

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-1092]

Bank Holding Companies and Change in Bank Control

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending Regulation Y to expand the ability of all bank holding companies, including financial holding companies, to process, store and transmit nonfinancial data in connection with their financial data processing, storage and transmission activities. Specifically, the Board is raising the revenue limit that currently applies to the nonfinancial data processing activities of bank holding companies from 30 percent to 49 percent. The Board also announced that it will consider proposals by a financial holding company to engage in, or acquire a company engaged in, other nonfinancial data processing, information portal, and technology-related activities that the financial holding company believes are complementary to financial activities on a case-by-case basis in accordance with the procedures established by section 4(j) of the Bank Holding Company Act.

EFFECTIVE DATE: The final rule is effective January 8, 2004.

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SUPPLEMENTARY INFORMATION:

A. Background

The Bank Holding Company Act (12 U.S.C. §§ 1841 et seq.) (BHC Act), as amended by the Gramm-Leach-Bliley Act (GLB Act),¹ permits all bank holding companies to engage in any nonbanking activity that the Board had determined, by order or regulation prior to November 12, 1999, to be “so closely related to banking as to be a proper incident thereto” under section 4(c)(8) of the BHC Act.² The GLB Act requires bank holding companies to conduct these activities subject to the terms and conditions

¹ Pub. L. No. 106-102, 113 Stat. 1338 (1999).

² See 12 U.S.C. 1843(c)(8).

contained in the Board's regulation or order authorizing the activity, unless the Board modifies those terms or conditions.³

The GLB Act also permits a bank holding company or foreign bank that has made an effective election to become a financial holding company (FHC) to engage in a broader range of activities that the GLB Act defines as being financial in nature or incidental to a financial activity, including the sale of insurance as principal or agent, full-scope securities underwriting and dealing, and merchant banking.⁴ FHCs also may engage in any other activity that the Board, in consultation with the Secretary of the Treasury, determines to be financial in nature or incidental to a financial activity.⁵ The text and legislative history of the GLB Act indicate that the "financial in nature" test was intended to be broader and more flexible than the "closely related to banking" standard that previously governed the scope of permissible nonbanking activities under section 4(c)(8) of the BHC Act.⁶ Moreover, the factors that the Board is directed to consider in determining whether an activity is financial in nature or incidental to financial activities indicates that the scope of financial and incidental activities may expand over time in light of, among other things, changes in the marketplace in which FHCs compete.⁷

The GLB Act also permits an FHC to engage in a nonfinancial activity if the Board determines that the activity is "complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally."⁸ This authority was intended to permit the Board to authorize an FHC to engage, to a limited extent, in activities that appear to be commercial if a meaningful connection exists between the proposed commercial activity and the FHC's financial activities and the proposed commercial activity would not pose undue risks to the safety and soundness of the FHC's affiliated depository institutions or the

³ See id.

⁴ See 12 U.S.C. 1843(k)(4)(B), (E) and (H).

⁵ See 12 U.S.C. 1843(k)(1)(A), (2) and (4).

⁶ See H. Rept. No. 106-434 at 153 (1999) ("Permitting banks to affiliate with firms engaged in financial activities represents a significant expansion from the current requirement that bank affiliates may only be engaged in activities that are closely related to banking.").

⁷ The GLB Act directs the Board to consider a variety of factors in considering whether an activity is financial in nature or incidental thereto, including (1) the purposes of the BHC Act and the GLB Act; (2) changes and reasonably expected changes in the marketplace in which FHCs compete and in the technology for delivering financial services; and (3) whether the activity is necessary or appropriate to allow FHCs to compete effectively with other companies providing financial services, to deliver efficiently information and services that are financial in nature through the use of technological means, including any application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions, and to offer customers any available or emerging technological means for using financial services or for the document imaging of data. See 12 U.S.C. 1843(k)(3).

