

**FEDERAL RESERVE SYSTEM**

**12 CFR Parts 211 and 265**

**[Regulation K; Docket No. R-0994]**

**International Banking Operations; Rules Regarding Delegation of Authority**

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

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** Consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (the Regulatory Improvement Act) and the International Banking Act of 1978 (the IBA), the Board has reviewed Regulation K, which governs international banking operations, and is proposing for comment a number of changes to Subparts A, B and C of Regulation K.

Subpart A of Regulation K governs the foreign investments and activities of all member banks (national banks as well as state member banks), Edge and agreement corporations, and bank holding companies. The proposed amendments would streamline foreign branching procedures for U.S. banking organizations, authorize expanded activities in foreign branches of U.S. banks, and implement recent statutory changes authorizing a bank to invest up to 20 percent of capital in surplus in Edge corporations. Changes also are proposed to the provisions governing permissible foreign activities of U.S. banking organizations, including securities activities, and investments by U.S. banking organizations under the general consent procedures and portfolio investments authority.

Subpart B of Regulation K (Foreign Banking Organizations) governs the U.S. activities of foreign banking organizations. The proposed amendments include revisions aimed at streamlining the applications procedures applicable to foreign banks seeking to expand operations in the United States, changes to provisions regarding the qualification of certain foreign banking organizations for exemption from the nonbanking prohibitions of the section 4 of the Bank Holding Company Act (the BHC Act), and implementation of provisions of the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Interstate Act) that affect foreign banks.

In addition, there are proposed a number of technical and clarifying amendments for Subparts A and B, as well as Subpart C, which deals with export trading companies, and certain amendments to the Board's Rules Regarding Delegation of Authority.

**DATES:** Comments must be received by March 14, 1997.

**ADDRESSES:** Comments, which should refer to Docket No. R-0994, may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. Comments addressed to Mr. Wiles also may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments received will be available for inspection in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in ? 261.14 of the Board's Rules Regarding the Availability of Information, 12 CFR 261.14.

**FOR FURTHER INFORMATION CONTACT:** Kathleen M. O'Day, Associate General Counsel (202/452-3786); Sandra L. Richardson, Managing Senior Counsel (202/452-6406), or Jon Stoloff, Senior Attorney (202/452-3269), regarding Subpart A; Ann Misback, Managing Senior Counsel (202/452-3788), or Janet Crossen, Senior Attorney (202/452-3281), regarding Subparts B or C, Legal Division; or Michael G. Martinson, Associate Director (202/452-2798), or Betsy Cross, Assistant Director (202/452-2574), Division of Banking Supervision and Regulation. For the users of Telecommunications Device for the Deaf (TDD) only, please contact Diane Jenkins (202/452-3544).

**SUPPLEMENTARY INFORMATION:**

**Subpart A: International Operations of U.S. Banking Organizations  
Expansion of Permissible Foreign Activities**

**Statutory Framework**

The proposed amendments to Regulation K, which are in part the result of the Board's review of its regulations under section 303 of the Regulatory Improvement Act, seek to eliminate unnecessary regulatory burden, increase transparency, and streamline the approval process for U.S. banking organizations seeking to expand their operations abroad and foreign banks seeking to establish or expand operations in the United States. The Federal Reserve Act, as amended by the IBA, also requires the Board to review and revise its regulations issued under section 25A of the Federal Reserve Act (the Edge Act) at least once every five years to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions and banking practices. The provisions of Subpart A, which govern the

operations of Edge corporations, also were reviewed with this statutory mandate in mind.<sup>1/</sup>

Edge corporations are international banking and financial vehicles through which U.S. banking organizations offer international banking or other foreign financial services and through which they compete with similar foreign-owned institutions in the United States and abroad. The purposes of the Edge Act, which amended the Federal Reserve Act in 1919, include enabling U.S. banking organizations to compete effectively with foreign-owned institutions; providing the means to finance international trade, especially U.S. exports; fostering the participation of regional and smaller U.S. banks in providing international banking and financing services to U.S. business and agriculture; and stimulating competition in the provision of international banking and financing services throughout the United States. Congress, in enacting this legislation, recognized that U.S. banks needed vehicles that could exercise wider financial powers abroad than were permitted domestically in order to be competitive internationally and to serve the international needs of U.S. firms. At the same time, the Edge Act places limits on U.S. banks' exposure to these broader foreign activities, by limiting the amount that U.S. banks may invest in Edge corporations, establishing a number of statutory safety and soundness constraints, and granting the Board wide discretion in determining what activities should be permissible for such entities. In exercising its authority in this area, the Board is required by the IBA to implement the objectives of the Edge Act consistent with supervisory standards relating to the safety and soundness of U.S. banking organizations.

As a result of the current review, the Board has not identified any changes that appear to be necessary with regard to the provisions relating to the activities of Edge corporations in the United States. Nevertheless, comment is sought on any changes to the permissible U.S. activities of Edge corporations that are considered necessary or appropriate to fulfill the purposes of the Edge Act.

The Board, however, has determined that a number of the provisions relating to foreign activities of U.S. banking organizations could be revised. The Board proposes revisions to

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<sup>1/</sup> The Board last revised Subpart A in December 1995, at which time the general consent investment authority for strongly-capitalized and well-managed U.S. banking organizations was expanded significantly. A comprehensive review of Regulation K in its entirety was completed in 1991.

Subpart A that would: (1) expand permissible government bond trading by foreign branches of member banks; (2) streamline procedures for establishment of foreign branches by U.S. banking organizations; (3) expand permissible foreign activities of U.S. banking organizations, including securities activities; (4) expand general consent and portfolio investment authority for U.S. banking organizations; (5) amend the debt/equity swaps authority to reflect changes in circumstances of eligible countries; (6) implement the new statutory provision allowing member banks to invest, with the Board's approval, up to 20 percent of capital and surplus in the stock of Edge and agreement corporations; and (7) include additional technical and clarifying amendments. Each of these proposed changes is discussed below.

