will *not* take exception to the exercise of such custodial power during the Relevant Examination Period (or even earlier) without a prior finding (approval) of the Division of Banks. Secondly, the Division of Banks will treat the exercise of the Relevant Custodial Powers during the Relevant Examination Period (and earlier, if applicable) *as if* the Division of Banks had earlier made a finding that the conduct (1) served the convenience and advantage of depositors, borrowers, or the general public, and (2) maintained the fairness of competition and parity between state-chartered banks and federally chartered banks.

Accordingly, the Division of Banks certifies that the exercise of the Relevant Custodial Powers, both now and during the Relevant Examination Period, is permissible by reason of the exercise of "federal parity" pursuant to RCW § 30.04.215(3).

Concluding Remarks

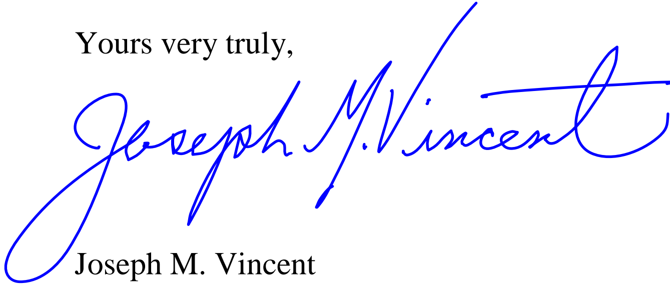
Notwithstanding the practical decision, in this instance, to treat the exercise of the Relevant Custodial Powers prior to July 27, 2003 as permissible, the Division of Banks has not endorsed nor granted permission for the same or similar conduct to be deemed permissible by any other Washington State Title 30 Bank. Moreover, our opinion contained herein is not an endorsement of the practice of ignoring the requirement of seeking the prior approval or finding of the Division of Banks where it is so clearly required, in the applicable instance noted above, before proceeding to exercise powers and authority only permissible under "federal parity" pursuant to RCW § 30.04.215(3).

We have taken this opportunity to correctly interpret the meaning of RCW § 30.04.215(3), particularly with respect to the issue of statutory construction regarding (1) the "grandfather" date when "federal parity" was first introduced into the statute and (2) the subsequent "date down" amendment. Indeed, similar statutory language and construction is recurring elsewhere in RCW Title 30 and also with respect to savings banks (RCW Title 32) and credit unions (RCW Chapter 31.12). So, to that extent, this opinion may have general applicability in the interpretation of other similarly worded statutes in RCW Title 30, RCW Title 32 and RCW Chapter 31.12.

However, as to our practical decision to overlook, in this instance, the failure of [redacted] Bank to seek the prior permission of the Division of Banks, for the Relevant Examination Period, before exercising the Relevant Custodial Powers, this opinion letter is limited to the unique facts presented, and is *not* an indication of how the Division of Banks would interpret the law or decide the same or even a different issue in another case or context involving the same or another of the financial institutions regulated by the Division of Banks.

If you have any further questions, please do not hesitate to call upon me at either (360) 902-8700 or (206) 956-3229.

Yours very truly,



Joseph M. Vincent
DFI Legal Counsel

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