

September 22, 2004

TO: The Board of Directors

FROM: Michael J. Zamorski
Director, Division of Supervision and Consumer Protection

SUBJECT: Final Rule Amending Part 335
to Require Electronic Filing of Beneficial Ownership Reports

SUMMARY

The Division of Supervision and Consumer Protection recommends that the Board of Directors approve the above-captioned final rule, which finalizes without amendment the interim final rule which was published on April 12, 2004, and became effective on June 11, 2004. The final rule will be effective upon publication in the Federal Register.

Section 16 of the Securities Exchange Act of 1934 (Exchange Act), as applied to state nonmember banks by Section 12(1) of the Exchange Act, requires directors, executive officers, and principal shareholders of state nonmember banks with registered equity securities (registered state nonmember banks) to file certain reports regarding their beneficial ownership of securities with the FDIC. Prior to the effective date of the interim final rule, electronic filing of these reports was prohibited by Section 335.801 of the FDIC's rules. Section 403 of the Sarbanes-Oxley Act of 2002 amended Section 16 to mandate electronic filing of certain of the beneficial ownership reports. The SEC's rules implementing the Sarbanes-Oxley Act requirements required that all three types of beneficial ownership reports be filed electronically. The FDIC's interim final rule amended Part 335 to implement the mandated electronic filing requirements for registered state nonmember banks. Consistent with SEC rules, the interim final rule contains provisions for a "continuing hardship exemption" to allow paper filing by a person who cannot file electronically, in a timely manner, without undue burden or expense. An electronic filer can request an adjustment of the filing date where a filing is delayed due to technical difficulties beyond the filer's control. The final rule will carry these provisions forward.

On July 30, 2003, the FDIC instituted the electronic Beneficial Ownership Filings system, which also is serving to host the other Federal banking agencies' beneficial ownership report filings. On July 28, 2003, the FDIC issued guidance notifying registered state nonmember banks that the new system was about to become operational and that although filing under the new system would be voluntary initially, use of the electronic filing system was encouraged when it became available.

Reviewed by:

William F. Kroener, III
General Counsel

The interim final rule had a delayed effective date of June 11, 2004, and comments were permitted through that date. Only one comment was filed, which did not contest the general efficacy of the rule. That comment is discussed below.

The final rule can be made effective immediately upon publication in the Federal Register. Because the rule is a procedural rule under the Administrative Procedure Act (APA) and merely implements a requirement of the Sarbanes-Oxley Act (i.e., the requirement to file these reports electronically), and because the filers have had ample time to convert to electronic filing, there is good cause to make the final rule effective without the usual 30 day delay imposed by the APA.

DISCUSSION

Section 12(i) of the Exchange Act (15 U.S.C. 78l(i)) authorizes the Federal banking agencies to enforce certain sections of the Exchange Act and the Sarbanes-Oxley Act of 2002, including Section 16 of the Exchange Act (beneficial ownership and reporting), in regard to the depository institutions for which each Federal banking agency is, respectively, the primary Federal supervisor. The Exchange Act seeks to protect investors by requiring accurate, reliable, and timely corporate securities disclosures.

The FDIC is authorized, in administering the statutory provisions specified in Section 12(i) of the Exchange Act, to promulgate regulations applicable to the securities of state nonmember banks (including foreign banks having an insured branch). These regulations must be substantially similar to the regulations of the Securities and Exchange Commission (SEC) under the specified sections of the Exchange Act, unless the FDIC publishes its reasons for deviating from the SEC's rules.

Section 16 of the Exchange Act applies to every person who is the beneficial owner of more than 10 percent of a class of equity security registered under Section 12 of the Exchange Act and to each officer and director of the issuer of the security (collectively, "reporting persons" or "insiders"). Upon becoming a reporting person, or upon the registration under Section 12 of the Exchange Act of that class of securities, Section 16(a) requires a reporting person to file an initial report with the SEC (or in the case of an insured depository institution, its appropriate Federal banking agency) disclosing the amount of his or her beneficial ownership of all equity securities of the issuer. To keep this information current, Section 16(a) also requires reporting persons to report changes in their beneficial ownership. Prior to the Sarbanes-Oxley Act, insiders of state nonmember banks with a class of equity securities registered under Section 12 of the Exchange Act filed these beneficial ownership reports on paper. In the case of insiders connected to registered state nonmember banks, reports were filed using FDIC Forms F-7, F-8, and F-8A.