### **Expansion of Government Bond Trading by Foreign Branches**

Section 25 of the Federal Reserve Act permits the Board to authorize foreign branches of member banks to conduct abroad activities that are not permitted domestically. However, the statute states that the Board shall not "except to such limited extent as the Board may deem necessary with respect to securities issued by any 'foreign state' ... authorize a foreign branch to engage or participate, directly or indirectly, in the business of underwriting, selling, or distributing securities."

Given the statutory language, the Board, to date, has only permitted foreign branches to underwrite and sell securities of the government of the country in which the branch was located. This was determined to be appropriate on the basis that it is often necessary in the ordinary course of banking business for a branch to participate in the selling of the bonds of the host country.

In recent years, U.S. banking organizations have become more active in trading and underwriting foreign government securities. Increasingly, such business, where possible, is being conducted in the foreign branches of U.S. banks. Rather than distributing the securities through their various branches, centralizing trading for all or for certain groups of countries in a single branch can be desirable to facilitate management and funding of this business. For example, a banking organization might wish to centralize government securities trading for all countries in the European Union in one European branch.

For these reasons, the Board proposes that banks be permitted to underwrite and deal through their foreign branches in obligations of governments other than the host government, provided that the obligations are of investment grade and the business is otherwise subject to sound banking practices and prudential regulations. The Board considers the requirement that

the obligations must be investment grade would limit cross-border transfer risk to the bank because trading of government securities giving rise to such risk would be required to be conducted either directly through a local branch that is funded locally or through a subsidiary instead of through the bank.

The Board believes that permitting branches to underwrite and sell securities of governments other than the host government on this basis is consistent with sound risk management and general business practices, as well as with the Board's statutory authority. The Board also proposes to retain the existing authority of foreign branches of member banks to underwrite and deal in host government bonds regardless of whether they are investment grade.

The Board seeks comment on these proposals, as well as on what ratings should be considered to be investment grade for these purposes.

### **Foreign Branching**

The Board's responsibilities as home country supervisor under the Minimum Standards for the Supervision of International Banking Groups and their Cross-border Establishments issued by the Basle Committee on Banking Supervision (the Minimum Standards) call for its specific authorization of a U.S. banking organization's outward expansion. Outward expansion for these purposes means the initial establishment of a banking presence in a country by the bank or any affiliate.

Regulation K currently requires the specific consent of the Board for the establishment of branches by a member bank, an Edge or agreement corporation, or a foreign bank subsidiary in its first two foreign countries. The Board believes that 30 days' prior notice before establishment of those initial foreign branches would be sufficient and would be consistent with the Minimum Standards. The Board considers that 30 days' prior notice also should be required consistent with the Minimum Standards if the initial banking presence abroad is in the form of a subsidiary bank; such notice would be required even if the amount to be invested were below the general consent limits.

Under Regulation K at present, no prior Board approval is required for a banking entity to establish additional branches in any foreign country where it already operates one or more branches. However, a banking entity must give the Board prior notice before establishing a branch in a foreign country where it has no branches even though a banking entity affiliate operates a branch in that country.

The Board proposes that Regulation K be liberalized such that if any of the member bank, its Edge or agreement corporation subsidiaries, or a foreign bank subsidiary (whether a subsidiary of the bank or of the bank holding company) already has a branch in a particular foreign country, a banking affiliate would be able to branch there without prior notice to the Board. After-the-fact notice, however, would still be required.

The Board also proposes that the 45 days' prior notice currently required in order to branch into additional countries where there is no affiliated banking presence (after the organization has branches engaged in banking in two foreign countries) should be reduced to 12 business days. In taking this approach, the foreign branching experience of the entire banking organization would be taken into account in determining whether the banking entity would be subject to the 30 day or 12 day prior notice procedure. Where a U.S. banking organization as a whole already operates foreign branches of banking entities in two countries, any banking affiliate would be able to open a branch in a country where such organization has no banking presence pursuant to the 12 days' prior notice procedure.

Finally, currently under Regulation K, nonbanking subsidiaries held pursuant to Regulation K may branch into any country in which any affiliate has a branch without prior notice, but a 45-day prior notice must be submitted to establish a branch in a country where no affiliate has a presence. The Board proposes permitting nonbanking subsidiaries held pursuant to Regulation K to establish foreign branches without prior review, subject only to an after-the-fact notice requirement.

The Board seeks comment on these proposed changes, including in particular whether the proposed modified notice periods would sufficiently accommodate foreign expansion plans.

### **Permissible Activities of Foreign Subsidiaries of U.S. Banking Organizations**

One aspect of bank regulation to which the Federal Reserve subscribes is the fostering of a level competitive playing field for financial intermediaries. Thus, in the United States, the Board has advocated that expansion by banking organizations into nonbanking activities should generally occur through the bank holding company and not the bank. Banks in the United States benefit from the implicit support of the national government and its sovereign credit rating through federal deposit insurance, Federal Reserve discount window access, and final riskless settlement of payment system transactions. Extension of this system would make the existing playing field in the United States unlevel for nonbank competitors and create

unnecessary distortions in competition.

The same principle applies to American banks abroad. Other nations have chosen to allow their banks to engage in a broad array of financial activities, especially investment banking activities, thereby extending to these banks the implicit support of their governments. In those markets, U.S. banks would be at a disadvantage if unable to offer their customers an equivalent range of key services with the convenience and efficiency of their local bank competitors. Indeed, in many of these markets, banks are the only significant providers of capital markets services. Independent securities firms are not generally substantial competitors in these markets, both for historical reasons and because they may be unable to compete effectively with banks that have the explicit and implicit support of their governments.

