

Fiscal Analysis

04 NCAC 03C .0905 INVESTMENT AUTHORITY

Prepared by

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April 8, 2014

General Information

Agency	North Carolina Commissioner of Banks
Rule Title	Investment Authority
Citation	04 NCAC 03C .0905
Proposed Action	The Commissioner of Banks proposes to adopt a rule setting the standard for commercial bank investment in mutual funds as required by N.C. Gen. Stat. § 53C-5-2(a)(6).
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Authority	N.C.G.S. § 53C-5-2
Impact Summary	State Government: No. Local Government: No. Federal Government: No. Substantial Impact: No.
Necessity	This action is not required by federal statutes, but it is proposed to comply with a rule-making requirement in revised Chapter 53C of the North Carolina General Statutes.

Summary

The North Carolina Commissioner of Banks (“NC COB”) is proposing to adopt a permanent rule that will set forth standards by which the Office evaluates bank investments in mutual funds. See the Appendix for the text of the proposed rule. It is not anticipated that this rule will have an impact on state or local government or a substantial economic impact.

The NC COB regulates state-chartered depository financial institutions in North Carolina. It has primary supervision authority over commercial banks, savings banks, savings and loans, as well as supervision authority over certain non-depository trust companies, lenders, check-cashers, and money transmitters.

The NC COB is charged with general rule-making authority with the review and approval of the North Carolina State Banking Commission (“NC SBC”) pursuant to N.C.G.S. § 53C-2-5. The NC SBC is a 15 member oversight committee composed of (i) the State Treasurer, (ii) 12 members appointed by the Governor, and (iii) 2 members appointed by the General Assembly

pursuant to N.C.G.S. § 53C-2-1(a). The NC COB is assisted in the duties of office by the Office of the Commissioner of Banks (“NC OCOB”).

Purpose and Description of the Rule Change

N.C.G.S. § 53C-5-2(a)(6) allows banks to invest in mutual funds “but subject to rules or orders adopted by the Commissioner.” Therefore, NC COB seeks to adopt a rule that will permit state-chartered bank investment in mutual funds to the same extent and with the same limits as permitted for national banks. Federal regulations allow national banks to purchase without limitations shares in a mutual funds as long as the fund is registered with the Securities and Exchange Commission and its portfolio consists of obligations that are not subject to limitations imposed in 12 USC 24 or 12 USC 84. However, banks may still invest in one or multiple mutual funds whose portfolios do contain restricted obligations as long as the banks’ total investment in those funds is less than 10% of the bank’s capital and surplus. See the US Comptroller’s Handbook on investment securities for additional details.¹

This action will give parity to state-chartered banks in their investment ability with national banking institutions, and will codify a long-standing practice of the NC COB.

Estimated Impact

State Government

The proposed rule adoption will not require the expenditure or distribution of State funds. All operations of the NC OCOB are funded through assessments and fee income from regulated entities. No state funds are used to pay NC OCOB salaries or operation costs.

Local Government

The proposed rule adoption will not affect local government. Assessment and fee income is not paid into any local government fund, and no local government expenditures are required as a result of the proposed change.

¹ U.S. Office of the Comptroller of the Currency. “Investment Securities: Comptroller’s Handbook (Section 203)” (Mar 1990), available at: <http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/investsecurities1.pdf> (last visited April 8, 2014)

Federal Government

The proposed rule adoption will not affect the federal government. Assessment and fee income is not paid to the federal government, and no federal funds are required as a result of the proposed change.

Private Impact

Only commercial banks that have invested or intend to invest in mutual funds are affected by the change. At present, the NC COB regulates 52 commercial banks that may use the authority granted in N.C. Gen. Stat. § 53C-5-2(a)(6) to invest in mutual funds.

To estimate the impact from the proposed fee changes, NC OCOB used bank Call Report data regarding investments in mutual funds and other marketable securities, and specialized knowledge of financial industry trends. The data used includes both bank investments in mutual funds and bank investments in unspecified securities, but is considered reliable as the maximum estimate of the total amount of commercial bank investment in mutual funds as of December 31, 2013.

