

# **FEDERAL RESERVE SYSTEM**

## **12 CFR Part 225**

### **Regulation Y; Docket No. R-1057**

#### **Bank Holding Companies and Change in Bank Control**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Interim rule with request for public comments.

**SUMMARY:** The Board of Governors of the Federal Reserve System is adopting on an interim basis effective March 11, 2000, and soliciting comment on a rule that establishes procedures for bank holding companies as well as foreign banks that operate a branch, agency, or commercial lending company in the United States to elect to become financial holding companies. The interim rule includes amended definitions of terms in existing Subpart A that are applicable to the new Subpart. The Board is promulgating this rule to implement provisions of the recently enacted Gramm-Leach-Bliley Act that enable bank holding companies and foreign banks that meet applicable statutory requirements to become financial holding companies and thereby engage in a broader range of financial and other activities than are permissible for bank holding companies.

The new Subpart sets forth the procedures by which bank holding companies and foreign banks may submit to the Board an election to become a financial holding company and describes the period in which the Board will act on financial holding company elections. This Subpart also enumerates the criteria that bank holding companies and foreign banks must meet in order to qualify as a financial holding company. In addition, the newly added sections set forth the limitations that the Board will apply to financial holding companies that fail to maintain compliance with applicable capital, management, and CRA criteria.

The Board has promulgated this Subpart on an interim basis, effective on March 11, 2000, in order to allow bank holding companies and foreign banks that meet applicable qualifications to become financial holding companies as soon as possible following the effective date of the relevant provisions of the Gramm-Leach-Bliley Act. The Board will allow bank holding companies and foreign banks to file elections in anticipation of the effective date of the Act and the interim rule and will

review elections as promptly as possible after the effective date. The Board anticipates that as soon as March 13, 2000, the Board will begin notifying qualifying companies that elections filed in accordance with the interim rule are effective. This will enable companies that the Board determines qualify as financial holding companies to take advantage of the new powers granted by the Gramm-Leach-Bliley Act as early as March 13, 2000, which is the first business day following the effective date of the financial holding company provisions of the Act.

The Board solicits comments on all aspects of the interim rule and will amend the rule as appropriate in response to comments received.

**DATES:** This interim rule is effective on March 11, 2000. Comments must be received by March 27, 2000.

**ADDRESSES:** Comments should refer to docket number R-1057 and should be sent to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, D.C., 20551. Comments addressed to Ms. Johnson also may be 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 mail room and the security control room are accessible from the Eccles Building courtyard entrance, located on 20<sup>th</sup> Street between Constitution Avenue and C Street, N.W. Members of the public may inspect comments in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Thomas M. Corsi, Managing Senior Counsel (202/452-3275), Ann E. Misback, Managing Senior Counsel (202/452-3788), Christopher W. Clubb, Counsel (202/452-3904), or Adrienne G. Threatt, Attorney (202/452-3554), Legal Division; Betsy Cross, Assistant Director (202/452-2574) or Melissa W. Clark, Manager, Global/International Applications (202/452-2277), Division of Banking Supervision and Regulation; Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, D.C., 20551.

**SUPPLEMENTARY INFORMATION:**

**Background**

Title I of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338 (1999)) repeals sections 20 and 32 of the Glass-Steagall Act (12 U.S.C. ' ' 377 and 78, respectively) and is intended to facilitate affiliations among banks, securities

firms, insurance firms, and other financial companies. To further this goal, the Gramm-Leach-Bliley Act amends section 4 of the Bank Holding Company Act (12 U.S.C. ' 1843) (BHC Act) to authorize bank holding companies and foreign banks that qualify as financial holding companies to engage in securities, insurance and other activities that are financial in nature or incidental to a financial activity. The activities of bank holding companies and foreign banks that are not financial holding companies would continue to be limited to activities authorized currently under the BHC Act, such as activities that the Board previously has determined in regulations and orders issued under section 4(c)(8) of the BHC Act to be closely related to banking and permissible for bank holding companies.

The Gramm-Leach-Bliley Act defines a financial holding company as a bank holding company that meets certain eligibility requirements. In order for a bank holding company to become a financial holding company and be eligible to engage in the new activities authorized under the Gramm-Leach-Bliley Act, the Act requires that all depository institutions controlled by the bank holding company be well capitalized and well managed. With regard to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, the Act requires the Board to apply comparable capital and management standards that give due regard to the principle of national treatment and equality of competitive opportunity.

To become a financial holding company, the Gramm-Leach-Bliley Act requires a bank holding company to submit to the Board a declaration that the company elects to be a financial holding company and a certification that all of the depository institutions controlled by the company are well capitalized and well managed. The Act also provides that a bank holding company's election to become a financial holding company will not be effective if the Board finds that, as of the date the company submits its election to the Board, not all of the insured depository institutions controlled by the company have achieved at least a satisfactory rating at the most recent examination of the institution under the Community Reinvestment Act (12 U.S.C. ' 2903 *et seq.*) (CRA).

The Gramm-Leach Bliley Act grants the Board discretion to impose limitations on the conduct or activities of any financial holding company that controls a depository institution that does not remain both well capitalized and well managed following the company's election to be a financial holding company. The Act also requires the Board to prohibit a financial holding company from commencing additional activities under new subsection 4(k) or 4(n) of the BHC Act, or from acquiring control of companies engaged in such activities, if any insured

depository institution controlled by the company fails to maintain at least a satisfactory CRA rating.