Congress has recognized the existence of the different competitive environments faced by U.S. banks operating abroad and has legislated specifically to deal with it. Under the Edge Act, the Board has been granted broad authority to permit Edge corporations, which may be owned by U.S. banks, to engage in a wider range of activities outside the United States than has been permitted to U.S. banks domestically, consistent with safety and soundness standards. As noted, the purposes of the Edge Act include enabling U.S. banking organizations to compete effectively with foreign-owned institutions. Congress, in enacting this legislation, recognized that U.S. banks needed vehicles that could exercise broader financial powers abroad in order to be able to be competitive internationally and to serve the needs of U.S. firms. Congress granted the Board similar broad discretion to allow bank holding companies to engage in activities outside the United States.

In exercising its statutory authority, the Board has sought to balance the need for U.S. banks to be competitive abroad with the public interest in assuring the safety and soundness of the banks, protecting the deposit insurance fund, and limiting the extension of the federal safety net. In proposing these revisions to Regulation K, the Board has sought to give U.S. banks appropriate expansion of those activities, such as investment banking, in which the competitive need is the greatest. Liberalization in relation to other activities, such as venture capital investments and insurance activities, has been proposed only in relation to subsidiaries of the bank holding company. These latter activities appear to be able to be conducted competitively outside the bank chain of ownership.

## **Securities Activities**

## Current Restrictions on Securities Activities

Foreign subsidiaries of U.S. banking organizations have been permitted broad authority to underwrite and deal in debt securities for over 25 years, subject to the provision that the securities must be included with loans for purposes of compliance with the parent bank's lending limit. No separate dollar limits have been placed on underwriting and dealing in debt securities.

Since 1979, Regulation K also has authorized foreign subsidiaries of both U.S. banks and bank holding companies to underwrite and deal in equity securities outside the United States, subject to certain limitations and restrictions. These activities were determined to be permissible, within the applicable limits, on two bases. First, it became clear that it was necessary for U.S. banking organizations to be able to engage in these activities abroad, if they were to compete successfully with foreign banks in the provision of services to foreign customers. Indeed, for some time, virtually all the major foreign competitors of U.S. banking organizations have been foreign banks that conduct equity securities activities either directly in the bank or in a subsidiary of the bank. Thus, consistent with the purposes underlying the Edge Act and the BHC Act, there is clear statutory authority for U.S. banking organizations to engage in these activities through subsidiaries abroad. Second, in any event, the provisions of the Glass-Steagall Act do not apply extra-territorially to the operations of foreign subsidiaries of U.S. banking organizations.

While equity underwriting and dealing have been permissible activities for U.S. banking organizations' foreign subsidiaries for some time, as noted above, the level of such activity is subject to limits under Regulation K. Prudential restrictions currently applied to equity securities underwriting and dealing activities under Regulation K include the following.

Underwriting limits--Through a foreign subsidiary, an investor<sup>2/</sup> may underwrite equity securities in amounts up to the lesser of \$60 million or 25 percent of its tier 1 capital. These limits do not include amounts covered by binding commitments from sub-underwriters or other purchasers. If the underwriting is done in a subsidiary of the member bank, the amount of the uncovered underwriting must be included in

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<sup>2/</sup> An investor for these purposes means an Edge corporation, agreement corporation, bank holding company, member bank and any foreign bank owned directly by a member bank.



computing the bank's single borrower lending limit with respect to the issuer.

Dealing limits--Through a foreign subsidiary, an investor may hold a dealing position in the equity securities of any one issuer in amounts up to the lesser of \$30 million or 10 percent of its tier 1 capital. An investor must include any shares of a company held in an affiliate's dealing account in determining compliance with any percentage limits placed on ownership of that company.

Aggregate limit--There is an aggregate limit on the total amount of equity securities that may be held in investment and dealing accounts, aggregating all shares held by subsidiaries: for a bank holding company, the limit is 25 percent of tier 1 capital; for an Edge corporation<sup>3/</sup>, the limit is 100 percent of the Edge's tier 1 capital.<sup>4/</sup>

Prior review--Banking organizations must submit to a review of their foreign securities operations prior to engaging in foreign equity securities activities to the extent of these limits. They may also seek Board approval for higher underwriting limits, subject to certain conditions.

### Proposed Revisions

#### Determination of Applicable Limits

Although, as discussed above, the limits on underwriting and dealing in equity securities in Regulation K are expressed both in terms of percentages of tier 1 capital of the investor and absolute dollar limits, as a practical matter it has been the dollar limits that have constrained the ability of U.S. banking organizations to engage in these activities through their foreign subsidiaries and, consequently, have impeded their efforts to compete with foreign banks abroad. In order to reduce further these constraints on competition, the Board proposes to replace the dollar limits for underwriting or dealing activity with limits based solely on percentages of the investor's tier 1 capital for well-capitalized and well-managed organizations.

The Board considers that, if a banking organization is well-capitalized and well-managed, tying the underwriting or

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<sup>3/</sup> Any foreign bank directly owned by a U.S. bank is treated as an Edge corporation for purposes of its limits.

<sup>4/</sup> Investments in companies must be added to any shares of such companies held in the dealing account for purposes of this limit.

dealing limits solely to capital levels would have the benefit of more closely linking the limits to the ability of the company to support the activity. It would also provide U.S. banking organizations with greater flexibility in responding to changing market conditions, because the amount of capital devoted to an activity is, after meeting regulatory constraints, determined by the firm.<sup>5/</sup>

Accordingly, the Board proposes to amend Regulation K in relation to those banking organizations that are well-capitalized and well-managed by removing the existing dollar limits applicable to equity securities activities, and instead providing that such activities would be limited to percentages of the investor's tier 1 capital. For well-capitalized and well-managed organizations, the Board proposes applicable limits to be determined as follows.<sup>6/</sup> In relation to securities activities of subsidiaries of bank holding companies, their limits would be determined by reference to percentages of the tier 1 capital of the holding company. The Board proposes, however, that limits applicable to such activities undertaken by subsidiaries of Edge and agreement corporations, as well as foreign banks that may be direct subsidiaries of member banks, would be determined by reference, at least in the first instance, to the tier 1 capital of the parent bank.