⁸ See id. at section 1843(k)(1)(B).

financial system. The GLB Act requires an FHC to obtain the Board's approval under section 4(j) of the BHC Act prior to engaging in an activity that the FHC believes is complementary to financial activities.⁹

B. Board Proposal

Following passage of the GLB Act, several FHCs, represented by their trade associations, requested that the Board authorize FHCs to engage in, or invest in companies engaged in, a wide range of data processing, technology, communication and e:commerce-related activities. In response to these requests, the Board took several steps. In December 2000, the Board adopted a final rule that authorizes FHCs to act as a "finder" through electronic or other means and thereby bring together buyers and sellers of financial and nonfinancial products for transactions that the parties themselves negotiate and consummate.¹⁰ The Board's Finder Rule addressed several of the activities requested by the FHCs and permits FHCs, among other things, to—

- Host an electronic marketplace on the FHC's Internet web site that provides hypertext links to the web-sites of third parties;
- Host the web site of a merchant that provides information concerning the merchant and its products and permits buyers to submit orders for such products or services; and
- Operate an Internet web site that allows multiple buyers and sellers to exchange information concerning the products and services that they are willing to purchase or sell, locate potential counterparties for transactions and enter into transactions between themselves.

To address other aspects of the FHCs' requests, the Board in December 2000, requested comment on a proposed rule that would modify the limits imposed by the Board on the amount of nonfinancial data processing activities that a bank holding company may conduct in connection with its financial data processing activities.¹¹ Regulation Y currently permits all bank holding companies to provide data processing and data transmission services, facilities (including data processing and data transmission hardware, software, documentation, or operating personnel), data bases, advice and access to such services, facilities and data to any customer if the data processed or furnished are financial, banking or economic in nature.¹² Regulation Y also currently

⁹ See 12 U.S.C. 1843(j)(1)(A) and (E).

¹⁰ See 65 FR 80735, Dec. 22, 2000 (Finder Rule). The Board, in consultation with the Secretary of the Treasury, determined that acting as finder, as defined in the rule, is an activity that is incidental to financial activities.

¹¹ See 65 FR 80384, Dec. 21, 2000.

¹² See 12 CFR 225.28(b)(14)(i). The phrases "data processing services" and "data processing activities" used herein refer collectively to the broad array of data processing and data transmission services and functions described above that a bank holding company may perform under section 225.28(b)(14).

permits a bank holding company or nonbank subsidiary engaged in processing financial data to provide data processing services for nonfinancial data so long as the annual revenues derived by the company or subsidiary from its nonfinancial data processing activities does not exceed 30 percent of the total annual revenue derived by the company or subsidiary from providing data processing services under section 225.28(b)(14).¹³ The Board proposed increasing this limit on nonfinancial data processing activities from 30 percent to 49 percent.

The proposal also requested comment on whether the Board should authorize an FHC to invest, as a complementary activity, up to 5 percent of its Tier 1 capital in companies that provide (1) data storage services for any type of data, so long as the company also provided data storage services for financial data; (2) general data processing services for any type of data, so long as the company derived at least 20 percent of its total revenues from financial data processing activities, providing data processing services to depository institutions and their affiliates, and the sale of other financial products and services; and (3) information portal services over electronic networks.¹⁴ The Board indicated that an FHC would be expected to market and provide financial products or services through any information portal owned under the proposed authority. The Board asked for comment on whether the connections described above between the acquired company's nonfinancial and financial activities were sufficient to ensure that the acquired company's nonfinancial activities were complementary to financial activities within the meaning of the GLB Act. Consistent with the GLB Act, the Board also proposed to require that FHCs obtain the Board's prior approval under section 4(j) of the BHC Act for any proposed investment under these complementary authorities.¹⁵

The Board also solicited the public's views on whether the Board should develop a proposal that would authorize FHCs to invest in companies engaged in developing new technologies that might support the marketing or sale of financial products or services, providing communication links, or selling and distributing financial and nonfinancial products and services through electronic means. The Board asked commenters supporting further Board action with respect to these investments to provide detailed arguments and data that would support a finding that investments in companies engaged in these activities are financial in nature or incidental or complementary to financial activities. The Board also sought comment on a variety of other potential issues associated with these investments, including whether authorizing such investments would be consistent with the intent of the GLB Act to maintain the general separation of banking and commerce, and whether investments in such companies, if permitted, should be limited to non-controlling positions.

¹³ See id. at section 225.28(b)(14)(ii); Letter from Scott G. Alvarez, Associate General Counsel of the Board, to Bryan G. Handlos, Esq., dated March 8, 1999.

¹⁴ Electronic information portal services involve providing or facilitating the search, exchange, consolidation, screening, filtering or aggregation of any type of information over electronic networks, and may include acting as an Internet service provider and providing on-line search engines, bulletin boards, newsgroup services and "chat" rooms.

¹⁵ See 12 U.S.C. 1843(j)(1)(A) and (E).