### **Proposed Rule**

In order to implement the provisions of the Gramm-Leach-Bliley Act governing the creation and conduct of financial holding companies, the Board is amending its Regulation Y by adding a Subpart I that (a) defines the term **Afinancial holding company@** and establishes procedures by which a bank holding company may become a financial holding company; (b) enumerates the criteria a bank holding company must meet in order for the Board to determine that an election is effective and describes the period within which the Board will act on an election; (c) sets forth the consequences if any depository institution controlled by a financial holding company fails to remain well capitalized and well managed, or if any insured depository institution controlled by the financial holding company fails to maintain at least a satisfactory CRA rating; and (d) specifically addresses procedures and requirements applicable to foreign banking organizations that seek to be treated as financial holding companies.

The Board welcomes comment on all parts of the interim rule.

### **Section 225.81 B What is a Financial Holding Company?**

The Gramm-Leach-Bliley Act defines a financial holding company as a bank holding company that meets certain specific requirements. In accordance with the Act, section 225.81 provides that, in order to qualify as a financial holding company, all depository institutions controlled by the company at the time of the election must be and remain well capitalized and well managed, and the company must have made an effective election to become a financial holding company as described in section 225.82. The definition of the terms **Awell capitalized@** and **Awell managed@** are described below and are based on specific capital levels and examination ratings.

### **Section 225.82 -- How Does a Company Elect to Become a Financial Holding Company?**

Subsection (a) provides that a bank holding company wishing to become a financial holding company must file a written declaration with the Board stating that the bank holding company elects to be a financial holding company. The Board envisions that a company's election to become a financial holding company could be a short and simple document signed by an official or representative with authority to bind

the company. Subsection (b) sets forth the information required as part of a declaration, which is limited to information about the location and capital position of each of the depository institutions controlled by the company, and a certification that each such institution is both well capitalized and well managed as of the date the election is filed.

The Gramm-Leach-Bliley Act provides that an election to be a financial holding company is ineffective if the Board finds, within a specified period, that any insured depository institution controlled by the bank holding company (other than a recently acquired institution) does not have at least a satisfactory CRA performance rating. Subsection (c) implements this provision. The interim rule also provides that an election is ineffective if the Board finds during this period that any depository institution controlled by the bank holding company is not well managed and well capitalized, as these terms are objectively defined, as of the date of the election.

The Board recognizes that there may be instances in which a bank holding company meets the statutory requirements to be a financial holding company but on a consolidated basis is not well capitalized and well managed or does not have adequate financial or managerial resources to conduct financial activities in a safe and sound manner. Under these circumstances, the Board may have significant supervisory concerns about the ability of the company to conduct additional activities or make additional acquisitions. Subsection (d) reserves the general supervisory authority of the Board to restrict or limit the commencement or conduct of activities or acquisitions of a financial holding company if the Board finds that the financial holding company lacks the financial or managerial strength to engage in new activities, make new acquisitions, or retain ownership of companies engaged in financial activities.

Subsection (e) describes circumstances under which the Gramm-Leach-Bliley Act allows the Board to exclude an insured depository institution when reviewing whether a bank holding company meets the applicable CRA requirement for financial holding companies. As provided in the Act, the Board will not consider institutions acquired by the company within the 12-month period preceding an election to be a financial holding company for purposes of the CRA criteria provided that (i) the bank holding company has submitted a plan to the appropriate Federal banking agency for the institution to take actions necessary to achieve at least a ~~A~~satisfactory@rating at the next CRA examination, and (ii) the appropriate Federal banking agency has accepted that plan.

Subsection (f) provides that, as a general matter, an election by a bank holding company to become a financial holding company will be effective on the

31<sup>st</sup> day after the election was received by the appropriate Federal Reserve Bank, unless the Board has notified the bank holding company prior to that date that its election is ineffective because an institution controlled by the company fails to meet an applicable requirement. The interim rule provides that the Board or the appropriate Federal Reserve Bank may affirmatively notify a bank holding company that an election is effective at any time during that 30-day period.

As noted above, the Board proposes to adopt the proposed rule on an interim basis, effective March 11, 2000 (which is the effective date of the financial holding company provisions of the Gramm-Leach-Bliley Act). This will allow bank holding companies and foreign banks that meet the qualifications to be financial holding companies to take advantage of the new authority granted by the Gramm-Leach-Bliley Act as soon as possible following the effective date of the relevant provisions of the Act.

The Board also proposes to allow bank holding companies and foreign banks to file elections to become financial holding companies immediately in anticipation of the effective date of the Act and interim rule. These elections will be considered to be made as of March 11, 2000, and must certify compliance with all applicable capital and management criteria as of March 11, 2000. While the 30-day period for ineligibility decisions does not begin on any election until the effective date of the Act, the Board will endeavor on March 13, 2000, which is the first business day following the effective date of the financial holding company provisions of the Act, to act on elections filed prior to February 15, 2000. The Board will act on all other elections as soon as practicable. Prior to the date that its election to become a financial holding company becomes effective, a bank holding company may not engage in the newly authorized activities described in new sections 4(k), 4(n), and 4(o) of the BHC Act.

Companies that are not now bank holding companies and seek to acquire a depository institution must still apply to the Board to become a bank holding company under section 3 of the BHC Act. A company may file a bank holding company application and a declaration to be a financial holding company at the same time. In that case, it is expected that the System would act to make the financial holding company election effective at the time the System acts on the underlying bank holding company application. Consequently, the company could become a financial holding company without filing a separate election after the company becomes a bank holding company.

**Section 225.83 -- What Are the Consequences of Ceasing to Meet Applicable Capital and Management Requirements?**

This section implements the provisions of the Gramm-Leach-Bliley Act that apply when a depository institution controlled by an existing financial holding company ceases to be both well capitalized and well managed. Subsection (a) states that the Board will notify a company in writing if the Board finds that not all depository institutions controlled by the company are well capitalized and well managed. In recognition of the fact that a company may know that one of its subsidiary depository institutions has ceased to be well capitalized or well managed before the Board will have access to such data, subsection (b) requires companies to notify the Board of the institutions involved and the areas of noncompliance promptly upon becoming aware of that the institution no longer meets applicable capital or management criteria.

