

**DEPARTMENT OF THE TREASURY**

**Office of the Under Secretary for Domestic Finance**

**12 CFR Part 1501**

**RIN 1505-AA77**

**and**

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 208**

**Regulation H; Docket No. R-1066**

**Financial Subsidiaries**

**AGENCIES:** The Department of the Treasury and the Board of Governors of the Federal Reserve System.

**ACTION:** Joint interim rule with request for comments.

**SUMMARY:** The Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Board) are jointly issuing this interim rule pursuant to section 121 of the Gramm-Leach-Bliley Act (GLBA). The GLBA permits a national bank or state member bank that is among the second 50 largest insured banks to own or control a financial subsidiary only if the bank meets either the eligible debt requirement set forth in section 121 of the Act or alternative criteria established jointly by Treasury and the Board. This interim rule establishes the alternative criteria and provides that a bank meets the criteria if it has a current long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization.

**DATES:** This interim rule is effective March 14, 2000. Written comments must be submitted on or before May 15, 2000.

**ADDRESSES:** Comments should refer to docket number R-1066 and should be sent both: to Comparable Ratings Regulation, Office of Financial Institutions Policy, U.S. Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Room SC 37, Washington, D.C. 20220, and to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments addressed to the Treasury Department also may be mailed electronically to [financial.institutions@do.treas.gov](mailto:financial.institutions@do.treas.gov) or delivered to the Treasury Department mail room between the hours of 8:45 a.m. and 5:15 p.m. at the 15<sup>th</sup> Street entrance to the Treasury Building. Comments addressed to Ms. Johnson also may be mailed electronically to

[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov) or delivered to the Board's mail room between the hours of 8:45 a.m. and 5:15 p.m. and, outside of those hours, to the Board's security control room. Both the Board's mail room and the security control room are accessible from the Eccles Building courtyard entrance, located on 20th Street between Constitution Avenue and C Street, N.W. Members of the public may inspect comments in Room SC 37 of the Treasury Department and in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. on weekdays.

#### **FOR FURTHER INFORMATION CONTACT:**

Department of the Treasury: Joan Affleck-Smith, Director, Office of Financial Institutions Policy (202/622-2740); Matthew Green, Senior Financial Analyst (202/622-2740); or Gary W. Sutton, Senior Banking Counsel (202/622-1976).

Board of Governors: Kieran J. Fallon, Senior Counsel, Legal Division (202/452-5270); or Mark S. Carey, Senior Economist, Division of Research & Statistics (202/452-2784). For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Janice Simms (202/872-4984).

#### **SUPPLEMENTARY INFORMATION:**

#### **BACKGROUND**

On November 12, 1999, the President signed the GLBA, Public Law 106-102, 113 Stat. 1338, which comprehensively restructures the statutory framework that governs the financial services industry. Section 121 of the Act authorizes national banks and state member banks to acquire control of, or hold an interest in, a new type of subsidiary called a "financial subsidiary." A financial subsidiary may, with certain exceptions, engage in activities that have been determined to be financial in nature or incidental to financial activities in accordance with the GLBA, and in other activities that the parent bank is permitted to conduct directly.

In order for a national bank or state member bank to control, or hold an interest in, a financial subsidiary, the bank and each of its depository institution affiliates must be "well-capitalized" and "well-managed," as those terms are defined in the GLBA. The aggregate consolidated total assets of all financial subsidiaries of the bank also may not exceed the lesser of 45 percent of the consolidated total assets of the parent bank or \$50 billion. (The \$50 billion limit is to be adjusted according to an indexing mechanism established in a separate regulation to be issued jointly by Treasury and the Board.) In addition, in order to acquire control of a financial subsidiary, the bank and each of its insured depository institution affiliates must have received a "satisfactory" or better rating at its most recent examination under the Community Reinvestment Act.

In addition, if the bank is one of the 50 largest insured banks, as determined by the bank's

consolidated total assets at the end of the most recent calendar year, the bank must have at least one issue of outstanding eligible debt that is rated in one of the three highest rating categories by a nationally recognized statistical rating organization (debt rating requirement). If the bank is one of the second 50 largest insured banks, the bank must meet either this debt rating requirement or such alternative criteria that the Secretary of the Treasury and the Board jointly determine by regulation to be comparable to and consistent with the purpose of the rating requirement.<sup>1</sup> This interim rule establishes such alternative criteria.