C. Overview of Public Comments

The Board received thirteen comments on the proposal from banks, bank holding companies, and trade associations that represent banking organizations, securities firms and other financial service providers. All of the commenters supported Board action in this area and the Board's efforts to expand the range of activities permissible for bank holding companies and FHCs. Several commenters also stated that the proposal was consistent with Congress's desire, as expressed in the GLB Act, to allow FHCs to engage in an expanded range of financially related activities. Commenters also indicated that the proposal would allow bank holding companies to develop additional sources of revenue and would not present significant safety and soundness concerns.

1. Amending Existing Limits on Nonfinancial Data Processing Activities.

Commenters strongly supported the Board's proposal to increase, from 30 percent to 49 percent, the amount of data processing revenues that a bank holding company or nonbank subsidiary engaged in financial data processing activities may derive from processing nonfinancial data. Commenters stated that there are no operational or functional differences between processing financial and nonfinancial data and that the proposal would allow bank holding companies to use more efficiently the systems, expertise and resources that they have developed for processing financial data. Commenters also stated that bank holding companies have gained experience in processing nonfinancial data under the more limited authority currently available under Regulation Y, and that the proposal would allow bank holding companies to meet the needs of their customers more effectively.

Also, customers increasingly are seeking data processing services that can satisfy both the financial and nonfinancial data processing needs of the customer. For example, some hospitals that previously sought only billing, payroll and accounting data processing services from bank holding companies now seek a more complete package of data processing services that include medical record organization, storage and retrieval, as well as billing, payroll and accounting services.

2. General Data Processing, Storage and Portal Services by FHCs.

Commenters also supported the proposal to allow FHCs to invest in companies engaged in general data storage, general data processing, or electronic information portal activities. Commenters offered several reasons why the Board should find such investments to be financial in nature, incidental to financial activities or complementary to financial activities. For example, some commenters argued that data processing and data storage activities are, by their nature, financial activities regardless of the type of data involved. Others argued that the proposed activities were similar to, or an appropriate extension of, the existing data processing activities of bank holding

companies or the “finder” activities permissible for FHCs.¹⁶ Similarly, some commenters contended that general data storage activities are functionally similar to the safe deposit and custody services that banks have traditionally offered to their customers.

Alternatively, commenters asserted that the connections required by the proposed rule between the acquired company’s nonfinancial activities and financial activities were sufficient to demonstrate that the investments were complementary to financial activities for purposes of the GLB Act. Some, however, argued that the proposed investments should be deemed incidental to financial activities if the acquired company engaged in any financial data processing activities or did so to a substantial extent. Similarly, some commenters argued that investing in a company providing information portal services should be deemed to be incidental to financial activities if the portal was used to sell financial products or services, or if the company operating the portal derived a certain portion of its revenues (e.g. 50 percent) from financial activities.

Several commenters opposed the proposed 5 percent Tier 1 capital limit on investments made by FHCs in companies providing general data processing, data storage or information portal services. These commenters argued that the 5 percent investment limit was too low, was unnecessary to address any potential safety and soundness issues, or would force FHCs to sell profitable investments or engage in these activities only through separate subsidiaries.¹⁷

Some commenters also asserted that the 60-day prior notice requirement for complementary investments would impede the ability of FHCs to respond quickly to investment opportunities and marketplace developments, and asked the Board to consider establishing a streamlined notice procedure for complementary investments. One commenter, however, asserted that the prior approval process was appropriate and would allow the Board to review and address on an individualized basis the issues associated with proposals by FHCs to engage in complementary activities.

3. Broad technology, communication and e:commerce investments by FHCs.

Commenters generally favored allowing FHCs to invest in companies engaged in developing new technology, providing communication links, or marketing or selling financial and nonfinancial products or services through electronic means and encouraged the Board to take steps to determine that these types of investments are financial in nature or incidental or complementary to financial activities. Only a few commenters, however, addressed specifically this aspect of the proposal and the Board’s questions concerning these types of investments. Commenters generally asserted that the financial industry increasingly

¹⁶ A few commenters asserted that the Board should reclassify acting as a “finder” as an activity that is financial in nature, or should expand the types of services that an FHC may provide when acting as a finder. Such actions are outside the scope of this rulemaking.