Subsection (c) provides that, within 45 days (plus any additional time that the Board may grant) after receiving a notice of noncompliance from the Board, the company must execute an agreement with the Board to comply with applicable capital and management requirements. An agreement required by this subsection to correct a capital or management deficiency must explain the actions that the company will take to correct each deficiency, provide a schedule within which each action will be taken, provide any other information required by the Board, and be acceptable to the Board.

Until a company has corrected the conditions described in a notice provided by the Board under subsection (a), the Gramm-Leach-Bliley Act allows the Board to impose any limitations on the conduct or activities of the company or any of its affiliates as the Board deems to be appropriate and consistent with the purposes of the BHC Act. In particular, subsection (d) states that, until the Board determines that all deficiencies have been corrected, a company may not engage in any additional activity or acquire control or shares of any company under section 4(k) of the BHC Act without prior approval from the Board.

Subsection (e) provides that, if the conditions giving rise to a notice of noncompliance are not corrected within 180 days (or such longer period permitted by the Board), the Board may order the company to divest its subsidiary depository institutions. A company may comply with an order to divest by instead ceasing to engage in activities that are permissible only for financial holding companies. The Board's ability to require divestitures and impose limitations on financial holding companies that fail to meet the capital and management requirements is in addition to, not in lieu of, the Board's ability to take supervisory actions and enforce

compliance with applicable provisions of law under section 8 of the BHC Act and section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818).

**Section 225.84 -- What Are the Consequences of Ceasing to Maintain a Satisfactory or Better Rating Under the Community Reinvestment Act at All Insured Depository Institution Subsidiaries?**

The Gramm-Leach-Bliley Act requires the Board to prohibit a financial holding company from commencing any additional activity under sections 4(k) or 4(n) of the BHC Act, or from acquiring control of a company engaged in activities under those sections, if any insured depository institution controlled by the company receives a rating of less than ~~A~~satisfactory@under the CRA. Subsection (a) provides that a financial holding company is deemed to have received notice that these prohibitions are in effect at the time the appropriate Federal banking agency for any insured depository institution controlled by the company or the Board notifies the institution or company that the institution has received a rating of ~~A~~needs to improve@ or ~~A~~substantial noncompliance@under the CRA. The prohibitions will continue to apply until such time as each insured depository institution controlled by the company has received at least a ~~A~~satisfactory@rating at its most recent examinations under the CRA.

This prohibition does not prevent a financial holding company from making additional investments as part of merchant banking, investment banking, or insurance company investment activities pursuant to section 4(k)(4)(H) or 4(k)(4)(I) of the BHC Act, provided that the company was lawfully engaged in the merchant banking, investment banking, or insurance company investment activity prior to the time that one of its insured depository institutions received less than a ~~A~~satisfactory@ rating under the CRA and the Board has not prohibited or limited these activities.

Under the Gramm-Leach-Bliley Act, financial holding companies that do not comply with the CRA requirement are not prohibited from making acquisitions or engaging in activities that meet the more narrow ~~A~~closely related to banking@ standard pursuant to 4(c)(8). Financial holding companies that seek to engage in activities or make acquisitions pursuant to section 4(c)(8) of the BHC Act must, however, comply with the requirements of that section as well as the notice and approval requirements of section 4(j).

**Section 225.90 -- What are the Requirements for a Foreign Bank to be Treated as a Financial Holding Company?**

A foreign bank that is a bank holding company because it owns a subsidiary bank in the United States must comply with the same requirements as any other bank holding company that elects to be a financial holding company. Most foreign banks, however, do not own subsidiary banks in the United States; instead, they operate through branches that are part of the foreign bank itself.<sup>1</sup> If a foreign bank operates a U.S. branch, the foreign bank (and any company that controls the foreign bank) is subject to the BHC Act as if the foreign bank or company were a bank holding company. Such foreign banks may, like U.S. bank holding companies, also elect to be treated as financial holding companies and thereby be able to engage in the new financial activities.

Under the Gramm-Leach-Bliley Act, a company qualifies to be a financial holding company only if its insured bank and thrift subsidiaries are well capitalized and well managed. These standards are not by their terms applicable to the branches of a foreign bank. Consequently, the Act provides that **A**the Board shall apply comparable capital and management standards to a foreign bank that operates a branch . . . in the United States giving due regard to the principle of national treatment and equality of competitive opportunity.<sup>@</sup> The provision is necessary because it would be competitively harmful if a foreign bank that conducts a banking business in the United States in direct competition with U.S. banks could be treated as a financial holding company without meeting standards comparable to those applicable to U.S. banks. Without such a provision, a foreign bank could make securities and insurance acquisitions without meeting standards comparable to those applicable to U.S. banks, simply because the foreign bank conducts its U.S. banking business through a branch rather than through a subsidiary bank.

As described below, the Board is proposing to adopt standards and procedures that establish a flexible approach to carry out the statutory requirement for comparability of capital and management standards while, at the same time, assuring national treatment and equality of competitive opportunity for foreign banks operating in the United States.

Section 225.90 of the new Subpart sets forth the capital and management standards that foreign banks that maintain a branch, agency, or commercial lending

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<sup>1</sup>A foreign bank that operates a branch, agency or commercial lending company subsidiary in the United States is subject to the BHC Act as if it were a bank holding company. In this notice, the term **Abranch@** is used to include all three forms of operation.

company in the United States must meet in order to be considered to be well capitalized and well managed for purposes of being treated as financial holding companies. Under section 225.90, in order for a foreign bank or company to be treated as a financial holding company, the foreign bank must be well capitalized and well managed in accordance with standards comparable to those required of U.S. banks as determined by the Board, taking into account certain financial factors that may affect the analysis of capital and management.