Using historical data from the Call Report the NC OCOB estimates that North Carolina state-chartered commercial banks earn approximately \$402,000 on an annual basis from mutual fund investments. In practice, the NC OCOB does not expect the proposed rule to alter amounts currently invested in or earned from mutual funds by state-chartered commercial banks given that the rule is a codification of a long-standing practice. Based upon the data from the Call Report the NC OCOB expects banks to continue to earn approximately \$402,000 annually.

Call Report data as of December 31, 2013 indicates that all North Carolina state-chartered commercial banks hold “Mutual Funds and Other Equity Securities with Readily Determinable Fair Values” with a fair market value of approximately \$67,000,000.

Unfortunately, the Call Report data does not provide a granular allocation of investments in mutual funds versus marketable securities. It is significant to note that “other marketable securities” captures a number of other securities in which state-chartered banks invest. The instructions for this portion of the Call Report (Schedule RC-B) indicate that the category “Mutual Funds and Other Equity Securities with Readily Determinable Fair Values” includes: “common stock and perpetual preferred stock of the Federal National Mortgage Association (Fannie Mae), common stock and perpetual preferred stock of the Federal Home Loan Mortgage Corporation (Freddie Mac), Class A voting and Class C non-voting common stock of the Federal

Agricultural Mortgage Corporation (Farmer Mac), and common and preferred stock of SLM Corporation (the private-sector successor to the Student Loan Marketing Association).”²

Because granular data is unavailable for this specific investment category, NC OCOB estimates, based on specialized knowledge of North Carolina banks, that state-chartered bank investment in mutual funds is limited to approximately 5% of this Call Report category. As a result, NC OCOB estimates that state-chartered banks held approximately \$3,350,000 in mutual fund assets as of December 31, 2013.

Based on industry estimates of mutual fund performance, and recognizing that mutual funds vary in performance, expenses, and other financial characteristics, NC OCOB estimates that the average rate of return on all mutual fund investments is approximately 12% on an annualized basis. Accordingly, NC OCOB estimates that state-chartered banks earn approximately \$402,000 from investments in mutual funds. These earnings may be offset by fees that mutual funds may impose on the banks.

Investment in mutual funds does have some risk associated with it. In the event that a mutual fund did not perform as expected, earned 0% return, and was sold at a loss, such losses would be absorbed first by operating income and reflected in the institution’s net earnings. In the event a bank suffered multiple years of negative earnings, losses from such a fund would then be absorbed by capital. Because of limits related to bank investment concentrations, it would be highly unlikely for any mutual fund investment to result in the total depletion of an institution’s capital, such that stockholders would absorb losses specifically attributable to mutual fund investments. Note, the rule does allow for the Commissioner of Banks to modify the restrictions on investment in mutual funds based on “safety and soundness.”

NC OCOB does not expect mutual fund investments to decrease as a result of the proposed rule because the rule seeks to codify a long-standing policy of the agency. NC OCOB is unable to predict an increase in mutual fund investment stemming from the proposed rule because neither the rule nor the statute requires state-chartered banks to invest in mutual funds. NC OCOB expects state-chartered commercial banks will continue to use mutual funds as an investment vehicle at the present rate, with an annualized expected return of \$402,000.

² FFIEC Reports of Condition and Income, Instructions for Schedule RC-B at 9 (Mar. 2013), available at: http://www.fdic.gov/regulations/resources/call/crinst/2013-03/313RC-B_033113.pdf (last visited Apr. 3, 2014).

Total Impact

Assuming a statutory baseline of \$0, the net estimated impact of the proposed rule (both positive and negative) on regulated entities should be no greater than \$402,000. Accordingly, the NC COB respectfully submits that the rule change does not involve a substantial economic impact within the meaning of N.C.G.S. § 150B-21.4(b1).

APPENDIX

04 NCAC 03C .0905 is proposed for adoption as follows:

04 NCAC 03C .0905 **INVESTMENT AUTHORITY**

A bank may invest in mutual funds to the same extent and within the same limitation as permitted for national banks by statute, regulation, or interpretation of the applicable federal regulator, unless otherwise determined by the Commissioner of Banks based on safety and soundness.

History Note: Authority G.S. 53C-5-2;

Eff. September 1, 2014.