¹⁷ A few commenters also stated that no special regulatory capital charge should be imposed on the proposed complementary investments.

relies on technology, communication systems, and electronic sales channels to support the marketing and sale of financial products and services. Commenters also asserted that new technologies, systems and networks often are developed and operated to support a wide range of financial and nonfinancial applications, and that companies providing these services may seek equity (rather than contractual) partners. In light of these developments, commenters argued that FHCs must be able to invest in companies developing or operating new technologies, communication systems and electronic sales channels to ensure that these technologies, systems and networks will meet the needs of the financial industry, and to ensure that FHCs do not become reliant on third parties for the tools and delivery channels that may be used in the marketing and sale of financial products and services. Some commenters also noted that while FHCs may invest in technology-related companies under the GLB Act's merchant banking authority,¹⁸ the cross-marketing restrictions imposed on merchant banking investments by the GLB Act may diminish the ability of FHCs to compete for these investments.

D. Explanation of Final Rule

After carefully considering the comments received on the proposal, the Board has adopted a final rule that amends the limitations previously imposed by the Board to allow all bank holding companies additional flexibility to process, store and transmit nonfinancial data in connection with their financial data processing, storage and transmission activities. The Board believes that the final rule will enhance the ability of bank holding companies to compete in the market for data processing services and respond to the financial and nonfinancial data processing needs of their customers. The Board also believes that amending the limitations in this manner would not negatively affect the safety and soundness of bank holding companies and their depository institution subsidiaries.

As discussed further below, the Board also believes that there are a variety of ways that additional nonfinancial data processing, information portal and other technology-related investments and activities may be complementary to the financial activities of an FHC within the meaning of the GLB Act. However, the factors and relationships that may demonstrate that a proposed activity or investment by an FHC is complementary to the financial activities of the FHC may vary based on the facts and circumstances associated with the proposal. In light of these facts, and the limited record developed during this rulemaking, the Board believes it is appropriate at this time to review proposals by FHCs to engage in, or acquire a company engaged in, a complementary activity on a case-by-case basis in accordance with the prior notice procedures established by section 4(j) of the BHC Act. The Board expects to revisit whether it would be appropriate to propose a rule permitting FHCs generally to engage in, or invest in companies engaged in, additional nonfinancial data processing, information portal or other technology-related activities after the Board has gained experience in reviewing requests by individual FHCs to engage complementary activities.

¹⁸ See 12 U.S.C. 1843(k)(4)(H).

1. Expanded Nonfinancial Data Processing Authority for All Bank Holding Companies

Section 225.28(b)(14) of Regulation Y currently permits bank holding companies, including FHCs, to provide data processing services (including software, hardware, advice and personnel) to any customer if the data to be processed is financial, banking or economic in nature.¹⁹ The authority to engage in financial data processing activities permits bank holding companies to provide their customers with a wide range of data processing services, including data processing related to payroll, accounts receivable and accounts payable processing; bill preparation and bill payment; processing credit card, debit card and ATM transactions and other electronic funds transfers; loan processing; credit analysis; tax planning; accounting and bookkeeping services; economic forecasting; and data processing services to support the customer's marketing, sale and delivery of financial products and services over the Internet or other electronic networks, such as home banking or securities brokerage services.²⁰

Regulation Y also currently permits a company engaged in financial data processing activities under section 225.28(b)(14) to process nonfinancial data so long as the annual revenue derived by the company from its nonfinancial data processing activities does not exceed 30 percent of the company's total annual data processing revenues. As noted above, the Board proposed to raise this 30 percent limit on the nonfinancial data processing activities of bank holding companies to 49 percent. Commenters strongly supported this change for the reasons outlined above.

The Board has amended its regulatory limitation governing the conduct of data processing activities previously authorized for bank holding companies under section 4(c)(8) of the BHC Act to raise the threshold on nonfinancial data processing services as proposed.²¹ In accordance with the GLB Act, all bank holding companies, including

¹⁹ See 12 CFR 225.28(b)(14)(i). Any hardware provided must be offered only in conjunction with software designed and marketed for the processing and transmission of financial, banking or economic data, and any general purpose hardware may not constitute more than 30 percent of the cost of any packaged offering. See 12 CFR 225.28(b)(14)(i)(B).

²⁰ See The Toronto-Dominion Bank, 83 Federal Reserve Bulletin 335 (1997); Royal Bank of Canada, 83 Federal Reserve Bulletin 135 (1997); Compagnie Financiere de Paribas, 82 Federal Reserve Bulletin 348 (1996); BNCCORP, INC., 81 Federal Reserve Bulletin 294 (1995); The Bank of New York Company, Inc., 80 Federal Reserve Bulletin 1107 (1994); Bank One Corporation, 80 Federal Reserve Bulletin 139 (1994); see also Letter from J. Virgil Mattingly, General Counsel of the Board, to Thomas A. Plant, Esq., dated Nov. 25, 1997.