Section 225.90 provides two methods under which a foreign bank may be considered well capitalized. The first method is applicable to foreign banks whose home country supervisors have adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord). Under this method, the foreign bank's total and Tier 1 risk-based capital ratios, as calculated under its home country standard, must be at least 6 percent for Tier 1 capital to total risk-based assets and 10 percent for total capital to risk-based assets.

In addition, section 225.90 requires that the foreign bank's ratio of Tier 1 capital to total assets must be at least 3 percent. The Board solicits comment on this requirement. The Board believes that the imposition of a leverage ratio requirement on a foreign bank maintaining a branch, agency, or commercial lending company in the United States and that elects to be treated as a financial holding company is appropriate in order to ensure that the capital standards applicable to foreign banking organizations are comparable to those for domestic depository institutions. In addition, the Board believes that imposing a 3 percent leverage ratio requirement, rather than the 5 percent required for domestic depository institutions, is appropriate in recognition of the fact that foreign banks hold both banking and nonbanking operations under the foreign bank. Domestic bank holding companies, which also hold banking and nonbanking operations, are subject under Regulation Y to a minimum leverage ratio of 4 percent, or 3 percent if they have implemented the market risk amendment to the risk-based capital guidelines or have a composite supervisory rating of A1. Most internationally active foreign banks also follow the market risk guidelines.

The Board recognizes that many countries do not impose a leverage ratio or similar requirements. U.S. banks are, however, subject to a leverage ratio requirement and in order to assure comparability of capital standards, a leverage ratio requirement for foreign banks is being proposed.

The second method for a foreign banking organization to be considered well capitalized in section 225.90 applies to foreign banks whose home country

supervisors have not adopted the Basel Accord standards and to any other foreign banking organizations that otherwise do not meet the standards set out under the first method. Any such institution may be considered well capitalized only by obtaining from the Board a prior determination that its capital is otherwise comparable to the capital that would be required of a U.S. bank.

In order to qualify as well managed under section 225.90, each U.S. branch, agency, and commercial lending company of a foreign banking organization must have received at least a satisfactory composite rating at the most recent assessment. In addition, the home country supervisor of the foreign bank must consider the overall operations of the foreign bank to be satisfactory.

In determining whether a foreign bank is well capitalized and well managed, the Board may take into account the foreign bank's composition of capital, accounting standards, long-term debt ratings, reliance on government support to meet capital standards, the extent to which the foreign bank is subject to comprehensive consolidated supervision, and other factors that may affect the analysis of capital and management. The Board will consult with the home country supervisor for the foreign bank as appropriate. The information gathered under these factors will assist the Board in determining whether the foreign bank operates under capital and managerial standards that are comparable to those applied to U.S. banks. The Board expects that most foreign banks that elect to be treated as financial holding companies will be subject to comprehensive consolidated supervision. An election by a foreign bank that is not subject to comprehensive consolidated supervision will receive a more detailed review.

### **Section 225.91 -- How May a Foreign Bank Elect to be Treated as a Financial Holding Company?**

The procedures applicable to a foreign bank, or company that owns or controls the foreign bank, electing to become a financial holding company are similar to the procedures discussed above for domestic bank holding companies. The foreign bank or company must file a written declaration with the appropriate Reserve Bank that it elects to be treated as a financial holding company. The declaration must be accompanied by the risk-based and leverage capital ratios of the foreign bank as of the close of the most recent quarter and as of the close of the most recent audited reporting period, a certification that the foreign bank is well capitalized as of the date the foreign bank or company files its election, and a certification that the foreign bank is well managed as of the date the foreign bank or company files its election.

**Section 225.92 -- How Does an Election by a Foreign Bank Become Effective?**

An election filed by a foreign bank or company to become a financial holding company under section 225.91 will not become effective until the Board notifies the foreign bank or company that the foreign bank meets the standards set out above. The Board will notify the foreign bank or company of its finding within 30 days of the filing of the written declaration, unless the Board determines that it does not have sufficient information on which to base a determination. Before filing an election to be treated as a financial holding company, a foreign bank or company may file with the Board a request for review of its qualifications to be treated as a financial holding company. The Board will endeavor to make a determination on such requests within 30 days of receipt.

An election filed by a foreign bank or company under this section will be effective only if the Board finds that the foreign bank is well capitalized and well managed in accordance with capital and management standards comparable to those required of U.S. banks owned by financial holding companies, and, in the case of a foreign bank that operates a branch in the United States that is federally insured, the branch received a rating of at least ~~A~~satisfactory@under the CRA at its most recent examination.

**Section 225.93 -- What are the Consequences of a Foreign Bank Failing to Continue to Meet Applicable Capital and Management Requirements?**

This section parallels section 225.83, with appropriate modifications. It sets forth the procedures to be followed in the event that a foreign bank that is treated as a financial holding company ceases to meet the applicable capital and management requirements. It provides for the execution of an agreement designed to bring the foreign bank back into compliance with the requirements of the regulation and permits the Board to impose certain limitations on the U.S. activities of such a foreign bank during any period of noncompliance. Finally, the section sets forth the consequences of a failure to correct the noncompliance within a period of 180 days.

Such consequences could include termination of the foreign bank's U.S. branches and agencies and divestiture of its commercial lending company subsidiaries or ceasing to engage in the expanded activities permitted for financial holding companies.

**Section 225.94 -- What are the Consequences of an Insured Branch Failing to Maintain a Satisfactory or Better Rating Under the Community Reinvestment Act?**

This section provides that the provisions of section 225.84, with appropriate modifications, apply to a foreign bank that operates an insured branch, and its parent, and that is treated as a financial holding. For these purposes, the insured branch is treated as an insured depository institution.