## **DESCRIPTION OF THE INTERIM RULE**

The interim rule provides that a national bank or state member bank within the second 50 largest insured banks satisfies the alternative criteria if the bank has a current long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the rating organization. A long-term issuer credit rating is one that assesses the bank's overall capacity and willingness to pay on a timely basis its unsecured financial obligations.<sup>2</sup> Unlike debt ratings, an issuer credit rating does not assess the bank's ability and willingness to make payments on any individual class or issue of debt, nor does it reflect priority or preference in payment among financial obligations. Ratings organizations may issue long-term or short-term issuer credit ratings for the same bank and separate ratings for dollar-denominated and foreign currency-denominated obligations. Only long-term issuer credit ratings for dollar-denominated obligations satisfy the requirements of the rule. A long-term issuer credit rating is one that reflects the bank's ability over a period of not less than one year to fulfill its financial obligations on a timely basis.

Treasury and the Board believe that the long-term issuer credit rating required by the rule is comparable to, and consistent with the purposes of, the debt rating requirement applicable to the 50 largest insured banks. The long-term issuer credit rating assigned large banks generally is identical to the rating given the bank's senior long-term unsecured debt, where such rated debt exists. Furthermore, representatives of rating organizations have indicated that the rating given to a specific long-term unsecured financial obligation of an issuer is anchored to the issuer's long-term issuer credit rating because the latter rating exemplifies the issuer's fundamental creditworthiness over the long-term. For these reasons, Treasury and the Board believe that the long-term issuer credit rating is consistent with the purposes underlying the debt rating requirement.

The interim rule requires that the parent bank have a long-term issuer credit rating in the

---

<sup>1</sup>A bank does not have to satisfy the debt rating requirement or the alternative criteria established by this rule if the bank's financial subsidiaries engage in the newly authorized financial activities solely as agent and not as principal.

<sup>2</sup>Issuer credit ratings that are assigned to a subsidiary or affiliate of the bank, such as a subsidiary engaged in derivatives activities, do not meet the rule's requirements.

top three investment grade rating categories from at least one nationally recognized statistical rating organization. Standard & Poor's top three investment grade categories for long-term issuer credit ratings are AAA, AA, or A, with AAA denoting the highest rating.<sup>3</sup> Standard & Poor's may modify its AA or A ratings with the addition of a plus (+) or minus (-) sign to show relative standing within these rating categories. Any rating from A minus to AAA would satisfy the long-term issuer credit rating requirement; an A minus would constitute the lowest acceptable rating (in the case of Standard & Poor's). Moody's top three investment grade categories for long-term issuer credit ratings are Aaa, Aa, or A, with Aaa denoting the highest rating. Moody's likewise applies numerical modifiers of 1, 2 and 3 in the Aa and A rating categories, with 3 denoting the lowest end of the letter-rating modifiers. Any rating from A-3 to Aaa would satisfy the long-term issuer credit rating requirement; a rating of A-3 would be the lowest acceptable rating (in the case of Moody's).

### **Interim Effectiveness of the Rule**

This interim rule is effective on March 14, 2000. Section 553 of the Administrative Procedure Act permits agencies to issue a rule without public notice and comment when the agency, for good cause, finds (and incorporates the finding and a brief statement of reasons therefor in the rule issued) that notice and public comment are impracticable, unnecessary, or contrary to the public interest. 5 U.S.C. § 553(b)(B). Section 553 also permits agencies to issue a rule without delaying its effectiveness for thirty days from publication if the agency finds good cause and publishes this finding with the rule. 5 U.S.C. § 553(d)(3). In addition, section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C. § 4802(b), permits federal banking agencies to issue a regulation which takes effect before the first day of a calendar quarter beginning on or after the date on which the regulations are published in final form when the agency determines for good cause (published with the regulation) that the regulation should become effective before such time.

For the reasons set forth below, Treasury and the Board find that there is good cause for issuing this interim rule without notice and public comment and without a delayed effective date. For the same reasons, Treasury and the Board find that there is good cause for the interim rule to become effective before the first day of a calendar quarter beginning on or after the date on which the regulations are published in final form.

Section 121 of the GLBA becomes effective on March 11, 2000. A national bank or state member bank that is among the second 50 largest insured banks may control a financial subsidiary or hold an interest in a financial subsidiary only if the bank meets the debt rating requirement or the alternative criteria established by this rule. To prevent any bank from being denied the opportunity to control or hold an interest in a financial subsidiary, it is in the public interest to make this interim rule effective immediately. Treasury and the Board are soliciting comments on

---

<sup>3</sup>Standard & Poor's also issues counterparty credit ratings, which are a form of issuer credit rating.

all aspects of the interim rule and will consider those comments before the rule is finalized.