²¹ See 12 U.S.C. 1843(c)(8). At the time the Board adopted the current 30-percent revenue limit on nonfinancial data processing activities, the Board specifically noted that it reserved the authority to review and adjust this limit as appropriate. See 62 FR 9290, 9304, Feb. 28, 1997.

FHCs, may take advantage of the expanded data processing authority granted by the final rule.

The Board believes that the final rule will allow all bank holding companies to leverage more effectively the experience and resources they have developed from engaging in financial data processing activities. In addition, by allowing bank holding companies to process additional amounts of nonfinancial data for their customers, the final rule should allow bank holding companies to achieve additional economies of scale and compete more effectively with nonbank providers of data processing services.

The 49-percent revenue limit included in the final rule ensures that the data processing subsidiaries of bank holding companies operating under section 4(c)(8) of the BHC Act remain predominantly engaged in processing financial, banking or economic data. The Board believes this limit provides reasonable assurances that any nonfinancial data processing activities conducted by a bank holding company under section 225.28(b)(14) will remain incidental to the company's financial data processing for purposes of section 4(c)(8) of the BHC Act.

Bank holding companies that provide data processing services to customers should take appropriate steps to maintain the security, integrity and confidentiality of the customer's data.²² In addition, bank holding companies must take appropriate steps to ensure compliance with all applicable federal and state laws governing the privacy of consumer data processed by the bank holding company on behalf of third parties.

Several commenters asked the Board to clarify the ability of bank holding companies to provide data storage, retrieval and imaging services as part of their data processing activities under section 225.28(b)(14). Data storage, retrieval and imaging are functions that are an integral and often necessary part of data processing and data transmission activities. Accordingly, the Board previously has indicated that the data processing services that bank holding companies may provide under section 225.28(b)(14) include data storage, imaging and retrieval.²³ In light of the commenters' requests, the Board has included language in the final rule that clarifies that bank holding companies may provide data storage, imaging and retrieval services for financial, economic or banking data without limit, and may provide such services for nonfinancial data to the extent permitted by the 49-percent revenue limit adopted by the final rule.²⁴

²² See Federal Financial Institutions Examination Council, *IT Examination Handbook—Information Security* (Dec. 2002).

²³ See Royal Bank of Canada, 83 Federal Reserve Bulletin 135 (1997); BNCCORP, INC., 81 Federal Reserve Bulletin 295 (1995); State Street Boston Corporation, 81 Federal Reserve Bulletin 1049 (1995).

²⁴ A few commenters expressed concern that any revenue-based limit on nonfinancial data processing activities may be difficult to monitor or may cause pricing distortions in the market for data processing services. These commenters did not present any evidence indicating that the existing 30-percent test, which also is based on revenue, has caused significant compliance or pricing difficulties, and the Board notes that other measures of

(continued . . .)

A few commenters also asserted that the Board should allow a bank holding company to use any excess capacity that may exist in the company's data processing systems to process nonfinancial data. The Board previously has indicated that bank holding companies may use any excess capacity that results in good faith from the bank holding company's financial data processing activities under section 225.28(b)(14) to process nonfinancial data, and bank holding companies may continue to use their excess capacity in this manner subject to the Board's regulations and policies governing these activities.²⁵ The Board also previously has indicated that revenue derived by a bank holding company from the use of excess capacity is not included for purposes of determining the company's compliance with the rule's revenue limit on nonfinancial data processing activities.²⁶

A bank holding company may use any currently available or newly developed technological means, including dedicated or shared electronic facilities, the Internet and optical technology, to provide its customers permissible data processing services. In addition, a bank holding company may provide its customers data processing services either as a stand-alone service or in conjunction with other products and services that the bank holding company is authorized to provide under the BHC Act.