### **Subpart A -- General Provisions; Section 225.2 -- Definitions**

The Board also is amending the definitions of well capitalized and well managed at sections 225.2(r)(2) and 225.2(s) to take account of the broader applicability of these definitions under the Gramm-Leach-Bliley Act. The definition of well capitalized has been amended to apply to all depository institutions, rather than insured depository institutions. The rule applies the same capital requirements to depository institutions that are not FDIC-insured for purposes of determining whether the institution is well capitalized as apply to insured depository institutions.

The definition of well managed has, in the case of depository institutions that have not received an examination rating, been amended in subparagraph (1)(ii) to allow the Board to determine that an institution is well managed after consulting with the appropriate Federal banking agency for the institution. In addition, the rule provides that a depository institution resulting from the merger of two or more institutions that are well managed would be considered to be well managed unless the Board determined otherwise after consulting with the appropriate Federal banking agency.

### **Regulatory Flexibility Act Analysis**

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a)), the Board must publish an initial regulatory flexibility analysis with this interim regulation. This rule implements provisions of Title I of the Gramm-Leach-Bliley Act that allow entities that qualify as financial holding companies to engage in a broad range of securities, insurance, and other financial activities by providing the Board with a simple, post-commencement notice. The interim rule will enable bank holding companies and foreign banks that qualify as financial holding companies to engage in an expanded range of activities using a streamlined notification procedure.

The financial holding company election procedure described in this rule is voluntary, and the criteria set forth in the rule for an effective election filing are those required by the Gramm-Leach-Bliley Act. The Board has established a simple, one-time procedure involving minimum paperwork to fulfill the statutory election requirement. In addition, the new powers described in the Act and

implemented by this regulation should enhance the overall efficiency of bank holding companies and the other financial companies that seek to affiliate with them.

The rule applies to all companies that attempt to qualify as financial holding companies, regardless of their size, and allows small organizations to take advantage of the broad new powers conferred by the Gramm-Leach-Bliley Act with minimal additional burden. Finally, the Board specifically seeks comment on the likely burden this interim rule will impose on entities that elect to become financial holding companies.

### **Administrative Procedure Act**

The Board will make this interim rule effective on March 11, 2000 without first reviewing public comments. Pursuant to 5 U.S.C. ' 553, the Board finds that it is impracticable to review public comments prior to the effective date of the interim rule, and that there is good cause to make the interim rule effective on March 11, 2000, due to the fact that the rule sets forth procedures to implement statutory changes that will become effective on March 11, 2000. The Board is seeking public comment on the interim rule and will amend the rule as appropriate after reviewing the comments.

### **Paperwork Reduction Act**

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget in accordance with the emergency review procedures of the Paperwork Reduction Act of 1995.

The collection of information requirements in this proposed rulemaking are found in 12 CFR 225.82 (a) and (b). This information is required to evidence compliance with the requirements of Title I of the Gramm-Leach-Bliley Act (Pub. L. No. 106-103, 113 Stat. 1338 (1999) which amends section 4 of the Bank Holding Company Act (12 U.S.C. 1843). The respondents are current and future bank holding companies and foreign banking organizations.

The notice cited in 12 CFR 225.82(b) provides that a bank holding company may elect to become a financial holding company by filing a simple written declaration with the Federal Reserve. The declaration must include information identifying the company's subsidiary depository institutions and their capital ratios, and a certification that each depository institution is well capitalized and well managed (for specific details, see 12 CFR 225.82(b)). There will be no reporting form for

this information collection. The agency form number for this declaration will be the FR 4010. The Board estimates that approximately half of all bank holding companies will file this declaration during the first year and that it will take on average approximately 15 minutes to complete this information. This would result in estimated annual burden of 625 hours. Based on a rate of \$20 per hour, the annual cost to the public for this information collection is estimated to be \$12,500.

The OMB control number for this interim rule is 7100-0292. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to this information collection unless the Board has displayed a valid OMB control number.

A bank holding company may request confidentiality for the information contained in these information collections pursuant to section (b)(4) and (b)(6) of the Freedom of Information Act (5 U.S.C. 552(b)(4) and (b)(6)).

Comments are invited on: (a) whether the proposed collection of information is necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503, with copies of such comments to be sent to Mary M. West, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

#### **List of subjects in 12 CFR Part 225**

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and record keeping requirements, Securities.

For the reasons set out in the preamble, the Board amends 12 CFR part 225 as follows:

#### **PART 225 -- BANK HOLDING COMPANY AND CHANGE IN BANK CONTROL (REGULATION Y)**

1. The authority citation for part 225 continues to read as follows:  
**Authority:** 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831(i), 1831p-1, 1843(c)(8), 1844(b), 1972(l), 3106, 3108, 3310, 3331-3351, 3907, and 3909.
2. In subpart A, 225.2(r)(2) and (s) are amended to read as follows:

' **225.2 Definitions.**

\* \* \* \* \*

(r) \* \* \*

(2) Insured and uninsured depository institutions.

(i) Insured depository institution. In the case of an insured depository institution, **As well capitalized** means that the institution has and maintains at least the capital levels required to be well capitalized under the capital adequacy regulations or guidelines applicable to the institution that have been adopted by the appropriate Federal banking agency for the institution under section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

(ii) Uninsured depository institution. In the case of a depository institution the deposits of which are not insured by the Federal Deposit Insurance Corporation, **As well capitalized** means that the institution has and maintains at least the capital levels required for an insured depository institution to be well capitalized.

\* \* \* \* \*

(s) Well managed.