### **Regulatory Flexibility Act Analysis**

Because no notice of proposed rulemaking is required for this interim final rule, the provisions of the Regulatory Flexibility Act (5 U.S.C. §§ 601 et. seq.) do not apply. In addition, the interim rule applies only to national banks and state member banks that are within the second 50 largest insured banks. Accordingly, the interim rule is not expected to have a significant economic impact on a substantial number of small entities.

### **Executive Order 12866 Determination**

The Department of the Treasury has determined that this rule does not constitute a “significant regulatory action” for the purposes of Executive Order 12866.

### **Solicitation of Comments Regarding the Use of "Plain Language"**

Section 722 of the Gramm-Leach-Bliley Act requires the Board to use "plain language" in all proposed and final rules published after January 1, 2000. The Board invites comments about how to make the interim rule easier to understand, including answers to the following questions:

- 1) Is the material organized in an effective manner? If not, how could the material be better organized?
- 2) Are the terms of the rule clearly stated? If not, how could the terms be more clearly stated?
- 3) Does the rule contain technical language or jargon that is unclear? If not, which language requires clarification?
- 4) Would a different format (with respect to the grouping and order of sections and use of headings) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?
- 5) Would increasing the number of sections (and making each section shorter) clarify the rule? If so, which portions of the rule should be changed in this respect?
- 6) What additional changes would make the rule easier to understand?

### **List of Subjects**

#### **12 CFR Chapter XV Part 1501**

Administrative practice and procedure, National banks.

#### **12 CFR Part 208**

Administrative practice and procedure, Federal Reserve System, Banks.

## **Department of the Treasury**

### **12 CFR Chapter XV**

#### **Authority and Issuance**

For the reasons set forth in the preamble, the Department of the Treasury amends part 1501 of Chapter XV of Title 12 of the Code of Federal Regulations as follows:

#### **PART 1501 – FINANCIAL SUBSIDIARIES**

1. The authority citation for part 1501 continues to read as follows:

**Authority:** Section 5136A of the Revised Statutes of the United States (12 U.S.C. 24a).

2. A new § 1501.2 is added to read as follows:

#### **SECTION 1501.2 - Comparable Ratings Requirement for National Banks among the Second 50 Largest Insured Banks**

(a) Scope and Purpose. Section 5136A of the Revised Statutes permits a national bank that is within the second 50 largest insured banks to own or control a financial subsidiary only if, among other requirements, the bank satisfies the eligible debt requirement set forth in section 5136A or an alternative criteria jointly established by the Secretary of the Treasury and the Board of Governors of the Federal Reserve System. This section establishes the alternative criteria that national banks among the second 50 largest insured banks may meet, which criteria is comparable to and consistent with the purposes of the eligible debt requirement established by section 5136A.

(b) Alternative criteria. A national bank satisfies the alternative criteria referenced in Section 5136A(a)(2)(E) of the Revised Statutes (12 U.S.C. § 24a) and 12 CFR 5.39(g)(3) if the bank has a current long-term issuer credit rating from at least one nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization.

(c) Definition of long-term issuer credit rating. A “long-term issuer credit rating” is a written opinion issued by a nationally recognized statistical rating organization of the bank’s

overall capacity and willingness to pay on a timely basis its unsecured, dollar-denominated financial obligations maturing in not less than one year.

Dated: March 14, 2000

(Signed) Gregory A. Baer

---

Gregory A. Baer,  
Assistant Secretary for Financial Institutions,  
Department of the Treasury.

## **Federal Reserve System**

### **12 CFR Chapter II**

For the reasons set forth in the preamble, the Board of Governors of the Federal Reserve System amends part 208 of Chapter II, Title 12 of the Code of Federal Regulations as follows:

#### **PART 208 – MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for part 208 continues to read as follows:

**Authority:** 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

2. Section 208.71 is amended by adding a new paragraph (c) to read as follows:

#### **§ 208.71 What are the requirements to invest in or control a financial subsidiary?**

\* \* \* \* \*

(c) Alternative Requirement. A state member bank satisfies the alternative criteria referenced in paragraph (b)(1)(ii) of this section if the bank has a current long-term issuer credit rating from at least one nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization.

3. Section 208.77 is amended by redesignating paragraphs (e) and (f) as paragraphs (f) and (g), respectively, and inserting a new paragraph (e) to read as follows:

(e) Long-term Issuer Credit Rating. The term “long-term issuer credit rating” means a written opinion issued by a nationally recognized statistical rating organization of the bank’s overall capacity and willingness to pay on a timely basis its unsecured, dollar-denominated financial obligations maturing in not less than one year.

By order of the Board of Governors of the Federal Reserve System, March 14, 2000.

(Signed) Jennifer J. Johnson

---

Jennifer J. Johnson,  
Secretary of the Board.