The Board notes, however, that the authority to provide data processing services for financial and nonfinancial data does not authorize bank holding companies to engage in an activity simply because it involves the use of a computer or the transmission of data in electronic form. Section 225.28(b)(14) permits a bank holding company to provide data processing services to third-party customers to support the functions or activities of the customer. Where the bank holding company's data processing activities represent the conduct of a separate or different activity by the bank holding company itself, the bank holding company must have the authority to engage in that activity under other provisions of Regulation Y. For example, while a bank holding company may provide data processing support to an unaffiliated insurance agency under section 225.28(b)(14), such as, for example, by processing customer payments and optically scanning and storing the insurance policies issued by the agency, a bank holding company may not itself sell insurance (through electronic means or otherwise) under section 225.28(b)(14).

A few commenters asked that the Board permit bank holding companies to determine their compliance with the 49-percent revenue limit on nonfinancial data processing activities on a business line or organization-wide basis. The Board recognizes

activity (such as one based on the quantity of financial and nonfinancial data processed) likely would be even more difficult for bank holding companies to monitor than the existing revenue-based test.

²⁵ See 12 CFR 225.123(e)(1); Citicorp, 68 Federal Reserve Bulletin 505, 510 (1982).

These policies prohibit a bank holding company from acquiring equipment solely for the purpose of creating excess capacity and limit the ability of bank holding companies to provide hardware and software in connection with their sale or provision of excess data processing capacity. See 12 CFR 225.123(e)(1).

²⁶ See 62 FR 9290, 9304 at n.5, Feb. 28, 1997.

that there may be situations where a bank holding company has bona fide operational reasons for conducting its financial and related nonfinancial data processing activities through separately incorporated subsidiaries. Accordingly, bank holding companies may request permission to administer the 49-percent revenue limit on a business-line or multiple-entity basis in appropriate circumstances. The Board has delegated authority to its General Counsel, in consultation with the Director of the Division of Banking Supervision and Regulation, to review and act on these requests. Such requests should describe the structure of the holding company's data processing operations, the methodology the holding company proposes to use to administer the revenue test, and the reasons why the holding company believes the proposed methodology is appropriate. The General Counsel or the Board where appropriate will consider any request in light of all the facts and circumstances, including the inter-relationships between the data processing activities conducted by the bank holding company's separate subsidiaries, the holding company's business or operational reasons for conducting its data processing activities in different subsidiaries, and the level of the holding company's ownership interest in the individual subsidiaries.

The Board will revisit whether it would be appropriate to authorize all bank holding companies to monitor compliance with the revenue limit on a consolidated or business-line basis based on the experience gained from reviewing any such requests.

2. General Data Storage, Data Processing, Electronic Information Portal, Technology, Communication and E:Commerce Investments

In response to requests from FHCs, the Board also requested comment on whether the Board should adopt a rule permitting FHCs to invest, as a complementary activity, in any company that provides (1) data storage services for nonfinancial data without regard to the revenue limitations discussed above, so long as the company provided data storage services for some financial data; (2) data processing services for nonfinancial data, so long as the company derived at least 20 percent of its total revenues from processing financial data, processing data for depository institutions, or the sale of other financial products or services; or (3) electronic information portal services.²⁷ The Board proposed limiting the aggregate carrying value of an FHC's investments in companies engaged in these activities to 5 percent of the FHC's Tier 1 capital. FHCs also had requested authority to invest in companies that develop technology that might support the marketing or sale of financial products or services in the future; provide communication linkages for any type of information; or market and sell nonfinancial and financial products or services through electronic means.

The Board notes that much of the need expressed by FHCs for authority to make these types of investments may be addressed by the Board's decision to raise the revenue limit on the nonfinancial data processing activities of bank holding companies to 49 percent. In addition, the Board notes that FHCs currently have the authority to make

²⁷ The Board indicated that it expected an FHC to market or provide financial products or services through any electronic information portal service owned under this proposed authority.

investments in data processing companies that do not comply with the 49 percent revenue limit and other technology-related companies under the GLB Act's merchant banking authority. Although some commenters noted that the cross-marketing restrictions applicable to merchant banking investments may diminish the attractiveness of this investment authority, the Board notes that these restrictions apply only to the depository institution subsidiaries of an FHC (and not to the FHC itself or its nonbank affiliates) and Congress currently is considering legislation that would loosen these restrictions in several important respects.²⁸ Commenters also presented little evidence that, in the Board's view, indicates why data processing, information portal and the other technology-related activities, without limit on the type of data processed or amount of nonfinancial data processed, should, in all circumstances, be found to be financial in nature or incidental to a financial activity.