(1) In general. A company or depository institution is well managed if:

(i) At its most recent inspection or examination or subsequent review by the appropriate Federal banking agency for the company or institution, the company or institution received:

(A) At least a satisfactory composite rating; and

(B) At least a satisfactory rating for management and for compliance, if such a rating is given; or

(ii) In the case of a company or depository institution that has not received an examination rating, the Board has determined, after a review of managerial and other resources of the company or depository institution and after consulting the appropriate Federal banking agency for the institution, that the company or institution is well managed.

(2) Merged institutions. A depository institution that results from the merger of two or more depository institutions that are well managed shall be considered to be well managed unless the Board determines otherwise after consulting with the

appropriate Federal banking agency for each depository institution involved in the merger.

(3) Foreign banking organizations. Except as otherwise provided in this rule, a foreign banking organization shall qualify under this paragraph if the combined operations of the foreign banking organization in the United States have received at least a satisfactory composite rating at the most recent annual assessment.

3. A new Subpart I is added after Subpart H to read as follows:

### **Subpart I -- Financial Holding Companies**

224.81 What is a financial holding company?

224.82 How does a company elect to become a financial holding company?

224.83 What are the consequences of failing to continue to meet applicable capital and management requirements?

224.84 What are the consequences of failing to maintain a satisfactory or better rating under the Community Reinvestment Act at all insured depository institution subsidiaries?

224.90 What are the requirements for a foreign bank to be treated as a financial holding company?

224.91 How may a foreign bank elect to be treated as a financial holding company?

224.92 How does an election by a foreign bank become effective?

224.93 What are the consequences of a foreign bank failing to continue to meet applicable capital and management requirements?

224.94 What are the consequences of an insured branch failing to maintain a satisfactory or better rating under the Community Reinvestment Act?

### **Subpart I B Financial Holding Companies**

#### **' 225.81 What is a financial holding company?**

(a) Definition. A financial holding company is a bank holding company that meets the requirements of this section.

(b) Requirements to be a financial holding company. In order to be a financial holding company:

(1) All depository institutions controlled by the bank holding company must be and remain well capitalized;

(2) All depository institutions controlled by the bank holding company must be and remain well managed; and

(3) The bank holding company must have made an effective election to become a financial holding company.

(c) Requirements for foreign banks that are or are owned by bank holding companies.

(1) Foreign banks with U.S. branches or agencies. A foreign bank that is a bank holding company and that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section, section 225.82 and sections 225.90 through 225.93 in order to be a financial holding company.

(2) Bank holding companies that own foreign banks with U.S. branches or agencies. A bank holding company that owns a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section and section 225.82, and the foreign bank must comply with sections 225.90 through 225.93 in order for the company to be a financial holding company.

' **225.82 How does a company elect to become a financial holding company?**

(a) Filing requirement. A bank holding company may elect to become a financial holding company by filing a written declaration with the appropriate Federal Reserve Bank.

(b) Contents of declaration. The declaration must:

(1) State that the bank holding company elects to be a financial holding company;

(2) Provide the name and head office address of the company and of each depository institution controlled by the company;

(3) Certify that all depository institutions controlled by the company are well capitalized as of the date the company files its election;

(4) Provide the capital ratios for all relevant capital measures (as defined in section 38 of the Federal Deposit Insurance Act) as of the close of the previous quarter for each depository institution controlled by the company on the date the company files its election; and

(5) Certify that all depository institutions controlled by the company are well managed as of the date the company files its election.

(c) Under what circumstances will the Board find an election to be ineffective? An election to become a financial holding company shall not be effective if, during

the period provided in subsection (f), the Board finds that as of the date the election is received by the appropriate Federal Reserve Bank:

(1) Any insured depository institution controlled by the bank holding company (except an institution excluded under subsection (e) below) has not achieved at least a rating of **A**satisfactory record of meeting community credit needs@under the Community Reinvestment Act at the institution's most recent examination; or

(2) Any depository institution controlled by the bank holding company is not both well capitalized and well managed.

(d) May the Board impose supervisory limits on financial holding companies? The Board may, in the exercise of its supervisory authority, restrict or limit the commencement or conduct of additional activities or acquisitions of a financial holding company, or take other appropriate action, if the Board finds that the financial holding company does not have the financial resources, including capital resources, or managerial resources to engage in activities, make acquisitions, or retain ownership of companies permitted for financial holding companies.

(e) How is CRA performance of recently acquired insured depository institutions considered? An insured depository institution will be excluded for purposes of the review of CRA ratings described in subsection (c)(1) if:

(1) The bank holding company acquired the insured depository institution during the 12-month period preceding the filing of an election under subsection (a);

(2) The bank holding company has submitted an affirmative plan to the appropriate Federal banking agency for the institution to take actions necessary for the institution to achieve at least a rating of **A**satisfactory record of meeting community credit needs@under the Community Reinvestment Act at the next examination of the institution; and

(3) The appropriate Federal banking agency for the institution has accepted that plan.

(f) When is an election effective?

(1) In general. An election described in subsection (a) is effective on the 31<sup>st</sup> day after the date that the election was received by the appropriate Federal Reserve Bank, unless the Board notifies the bank holding company prior to that time that the election is ineffective.

(2) Earlier notification that an election is effective. The Board or the appropriate Federal Reserve Bank may notify a bank holding company that its election to become a financial holding company is effective prior to the 31<sup>st</sup> day after the election was filed with the appropriate Federal Reserve Bank. Such a notification must be in writing.

**' 225.83 What are the consequences of failing to continue to meet applicable capital and management requirements?**

(a) Notice by the Board. If the Board finds that any depository institution controlled by a financial holding company ceases to be well capitalized or well managed, the Board will notify the company in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the areas of noncompliance.