In the Board's view, tying applicable limits to the capital of the parent bank is particularly important for subsidiaries of Edge corporations. As previously noted, Congress has limited a member bank's investment in Edge and agreement corporations to 20 percent of the bank's capital.<sup>7/</sup> However,

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<sup>5/</sup> Arguably, this flexibility could be enhanced further if foreign subsidiaries of U.S. banking organizations were permitted to exceed the individual and aggregate limits, subject to a requirement that the amount in excess of the limits be deducted from capital and, after such deduction, the institution would continue to be well-capitalized.

<sup>6/</sup> The Board proposes that existing dollar limits would be retained for companies that are not well-capitalized and well-managed.

<sup>7/</sup> The Edge Act prohibited member banks from investing more than 10 percent of their capital and surplus in the capital stock of Edge and agreement corporations. In September 1996, Congress amended this limit to permit investments in excess of 10 percent of capital and surplus with the specific approval of the Board, provided the amount invested shall not exceed 20 percent of capital and surplus of the bank.

partly for tax reasons, Edge corporations historically have tended to retain their earnings rather than dividending them to the parent bank. In some cases due to such retained earnings, the capital of a bank's Edge and agreement corporations may be in excess of 20 percent of the parent bank's consolidated capital, even though the its investment in the Edge subject to the above-referenced statutory limit is below 20 percent.

In these circumstances, the Board considers that the capital of an Edge corporation that is in excess of 20 percent of the parent bank's consolidated capital, when retained earnings are counted, should be excluded for purposes of determining applicable limits for activities of the Edge and its subsidiaries. The Board proposes to accomplish this by setting limits for Edge corporations tied both to percentages of the Edge's and parent bank's capital, respectively.<sup>8/</sup> Limits tied to the parent bank's capital would be 20 percent of the limits otherwise applicable to Edge corporations. The lower limit would be the binding limit. For example, if a limit proposed for a given activity of an Edge corporation is 10 percent of capital but the Edge's capital is in excess of 20 percent of the bank's total capital, the binding limit for the Edge would be two percent of the parent bank's tier 1 capital. For those U.S. banks that do not have significant levels of retained earnings at the Edge, the binding limit more than likely would be the separate limit tied to the Edge's capital.

The Board considers that this approach would be consistent with the intent underlying the provisions of the Edge Act limiting the total amount of capital a bank may invest in Edge corporations. This approach effectively would place a cap on the percentage of total bank capital that could be placed at risk through activities or investments not otherwise permitted to the bank directly, regardless of the capital level of the Edge corporation. This approach also would remove any regulatory incentive to retain earnings at the Edge because any regulatory benefit from such retained earnings, in terms of expanded limits on activities abroad, would be denied.

The Board proposes that all limits applicable to well-capitalized and well-managed Edge corporations under the amended Regulation K would proceed on this basis. Comment is requested on these proposals and whether any other approach might achieve similar objectives.

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<sup>8/</sup> As noted above, Regulation K currently treats any foreign bank owned directly by a member bank as an Edge corporation for purposes of its limits. The Board proposes that this treatment would be continued under the revised Regulation K limits.

## Equity Underwriting

The \$60 million limit on underwriting equity securities significantly impedes the ability of U.S. banking organizations to compete for this business in foreign markets, where securities underwriting is increasingly a service offered by local banks. At the same time, the risks associated with the activity suggest that such a stringent limit is not required for safety and soundness purposes for well-capitalized and well-managed banking organizations. While initial underwriting commitments may involve large sums, in most cases by the time the underwriting goes to market, large portions of the exposure have been passed on sub-underwriters or presold. Thus, in most cases, the initial underwriting commitment overstates the risk being assumed.

The Board proposes to remove the absolute dollar limits on underwriting exposure for well-capitalized and well-managed banking organizations, but retain a limit based on a percentage of the investor's capital. More specifically, limits for underwriting exposure to a single company would be established at 15 percent of the bank holding company's tier 1 capital for its subsidiaries and, for subsidiaries of Edge corporations, the lesser of three percent of tier 1 capital of the bank or 15 percent of the tier 1 capital of the Edge.

These limits on underwriting exposure to a single company would be applied on an aggregate basis. A bank holding company's limit would include all underwriting exposure to one issuer by all of the holding company's direct and indirect subsidiaries, including exposures held through its bank subsidiaries. The bank's and Edge's limits would include all exposures held by their respective subsidiaries. The Board proposes, however, that this expanded underwriting authority would be available to U.S. banking organizations only if each of the bank holding company, bank and Edge or agreement corporation qualify as well-capitalized and well-managed.<sup>9/</sup>

For organizations that fail to meet the well-capitalized and well-managed criteria, the Board proposes that the existing dollar limits (i.e., \$60 million) on commitments by an investor and its affiliates for the shares of an organization would be retained.

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<sup>9/</sup> The Board proposes that what, if any, action should be taken in relation to banking organizations' limits and dealing positions if they cease to be well-capitalized and well-managed would be addressed on a case-by-case basis through supervisory action.

The Board proposes that, in order to engage in such activities, all banking organizations would be required to implement internal systems and controls adequate to ensure proper risk management. Controls would have to be in place to assure that underwriting positions do not result in violations of limits on securities held in the trading account or exceed the parent bank's lending limits when the underwriting positions are combined with other credit exposures. Sanctions (such as temporary suspension of underwriting authority) may be imposed for violations of such limits.

### **Dealing in equity securities**

The Board also proposes for comment liberalization of dealing activities for well-capitalized and well-managed banking organizations. As with underwriting limits, the proposed dealing limits would be based on percentages of capital of the organization and, thus, on the ability of the organization to accommodate risk. This change would permit U.S. banking organizations to compete more effectively with foreign banks in providing equity dealing and underwriting services to customers abroad, where such activities are generally permissible to banking organizations. Nevertheless, in the Board's view, dealing activities appear to present somewhat greater risk of loss than underwriting, which suggests somewhat more restrictive limits are needed for dealing activities relative to underwriting activities.