The GLB Act does permit an FHC to engage in, or acquire a company engaged in, a nonfinancial activity if the Board determines that the activity is complementary to financial activities and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system. As noted above, this authority was intended to provide the Board a mechanism to allow an FHC to engage to a limited degree in commercial activities if the proposed commercial activities would meaningfully complement or enhance the financial activities of the FHC, and the proposed activities would not present undue risks to the subsidiary depository institutions of the FHC or the financial system.

The Board believes that there are a variety of relationships or connections between a commercial activity or investment and an FHC's financial activities that may indicate that the activity or investment is complementary to the FHC's activities within the meaning of the GLB Act. Ultimately, the determination whether a commercial activity or investment is complementary will depend on the nature of the activity and the level and quality of the many types of connections that may exist between the proposed activity or investment and the FHC's financial activities.

The Board does not believe that the limited record developed during this rulemaking provides the Board a sufficient basis for determining, by rule, that nonfinancial data processing and information portal activities are as a general matter financial in nature, incidental to a financial activity, or complementary to the financial activities of FHCs. The Board also does not believe that the record is sufficient at this time to warrant developing a formal proposal requesting comment on whether the Board should determine, by rule, that the other technology-related investments suggested by the initial FHC requestors are as a general matter financial in nature, incidental to a financial activity, or complementary to the financial activities of FHCs.

In light of the foregoing, the Board believes it is appropriate to review proposals by FHCs to engage in, or acquire a company engaged in, general data processing and electronic information portal activities, as well as other nonfinancial technology-related

²⁸ See Financial Services Regulatory Relief Act of 2003, section 501, H.R. 1375, 108 Cong., 1st Sess. (2003); H. Rept. 108-152, Part 1, 108 Cong., 1st Sess. (2003).

activities, on a case-by-case basis under section 4(j) of the BHC Act. This approach is consistent with the procedure established by the GLB Act for FHCs to engage in complementary activities.²⁹ This process will allow an FHC to present, and the Board to review, all the connections that may demonstrate that a proposed investment or activity is complementary to the FHC's financial activities for purposes of the GLB Act. Moreover, because the proposed rule would have required FHCs to obtain the Board's approval under section 4(j) prior to making any complementary investment under the proposal, the procedural approach adopted by the Board does not impose any additional filing burden on FHCs.

FHCs that believe a proposed investment or activity is complementary to the FHC's financial activities should submit a notice to the Board in accordance with section 4(j) of the BHC Act and section 225.89 of the Board's Regulation Y (12 CFR 225.89). The notice should, among other things, identify and define the proposed complementary activity, identify the financial activity to which the proposed complementary activity would be complementary, and describe the relationships and connections between the proposed activity and the identified financial activity that the FHC believes support a finding that the proposed activity is complementary.³⁰ In addition, the notice should explain why the proposed complementary activity or investment would not pose undue risks to the safety and soundness of the FHC's subsidiary depository institutions or the financial system and what, if any, limits would be appropriate to ensure that the investment or activity remains small in relation to the FHC's financial activities.

Regulatory Flexibility Act

In accordance with section 4(a) of the Regulatory Flexibility Act (5 U.S.C. 604(a)), the Board must publish a final regulatory flexibility analysis with this rulemaking. The final rule expands the ability of bank holding companies of all sizes to process, store and transmit nonfinancial data in connection with their financial data processing activities. The Board specifically requested comment on the likely burden that the proposed rule would have on bank holding companies of all sizes, including small bank holding companies.³¹ Commenters noted that the rule should enhance the ability of bank holding companies of all sizes to compete with other providers of data processing services, achieve additional economies of scale and utilize more efficiently their existing data processing resources and expertise. In response to comments received, the Board also has clarified the ability of bank holding companies to engage in data storage, imaging and retrieval activities in connection with their permissible data processing activities, and to use any excess capacity that may result, in good faith, from the bank holding company's financial data processing activities to process, store and transmit nonfinancial data.

²⁹ See 12 U.S.C. 1843(j)(A) and (E).

³⁰ See 12 CFR 225.89(a).

³¹ For purposes of the Regulatory Flexibility Act, small entities are defined to include bank holding companies that have \$150 million or less in assets. See 13 CFR 121.201. As of March 31, 2003, there were 3117 bank holding companies with consolidated total assets of \$150 million or less.