(b) Notification by a financial holding company required. Promptly upon becoming aware that any depository institution controlled by the financial holding company has ceased to be well capitalized or well managed, the company must notify the Board and identify the depository institution involved and the area of noncompliance.

(c) Execution of agreement acceptable to the Board.

(1) Agreement required; time period. Within 45 days after receiving a notice under subsection (a), the company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) Extension of time for executing agreement. Upon request by a company, the Board may extend the 45-day period under paragraph (1) if the Board determines that granting additional time is appropriate under the circumstances. A request by a company for additional time must include an explanation of why an extension is necessary.

(3) Agreement requirements. An agreement required by paragraph (1) to correct a capital or management deficiency must:

(i) Explain the specific actions that the company will take to correct all areas of noncompliance;

(ii) Provide a schedule within which each action will be taken;

(iii) Provide any other information that the Board may require; and

(iv) Be acceptable to the Board.

(d) Limitations during period of noncompliance. Until the Board determines that a company has corrected the conditions described in a notice under subsection (a):

(1) The Board may impose any limitations or conditions on the conduct or activities of the company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the Bank Holding Company Act; and

(2) The company and its affiliates may not engage in any additional activity or acquire control or shares of any company under section 4(k) of the Bank Holding Company Act without prior approval from the Board.

(e) Consequences of failure to correct conditions within 180 days.

(1) Divestiture of depository institutions. If a company does not correct the conditions described in a notice under subsection (a) within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the company to divest ownership or control of any depository institution owned or controlled by the company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) Alternative method of complying with a divestiture order. A company may comply with an order issued under paragraph (1) by ceasing to engage (both directly and through any subsidiary that is not a depository institution or a subsidiary of a depository institution) in all activities that are not permissible for a bank holding company to conduct under section 4(c)(8) of the Bank Holding Company Act. The termination of activities must be done within the time period referred to in paragraph (1) and subject to terms and conditions acceptable to the Board.

(f) Consultation with Other Agencies. In taking any action under this section, the Board will consult with the relevant Federal and state regulatory authorities.

**' 225.84 What Are the consequences of failing to maintain a satisfactory or better rating under the Community Reinvestment Act at all insured depository institution subsidiaries?**

(a) Limitations on activities.

(1) In general. Upon receiving a notice regarding performance under the Community Reinvestment Act in accordance with paragraph (2), a financial holding company may not:

(i) Commence any additional activity under subsection 4(k) or 4(n) of the Bank Holding Company Act; or

(ii) Directly or indirectly acquire control of a company engaged in any activity under subsections 4(k) or 4(n) of the Bank Holding Company Act.

(2) Notification. A financial holding company receives notice for purposes of this paragraph at the time that the appropriate Federal banking agency for any insured depository institution controlled by the company or the Board provides notice to the institution or company that the institution has received a rating of **A**needs to improve record of meeting community credit needs@or **A**substantial noncompliance in meeting community credit needs@in the institution's most recent examination under the Community Reinvestment Act.

(b) Exception for certain activities.

(1) Continuation of investment activities. The prohibition in subsection (a) does not prevent a financial holding company from continuing to make investments in the ordinary course of conducting investment activities under section 4(k)(4)(H) or

insurance company investment activities under section 4(k)(4)(I) of the Bank Holding Company Act if:

(i) The financial holding company lawfully was a financial holding company and commenced the investment activity under section 4(k)(4)(H) or the insurance company investment activities under section 4(k)(4)(I) prior to the time that an insured depository institution controlled by the financial holding company received a rating below **A**satisfactory record of meeting community credit needs<sup>®</sup> under the Community Reinvestment Act; and

(ii) The Board has not, in the exercise of its supervisory authority, advised the financial holding company that these activities must be restricted.

(2) Activities that are closely related to banking. The prohibition in subsection (a) does not prevent a financial holding company from commencing any additional activity or acquiring control of a company engaged in any activity under section 4(c) of the Bank Holding Company Act, if the company complies with the notice, approval, and other requirements under that section and section 4(j).

(c) Duration of Prohibitions. The prohibitions described in subsection (a) shall continue in effect until such time as each insured depository institution controlled by the financial holding company has achieved at least a rating of **A**satisfactory record of meeting community credit needs<sup>®</sup> under the Community Reinvestment Act at the most recent examination of the institution.

**' 225.90 -- What are the requirements for a foreign bank to be treated as a financial holding company?**

(a) Foreign banks as financial holding companies. A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, and any company that owns or controls such a foreign bank, will be treated as a financial holding company if:

(1) The foreign bank is and remains well capitalized and well managed; and

(2) The foreign bank, or the company that owns the foreign bank, has made an effective election to be treated as a financial holding company under this subpart.

(b) Standards for **A**well capitalized.<sup>®</sup> A foreign bank will be considered **A**well capitalized<sup>®</sup> if either:

(1) (i) Its home country supervisor, as defined in ' 211.21 of the Board's Regulation K (12 CFR 211.21), has adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord);

(ii) The foreign bank maintains a Tier 1 capital to total risk-based assets ratio of 6 percent and a total capital to total risk-based assets ratio of 10 percent, as calculated under its home country standard;

(iii) The foreign bank maintains a Tier 1 capital to total assets leverage ratio of at least 3 percent; and

(iv) The Board determines that the foreign bank's capital is comparable to the capital required for a U.S. bank owned by a financial holding company; or

(2) The foreign bank has obtained a determination from the Board under ' 225.91(c) that the foreign bank's capital is otherwise comparable to the capital that would be required of a U.S. bank owned by a financial holding company.

(c) Standards for Well managed. A foreign bank will be considered Well managed if:

(1) Each of the U.S. branches, agencies, and commercial lending subsidiaries of the foreign bank has received at least a satisfactory composite rating at its most recent assessment;

(2) The home country supervisor of the foreign bank considers the overall operations of the foreign bank to be satisfactory or better; and

(3) The Board determines that the management of the foreign bank meets standards comparable to those required of a U.S. bank owned by a financial holding company.