For well-capitalized and well-managed organizations, the Board, therefore, proposes to remove the current dollar limits and revise the existing percentage of capital limits as follows. First, in order to provide diversification in the trading account, the Board proposes a limit on holdings of any one stock in the trading account of 10 percent of the tier 1 capital of the bank holding company for its subsidiaries and, for subsidiaries of an Edge corporation, the lesser of two percent of the bank's tier 1 capital or 10 percent of the Edge's tier 1 capital.

Second, the Board proposes an aggregate limit applicable to all holdings of equities in the trading accounts of all direct and indirect subsidiaries authorized pursuant to Subpart A.<sup>10/</sup> Without such an aggregate ceiling, the Board is concerned that a banking organization could have excessive

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<sup>10/</sup> As at present, shares held as an investment pursuant to Subpart A also would be included in calculating the applicable aggregate limits.

exposure to movements in equity markets. The Board proposes aggregate limits of 50 percent of the bank holding company's tier 1 capital for its subsidiaries and, in the case of an Edge's subsidiaries, the lesser of 10 percent of the tier 1 capital of the bank or 50 percent of the Edge's tier 1 capital.

The Board proposes that the limits on equity trading and dealing would apply to net positions across legal vehicles held, directly or indirectly, by the regulated entity to which the limit is applicable (that is, the bank holding company, the bank or the Edge corporation).<sup>11/</sup> Long equity positions in a single stock could be netted against short positions in the same stock and against derivatives referenced to the same stock.<sup>12/</sup> For purposes of the aggregate limits, all physical and derivative long positions could be netted against physical and derivative short positions. It is further proposed that, for purposes of measuring compliance with these investment limits, banks would be permitted to use internal models to calculate the value of derivative positions used to offset exposures and net dealing positions in individual stocks, as well as the value of total net equity holdings in the trading account.<sup>13/</sup> The Board considers that the adequacy of such models is subject to review during the exam process, and proposes that no special review would be required for their use in connection with the proposed limits on securities activities.<sup>14/</sup>

For organizations that fail to satisfy the well-capitalized and well-managed criteria, the Board proposes to retain the existing dollar limit on individual shares held in the trading account (i.e., \$30 million), which would be calculated in the same manner as at present. With regard to an aggregate limit on shares held in the trading account, the Board considers that a reasonable limit for all equity positions of such organizations, aggregating all positions and investments held pursuant to

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<sup>11/</sup> Currently these limits are normally applied on a gross basis.

<sup>12/</sup> The Board also proposes that a basket of stocks, specifically segregated by the banking organization as an offset to a position in a stock index derivative product, as computed by the bank's internal model, may be netted as a whole against the stock index.

<sup>13/</sup> Currently, the use of internal models in computing net positions in stocks is subject to prior Board review and the limitation that any position in a security shall not be deemed to have been reduced through netting by more than 75 percent.

<sup>14/</sup> The Board also seeks comment on allowing netting of underwriting exposures.

Subpart A, would be 25 percent of the holding company's capital for its subsidiaries and, for subsidiaries of Edges and any foreign bank held directly by a member bank, the lesser of 5 percent of the bank's tier 1 capital or 25 percent of the Edge's tier 1 capital. These limits would be half of those applicable to organizations that are well-capitalized and well-managed as proposed above.

These proposed percentage limits may appear lower than the existing limits (which are 25 percent of tier 1 for subsidiaries of bank holding companies and 100 percent of tier 1 for any other investor). In this regard, however, the Board also proposes that an organizations' aggregate position in stocks also could be calculated on the net basis described above in determining compliance with these limits, rather than on the gross basis presently required by Regulation K. This netting authority in most cases would allow organizations to continue to conduct their current levels of activities, even under the proposed new limits. In these circumstances, the Board considers that the aggregate limits should be reduced. In particular, the Board is concerned that permitting an organization that is not well capitalized or well managed to maintain what would be essentially an open exposure to the stock markets in excess of 25 percent of the tier 1 capital of the holding company or the Edge or five percent of the tier 1 capital of the bank simply would not be consistent with safety and soundness considerations.

The Board seeks comment generally on the proposed limits and netting authority. Commenters' views in particular are solicited on whether:

-- the revised limits, when taken together with the netting authority, would enable U.S. banking organizations to compete with foreign banks in these activities abroad;

-- appropriate distinctions have been drawn, in terms of dealing authority, between organizations that are well-capitalized and those that are not;

-- the proposed netting authority should be available to organizations that are not well-capitalized or well-managed;

-- even with the proposed netting authority, the reduction in percentage limits for organizations that are not well-capitalized or well-managed would give rise to a need for grandfathering of, e.g., existing portfolio investments;

-- it would be appropriate to include underwriting commitments in the aggregate limits for dealing activities and portfolio investments; and

-- provision should be made for higher dealing limits for banking organizations on a case-by-case basis.

For organizations that are not well capitalized and well managed, the Board proposes to retain the existing dollar limits applicable to underwriting and dealing positions (that is, \$60 million on and \$30 million, respectively), without regard to limits on percentage of capital. As noted, it is generally the dollar limits that currently constrain organizations in their ability to conduct these activities. This is because, at present, only the largest banking organizations are engaged in these activities. The Board notes, however, that in the future a relatively small organization may seek to enter these lines of business and, for it, exposures of \$30 or \$60 million may be large relative to its capital. The Board seeks comments on whether, in addition to dollar limits, limits based on percentage of capital also should be adopted for organizations that are not well capitalized and well managed in order to address the relative exposure of such organizations to these activities.

#### **Additional Option**

The Board also seeks comment on whether, instead of imposing the limits discussed above in relation to equity underwriting and dealing activities by subsidiaries of well-capitalized and well-managed bank holding companies, it would be appropriate to lift all limits on these activities for such entities except for the limits on individual stocks held in the trading account discussed above (i.e., 10 percent of the holding company's tier 1 capital). The Board considers that, at a minimum, this limit should be imposed on holding companies in order to assure diversification in individual stock holdings. Under this alternative, banking organizations also would be required to implement internal systems and controls adequate to ensure proper risk management and that underwriting positions do not result in violations of limits on investments in any one company.