As amended by Section 403 of the Sarbanes-Oxley Act of 2002, Section 16(a) of the Exchange Act (15 U.S.C. 78p(a)) requires electronic submission of certain beneficial ownership reports submitted on or after July 30, 2003. The SEC or, respectively, the appropriate Federal banking agency, is required to make those filings available to the public on the Internet. Institutions with Internet websites are required to post their insiders' change in beneficial ownership reports on their websites. In addition, Section 16, as amended by Sarbanes-Oxley,

requires filing of beneficial ownership reports before the end of the second business day following the day on which the subject transaction was executed (effective for transactions on or after August 29, 2002).

On August 27, 2002, the SEC adopted rule amendments to implement the accelerated filing deadline for certain beneficial ownership reports. These amendments have, since their adoption, been applicable to insiders of registered state nonmember banks in accordance with Section 335.601 of the FDIC rules, which instructs such banks to follow SEC regulations issued under Section 16 of the Exchange Act. Previously, beneficial ownership reports filed by insiders of registered state nonmember banks were filed with the FDIC within 10 days from the end of the month of the transaction. On May 7, 2003, the SEC issued a final rule implementing the electronic submission requirements for beneficial ownership reports as required by Section 16 of the Exchange Act as amended. On July 30, 2003, the FDIC, FRB, and OCC established an interagency electronic filing and retrieval system for these beneficial ownership reports, hosted on the FDIC's public website. The OTS joined this filing system on October 27, 2003. From July 30, 2003, until the interim final rule took effect on June 11, 2004, the filing of beneficial ownership reports using the electronic interagency filing system was permitted, but not required, for insiders of registered state nonmember banks to provide a period to test the efficacy of the system. Electronic filing of these reports became mandatory on June 11, 2004, for these insiders.

The final rule will replace the interim final rule previously adopted by the Board. These rules are necessary because, until the interim final rule took effect, as noted, the FDIC's securities disclosure regulations (12 CFR Part 335) prohibited any electronically transmitted filings or submissions of materials in electronic format to the FDIC. In regard to the filing of beneficial ownership reports, that prohibition was superseded by Section 403 of the Sarbanes-Oxley Act of 2002, which amended Section 16 of the Exchange Act. As amended, Part 335 makes clear that, except in limited exceptional circumstances, electronic beneficial ownership reports by registered state nonmember bank insiders are to be filed electronically with the FDIC, consistent with timeframes provided in Section 16 of the Exchange Act and SEC regulations. Mandated electronic filing benefits members of the investing public and the financial community by making information contained in the filings available to them immediately after being filed with the FDIC. Electronically filed information concerning insiders' transactions in registered bank equity securities is publicly accessible substantially sooner and more readily than before. The electronic format of the filed information facilitates research and data analysis by investors and the public. The accelerated Section 16(a) filing requirements that took effect on August 29, 2002, also make electronic filing of beneficial ownership reports more useful to the public. Finally, the staff believes that investors want electronic access to these forms, reports of insiders' transactions in equity securities of registered banks provide useful information as to management's views of the bank's performance or prospects, and more timely and transparent access to reports will be useful to investors.

The one comment on the interim final rule was filed by America's Community Bankers. The SEC's rules for its EDGAR filing system provide that an electronic filer "shall not be subject to the liability and anti-fraud provisions of the federal securities laws with respect to an error or omission in an electronic filing resulting solely from electronic transmission errors beyond the control of the filer, where the filer corrects the error or omission by the filing of an

amendment in electronic format as soon as reasonably practicable after the electronic filer becomes aware of the error or omission.” The FDIC’s interim final rule asked whether the FDIC should insert a similar provision in its rules. The commenter stated that persons filing beneficial ownership reports electronically with the FDIC should be protected from liability to the same extent as filers with the SEC. However, the commenter believed it is unclear whether the FDIC’s authority under Section 12(i) of the Exchange Act is sufficient to incorporate the protection provided by the SEC. Therefore, the commenter argued, the FDIC should include in its regulations specific language to this effect.

Staff does not believe that including such language in the final rule is necessary. As stated in the preamble to the interim final rule, staff believes that the SEC’s regulation presents a reasonable approach to transmission errors and that it applies to electronic filings made with the FDIC as well. See 12 CFR 335.101(b). In circumstances where there has been a filing error or omission due solely to an electronic transmission error beyond the filer’s control, the FDIC will not cite a violation of Part 335 if the error or omission is corrected as soon as reasonably practicable.

RECOMMENDATION

DSC recommends that the Board approve the final rule, to be effective upon publication in the Federal Register.

Attachments:

Resolution

Federal Register Notice

Concur:

John M. Brennan
Deputy to the Chairman