**' 225.91 How may a foreign bank elect to be treated as a financial holding company?**

(a) Filing requirement. A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, or a company that owns or controls such a foreign bank, may elect to be treated as a financial holding company by filing a written declaration with the appropriate Reserve Bank.

(b) Contents of declaration. The declaration must:

(1) State that the foreign bank or the company elects to be treated as a financial holding company;

(2) Provide the risk-based and leverage capital ratios of the foreign bank as of the close of the most recent quarter and as of the close of the most recent audited reporting period;

(3) Certify that the foreign bank meets the standards of well capitalized set out in ' 225.90(b)(1)(i),(ii) and (iii) or ' 225.90(b)(2) as of the date the foreign bank or company files its election; and

(4) Certify that the foreign bank is well managed as defined in ' 225.90(c)(1) and (2) as of the date the foreign bank or company files its election.

(c) Pre-clearance process. Before filing an election to be treated as a financial holding company, a foreign bank or company may file a request for review of its qualifications to be treated as a financial holding company. The Board will endeavor to make a determination on such requests within 30 days of receipt.

' **225.92 How does an election by a foreign bank become effective?**

(a) In general. An election filed by a foreign bank or company under ' 225.91 will not be effective unless the Board determines that -

(1) The foreign bank is well capitalized and well managed; and

(2) In the case of a foreign bank that operates a branch in the United States that is insured by the Federal Deposit Insurance Corporation, the branch has received at its most recent examination a rating of ~~A~~satisfactory record of meeting community credit needs~~@~~or better under the Community Reinvestment Act.

(b) Factors Used in the Board's Determination Regarding Comparability of Capital and Management. In determining whether a foreign bank is well capitalized and well managed in accordance with comparable capital and management standards, the Board will give due regard to national treatment and equality of competitive opportunity. In this regard, the Board may take into account the foreign bank's composition of capital, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements, the extent to which the foreign bank is subject to comprehensive consolidated supervision, and other factors that may affect analysis of capital and management. The Board will consult with the home country supervisor for the foreign bank as appropriate.

(c) Timing. The Board will notify a foreign bank or company of its determination under this section within 30 days of the filing of the election unless the Board determines that it does not have sufficient information on which to base a finding.

' **225.93 What are the consequences of a foreign bank failing to continue to meet applicable capital and management requirements?**

(a) Notice by the Board. If a foreign bank or company has made an effective election to be treated as a financial holding company under this subpart and the Board finds that the foreign bank ceases to be well capitalized or well managed, the Board will notify the foreign bank or company in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the areas of noncompliance.

(b) Notification by a financial holding company required. Promptly upon becoming aware that it has ceased to be well capitalized or well managed, the

foreign bank, or any company that controls such foreign bank, must notify the Board and identify the area of noncompliance.

(c) Execution of agreement acceptable to the Board.

(1) Agreement required; time period. Within 45 days after receiving a notice under subsection (a), the foreign bank or company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) Extension of time for executing agreement. Upon request by a company, the Board may extend the 45-day period under paragraph (1) if the Board determines that granting additional time is appropriate under the circumstances. A request by a company for additional time must include an explanation of why an extension is necessary.

(3) Agreement requirements. An agreement required by paragraph (1) to correct a capital or management deficiency must:

(i) Explain the specific actions that the foreign bank or company will take to correct all areas of noncompliance;

(ii) Provide a schedule within which each action will be taken;

(iii) Provide any other information that the Board may require; and

(iv) Be acceptable to the Board.

(d) Limitations during period of noncompliance. Until the Board determines that a company has corrected the conditions described in a notice under subsection (a):

(1) The Board may impose any limitations or conditions on the conduct or the U.S. activities of the foreign bank or company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the Bank Holding Company Act; and

(2) The company and its affiliates may not engage in any new activity in the United States or acquire control or shares of any company under section 4(k) of the Bank Holding Company Act without prior approval from the Board.

(e) Consequences of failure to correct conditions within 180 days.

(1) Termination of Offices and Divestiture. If a foreign bank or company does not correct the conditions described in a notice under subsection (a) within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the foreign bank or company to terminate the foreign bank's U.S. branches and agencies and divest any commercial lending companies owned or controlled by the foreign bank or company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) Alternative method of complying with a divestiture order. A foreign bank or company may comply with an order issued under paragraph (1) by ceasing to engage (both directly and through any subsidiary) in all activities that are not permissible for a foreign bank to conduct under sections 2(h) and 4(c) of the Bank Holding Company Act. The termination of activities must be done within the time period referred to in paragraph (1) and subject to terms and conditions acceptable to the Board.

(f) Consultation with Other Agencies. In taking any action under this section, the Board will consult with the relevant Federal and state regulatory authorities.

**' 225.94 What are the consequences of an insured branch failing to maintain a satisfactory or better rating under the Community Reinvestment Act?**

(a) Insured branch as an Insured depository institution.@ A U.S. branch of a foreign bank that is insured by the Federal Deposit Insurance Corporation shall be treated as an Insured depository institution@ for purposes of ' 225.84.

(b) Applicability. The provisions of ' 225.84, with the modifications contained in this section, shall apply to a foreign bank that operates an insured branch referred to in paragraph (a), and any company that owns or controls such

a foreign bank, that has made an effective election under ' 225.92 in the same manner and to the same extent as they apply to a financial holding company.

By order of the Board of Governors of the Federal Reserve System,  
January 18, 2000.

(Signed) Jennifer J. Johnson

Jennifer J. Johnson,  
Secretary of the Board.