#### **Authority to Engage in Equity Securities Activity**

Board approval currently is required to engage in underwriting and dealing in equity securities pursuant to Regulation K. Because of the increased supervisory focus on risk management procedures, the Board seeks comment on whether banking organizations that are well capitalized and well managed should be allowed to engage in the expanded equity securities activities without seeking prior Board approval provided that they already have experience in equity securities activities under either Regulation K or Regulation Y.



As discussed above, the Board proposes that other banking organizations would be authorized to take positions in individual stocks only to the extent currently permissible (i.e., subject to the existing dollar limitations on equity underwriting and dealing). In view of these lower limits, the Board proposes that these banking organizations would not be required to obtain prior Board approval to engage in equity securities activities to this limited extent, provided that these organizations satisfy minimum capital and managerial criteria.

## **Venture Capital Activities through Portfolio Investments**

### Current Restrictions

Regulation K currently allows U.S. banking organizations to make portfolio investments, that is, limited, noncontrolling investments in foreign commercial and industrial companies. This authority is intended to enhance the competitiveness of U.S. banking organizations by increasing the range of financial services they may provide abroad. Many foreign financial institutions, including foreign banks, engage in venture capital activities, at times in connection with the provision of other financial services to the company.

At present, in order for a portfolio investment to be a permissible investment, an investor must hold less than 20 percent of the voting stock of the company, and no more than 40 percent of the company's total equity. Additionally, bank holding companies are subject to an aggregate limit on such investments in non-financial firms of 25 percent of tier 1 capital, and Edge corporations are subject to an aggregate limit of 100 percent of tier 1 capital.<sup>15/</sup> These limits are designed to ensure that U.S. banking organizations do not control commercial and industrial companies and that their overall risk exposure to nonfinancial investments is limited.

As a practical matter, however, venture capital, or portfolio, investments presently are made almost exclusively under general consent procedures and consequently also have been subject to a dollar limit of \$25 million in a single company (the same limit currently applied to most other investments for purposes of general consent). Such investments are generally made in companies engaged in activities unrelated to banking or

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<sup>15/</sup> In determining compliance with both the individual and aggregate limits, shares in such companies held in the dealing or trading account by the investor and any of its affiliates must be included.

finance. The \$25 million limit has had the effect of focusing banking organizations primarily on the small company end of the venture capital business.

#### Proposed Investment Limits

The Board believes that removing the practical constraint of the dollar limit on such investments by keying the limits solely to a percentage of the investor's tier 1 capital may be appropriate for well-capitalized and well-managed bank holding companies. The Board proposes to limit any liberalization in this area to subsidiaries of holding companies because it is concerned that, in view of the risk of loss inherent in venture capital investments and their low liquidity, these activities may be more appropriately conducted outside the bank ownership chain. In proposing this approach, the Board is aware that, even in the existing regulatory environment, much of the current venture capital activity abroad is conducted through subsidiaries of the holding company. Thus, there appear to be no major operational or competitive considerations that would weigh in favor of expanding the authority of Edge subsidiaries to engage in this activity. However, if appropriate diversification and aggregate limits were established, the Board considers that some expansion of the ability of holding company subsidiaries to engage in this activity, using shareholder funds, would not present undue risks to the affiliated U.S. bank and would enhance the ability of U.S. banking organizations to compete in the provision of banking and financial services abroad.

For these reasons, the Board proposes to establish limits for portfolio investments made by subsidiaries of well-capitalized and well-managed bank holding companies of 2 percent of the holding company's tier 1 capital for an individual investment (in order to assure diversification of these potentially volatile and illiquid investments), and an aggregate limit of 25 percent of the holding company's tier 1 capital for all such investments. In determining compliance with the individual limit, shares in such companies held in the trading account by the investor and any of its affiliates would be included.

For all other investors (i.e., Edge corporation and foreign bank subsidiaries of member banks, and subsidiaries of bank holding companies that are adequately capitalized but fail to meet the well-capitalized and well-managed standards), the Board proposes limits on investments in any one organization of \$25 million; larger investments would continue to be eligible for approval on a case-by-case basis. An aggregate limit on such investments, when taken together with other positions in equity securities held in the dealing account, also would be imposed

consistent with the aggregate dealing limits discussed above, namely, 25 percent of tier 1 capital for subsidiaries of holding companies and, for Edge or foreign bank subsidiaries, the lesser of 5 percent of the parent bank's tier 1 capital or 25 percent of the Edge's tier 1 capital.

The Board seeks comment on these proposals, including regarding the relative risk of portfolio investments and whether there is a need for competitive reasons for foreign subsidiaries of banks also to have expanded authority in relation to such investments.

#### Limits on Voting Shares in Target Company

At present, portfolio investments are limited to less than 20 percent of a company's voting shares. At the time this limit was adopted by the Board, the equity method of accounting was used for investments of 20 percent or more of a company's voting shares and the cost method of accounting was used for investments under this level. Venture capital investments, however, now may be reported at fair value irrespective of the percentage of ownership, with changes in fair value recognized in income and correspondingly in tier 1 capital. In light of these developments, the Board considers that the current limit of less than 20 percent of voting shares has lost its original purpose.

In these circumstances, the Board proposes permitting investors to make noncontrolling venture capital investments in up to 24.9 percent of a company's voting shares in recognition of this fact. The proposed limit on voting shares would be set at less than 25 percent in order to provide further assurance of the noncontrolling nature of the investment. The Board is concerned that at levels above 25 percent of voting shares, both other investors and foreign authorities may view the bank holding company as a controlling investor, with implicit responsibilities to support the company or with liability for industrial accidents. As at present, these investments also would be permissible only if the investor in fact does not control the company in which the investment is made. Thus, the investor may not control a majority of the board of directors or have a disproportionate representation on the board; it may not have a management contract with the company or exercise veto power over its actions; nor may the investor use other means to control the operations of the company.