A few commenters asked that the Board permit bank holding companies to derive more than 49 percent of their data processing revenues from processing, storing or transmitting nonfinancial data, or to apply the rule's revenue limit on nonfinancial data processing activities on a business-line or organization-wide basis. For the reasons discussed in the supplementary information above, the Board does not believe such actions would generally be appropriate or consistent with section 4(c)(8) of the BHC Act. The Board, however, has established a process whereby any bank holding company, including small bank holding companies, may obtain permission to administer the rule's revenue limit on nonfinancial data processing activities on a multiple-entity or consolidated basis. This process will permit bank holding companies, including small bank holding companies, to administer the revenue test in a more flexible manner when such action would be consistent with the BHC Act.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget ("OMB"). The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number.

As discussed in the Supplementary Information above, bank holding companies may request permission to administer the 49-percent revenue limit on nonfinancial data processing activities adopted by the final rule on a business-line or multiple-entity basis in appropriate circumstances. Such requests should be directed to the Board's General Counsel and should describe the structure of the holding company's data processing operations, the methodology the holding company proposes to use to administer the revenue test, and the reasons why the holding company believes the proposed methodology is appropriate. It is estimated that there will be 5 respondents per year with an estimated burden of 2 hours per response. Therefore the total amount of annual burden is estimated to be 10 hours. There is estimated to be \$200 annual cost burden over the annual hour burden. An OMB control number for this information collection will be obtained.

A request may be filed in letter form and there will be no reporting form for this information collection. The agency form number for the notice will be the FR 4021. A bank may request confidentiality for the information contained in the notice in accordance with the Freedom of Information Act and the Board's Rules Regarding the Availability of Information. See 5 U.S.C. 552; 12 CFR Part 261.

As required by the GLB Act, section 225.89 of the Board's Regulation Y currently requires an FHC to obtain the Board's approval prior to engaging in, or acquiring a company engaged in, an activity that the FHC believes is complementary to a financial activity. See 12 CFR 225.89. Section 225.89 also describes the information that must be included in any request to engage in, or acquire a company engaged in, a complementary activity. The Board previously has reviewed and approved this information collection in accordance with the requirements of the Paperwork Reduction

Act. See Requests for Approval to Engage in an Activity that is Complementary to a Financial Activity (FR 4012; OMB No. 7100-0292).

The Board has a continuing interest in the public’s opinions of the Federal Reserve’s collections of information. At any time, comments regarding the burden estimate, or any other aspect of this information collection, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503.

Use of Plain Language

Section 722 of the GLB Act requires the Board to use “plain language” in all proposed and final rules published after January 1, 2000. The Board requested comment on whether there were ways to make the proposed rule easier to understand. One commenter suggested that the Board reformat the portion of the proposed rule relating to the complementary general data processing activities of FHCs (§ 225.89(d)(1)(B) of the proposed rule) to make the rule easier to understand. For the reasons discussed above, the Board has determined not to adopt that section of the proposed rule. The Board also believes that the final rule is written plainly and presented clearly.

List of Subjects in 12 CFR Part 225

Administrative practice and procedures, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons set forth in the preamble, Title 12, Chapter II, of the Code of Federal Regulations is amended as follows:

PART 225—BANK HOLDING COMPANIES 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), 1831i, 1831p-1, 1843(c)(8), 1843(k); 1844(b), 1972(1), 2903, 3106, 3108, 3310, 3331-3351, 3907, and 3909; 15 U.S.C. 6801 and 6805.

2. Section 225.28(b)(14) is revised to read as follows:

§ 225.28 List of permissible nonbanking activities.

* * * * *

(b) * * *

(14) Data processing. (i) Providing data processing, data storage and data transmission services, facilities (including data processing, data storage and data transmission hardware, software, documentation, or operating personnel), data bases, advice, and access to such services, facilities, or data bases by any technological means, if:

(A) The data to be processed, stored or furnished are financial, banking or economic; and

(B) The hardware provided in connection therewith is offered only in conjunction with software designed and marketed for the processing, storage and transmission of financial, banking, or economic data, and where the general purpose hardware does not constitute more than 30 percent of the cost of any packaged offering.

(ii) A company conducting data processing, data storage, and data transmission activities may conduct data processing, data storage, and data transmission activities not described in paragraph (b)(14)(i) of this section if the total annual revenue derived from those activities does not exceed 49 percent of the company's total annual revenues derived from data processing, data storage and data transmission activities.

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By order of the Board of Governors of the Federal Reserve System, November 26, 2003.

Jennifer J. Johnson (signed)

Jennifer J. Johnson
Secretary of the Board