#### **"Incidental" Activities in the United States**

As a result of limitations in the Federal Reserve Act and the BHC Act, U.S. banking organizations are prohibited from investing in more than 5 percent of the voting shares of foreign

companies that engage in impermissible activities in the United States other than those activities that are an incident to their international or foreign business.<sup>16/</sup> The Board previously has taken the view that such permissible incidental activities in the United States are limited to those activities that the Board has determined are permissible for Edge corporations to conduct in the United States.<sup>17/</sup>

However, as noted above, companies in which portfolio investments are made generally are engaged in industrial or commercial activities, which are not permissible activities for Edge corporations. Consequently, under Regulation K at present, if a portfolio investment company decides to engage in activities in the United States, the U.S. banking organization is forced to sell the portfolio investment even if market considerations would not warrant selling the shares at that time. This is despite the fact that the U.S. banking organization, by reason of the mandatory noncontrolling nature of portfolio investments, is unlikely to be in a position to influence any decision regarding entry into the U.S. market. The Board is aware that, with the increasing globalization of economies around the world, this situation may become more common in the future.

The Board considers that these changes in circumstance may warrant a limited change in the interpretation of what constitutes activities in the United States that are "incidental" to international or foreign activities in order to provide some relief for U.S. banking organizations making portfolio investments abroad. Given the minority nature of the portfolio investments and the significant changes in international markets, the Board considers that, consistent with the Federal Reserve Act and the BHC Act, portfolio investment companies that derive no more than 10 percent of their total revenue in the United States may be considered to be engaged only in business that is an incident to their international or foreign business and therefore may be held for an appropriate investment period consistent with the nature of venture capital activities. In reaching this view, the Board has taken into account the particular nature of portfolio investments. Most portfolio investments are venture

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<sup>16/</sup> In particular, the FRA prohibits investments in companies engaging in "the general business of buying or selling goods, wares, merchandise or commodities in the United States." 12 U.S.C. section 615. Section 4(c)(13) investments under the BHC Act are limited only by a requirement that the company do "no business in the United States except as incident to its international or foreign business."

<sup>17/</sup> See 12 CFR 211.4(e).

capital investments that are intended to be sold after a period of time. They are not intended to be permanent holdings of the banking organization. In addition, the preponderance of the value of the portfolio investment is derived from its foreign business.

The Board seeks comment on this proposed change. The Board also seeks comment regarding what an appropriate period for divestiture would be for investments that exceed the proposed U.S. revenue limits, as well as whether a time limit should be placed on the period for holding these types of portfolio investments in view of their supposedly medium-term nature.

### **Insurance Activities**

Regulation K currently permits bank holding companies to own foreign companies that underwrite and reinsure life and related types of insurance outside the United States. The Board requests comment on whether the reinsuring by a foreign subsidiary of a bank holding company of annuities or life insurance policies sold to U.S. persons is an activity that should be considered to fall within this authority. This issue has been raised recently by several bank holding companies.

Under one proposal, an offshore insurance subsidiary, which has no U.S. office, would reinsure certain annuities sold in the United States to U.S. residents. These annuities would be underwritten by a U.S. insurance company unaffiliated with the bank holding company, and sold by various insurance agencies, including those affiliated with the bank holding company. The U.S. insurance company would cede a portion of the portfolio of annuities sold to the bank holding company's customers to the insurance company's foreign affiliate and the offshore insurance subsidiary of the bank holding company would enter into a retrocession agreement with that foreign company to reinsure no more than 50 percent of the portfolio of annuities sold to the bank holding company's customers. The offshore insurance subsidiary of the bank holding company would not have any contact with the annuity purchasers and would assume no liability to them. Moreover, the offshore insurance subsidiary would have no reinsurance liability to the U.S. insurance company, but only to the foreign affiliate of the U.S. insurance company.

The Board does not consider that an offshore insurance subsidiary of a bank holding company under Regulation K may sell policies directly into the United States. It appears, however, that the relevant statutes could permit a bank holding company, through its Regulation K subsidiary, to reinsure all or a portion of the risk of policies or annuities sold in the United States by U.S. affiliates of the bank holding company or unrelated parties.

A question is presented, however, regarding whether the fact

that the reinsurance takes place offshore is sufficient evidence that the activity is conducted outside the United States. On this view, any U.S. aspects of the activity would be considered merely an incident to the permissible offshore reinsurance activity. Alternatively, the fact that the risk to be reinsured is in the United States could cause the activity to be considered located in the United States, particularly given the significant involvement of the bank holding company's U.S. affiliates. In view of what appears to be increasing interest in this activity, the Board requests comment on these matters.

### **Debt/Equity Swaps**

Regulation K currently permits banking organizations to swap certain developing country debt for equity interests in companies of any type. The debt/equity swap authority was established in 1987. Under this authority, the Board granted its general consent for investors to invest up to one percent of their tier 1 capital in up to 40 percent of the shares, including voting shares, of private sector companies in eligible countries.

These foreign investment provisions are more liberal than provided elsewhere in Regulation K. Eligible countries were defined as countries that have rescheduled their debt since 1980, or any country the Board deemed to be eligible.<sup>18/</sup>

The debt/equity swap authority was viewed by the Board at that time as adding to the menu of options available to banking organizations for managing large amounts of sovereign developing country debt that was nonperforming and illiquid.<sup>19/</sup> In considering ways in which banking organizations could deal with these debt problems, the Board adopted an approach analogous to foreclosure on debts previously contracted ("DPC") by private parties and extended the DPC concept to permit an exchange of sovereign debt for any equity assets, private or public, in the country. Such an investment had to be held through the bank holding company, unless the Board specifically permitted it to be held through the bank or a bank subsidiary.

There is now a well developed secondary market in developing country debt. The vast bulk of developing country problem debt has been repackaged in the form of long-term Brady bonds, mostly denominated in U.S. dollars and fully

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<sup>18/</sup> Fifty-one countries reached debt relief agreements with commercial banks during the period January 1980-December 1995.

<sup>19/</sup> The only significant alternatives at that time were establishing provisions for the bad debts or writing the debts off and accepting the losses.

collateralized as to principal by U.S. government bonds. Many banking organizations actively trade these instruments in the secondary market.

Due to the development of the secondary markets for emerging market debt, U.S. banks now have the same options with regard to many of these assets as they have with other bank assets -- namely, they can hold the asset with a view toward collecting at maturity or sell the asset for cash to invest in other bank eligible assets. Indeed, the sovereign debt of most of the historically "eligible countries" is no longer illiquid, and those eligible countries that account for the vast share of rescheduled debt have largely regularized their relations with commercial banks.

Accordingly, the Board proposes that the term "eligible country" be redefined so that only countries with currently impaired sovereign debt (i.e., debt for which an allocated transfer risk reserve would be required under the International Lending Supervision Act and for which there is no liquid market) would be eligible for investments through debt/equity swaps under Regulation K. This proposal would redirect this special authority to the asset quality problem it was originally intended to help resolve. In connection with this change, the Board also proposes that existing holdings of such investments would be grandfathered, subject to the existing time period for divestiture of such investments (i.e., generally 10 years from the date of acquisition).

Comment is requested regarding these proposed changes. The Board also seeks comment on whether, alternatively, this exception to the limitations on investments by banking organizations in non-financial fitness is no longer needed and should be deleted in its entirety.

## **Streamlining Application Procedures**

### General Consent Limits

While existing Regulation K procedures have proved effective in maintaining the safety and soundness of U.S. banks' international operations, they have become increasingly complex over the years. For example, under prior notice procedures, the Board has reviewed all foreign investments made by banking organizations above a de minimis level as a principal mechanism for overseeing the safety and soundness of the investing organization. In view of relatively recent shift in emphasis to supervision based upon risk management capabilities, the Board believes that prior review of relatively small investments is no longer useful as a fundamental supervisory tool, especially where the investor is well capitalized and well managed. Accordingly, the Board proposes that only significant investments, as determined solely on the basis of the investor's capital, would be subject to prior review by the Board, provided that the investors are well capitalized<sup>20/</sup> and well managed.<sup>21/</sup> The proposed changes to the general consent procedures attempt to balance safety and soundness considerations with the objective of enhancing the ability of U.S. banking organizations to compete with foreign banks overseas.

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<sup>20/</sup> A bank holding company is considered well capitalized if, on a consolidated basis, it maintains total and tier 1 risk-based capital ratios of at least 10 percent and 6 percent, respectively. Further, the bank holding company may not be subject to any written agreement, order, capital directive, or prompt corrective action directive. In the case of an insured depository institution, well capitalized means that the institution 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 under section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o). The Board proposes that an Edge or agreement corporation would be considered well capitalized if it maintains total and tier 1 capital ratios of 10 and 6 percent, respectively.

<sup>21/</sup> A bank holding company or insured depository institution is considered well managed if, at its most recent inspection or examination or subsequent review, the holding company or institution received at least a satisfactory composite rating and at least a satisfactory rating for management and for compliance, if such a rating is given. Under the standards adopted by the Board in connection with the December 1995 expansion of general consent authority in Regulation K, an Edge or agreement corporation will be considered to be well managed for these purposes if it has received a composite rating of 1 or 2 at its most recent examination or review and it is not subject to any supervisory enforcement action.



### Limits on Investments in One Company

Historically, all general consent investments under Regulation K were subject to absolute dollar limits. Currently, the general consent limit for most investments is \$25 million. However, as a result of amendments to Regulation K implemented in December 1995, certain investments by strongly capitalized and well-managed banks are subject to Board review only to the extent they exceed a percentage of the investor's capital.

The Board proposes expanding upon this approach by eliminating the absolute dollar limits on foreign investments permissible under general consent authority for well-capitalized and well-managed investors (with the exception of those on venture capital investments made by the bank). Under the proposal, general consent limits for all investors (bank holding companies, banks, and Edge corporations) would be based solely on a percentage of their tier 1 capital.<sup>22/</sup>

The limits on individual investments made under general consent authority would vary according to the investor (bank holding company, bank, or Edge corporation) and the type of entity in which the investment is made. For well-capitalized and well-managed investors, the Board proposes the following percentage limits.

#### General consent limits on investment in a subsidiary

Bank holding company subsidiaries:	10 percent of tier 1 capital of the bank holding company.
Bank subsidiaries:	the lesser of 2 percent of tier 1 capital of the bank or 10 percent of tier 1 capital of the bank subsidiary.

#### General consent limits on investment in a joint venture

Bank holding	5 percent of tier 1 capital of
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<sup>22/</sup> If the Edge corporation were making the investment, then the Edge corporation, the member bank, and the bank holding company would be required to meet the well-capitalized and well-managed tests. If the member bank were making the investment, then the bank and the bank holding company would be required to meet the tests.

company subsidiaries: the bank holding company.

Bank subsidiaries: the lesser of 1 percent of tier 1 capital of the Bank or 5 percent of tier 1 capital of the Bank subsidiary.

The proposed limits are intended to reflect the risk involved in the type of investment. A higher percentage of capital would be permitted in the case of an investment in a subsidiary as opposed to an investment in a joint venture because the latter is considered to carry a greater risk of loss. Thus, with joint ventures, investors acquire less than full control, and the record on such investments has shown that they experience a higher rate of loss. As a result, most U.S. banks do not now make sizeable joint venture investments. In light of these considerations, the Board believes that lower general consent limits may be appropriate for joint venture investments.

For investors that fail to meet the well-capitalized or well-managed standards, the Board proposes the following limits.

Individual investments under general consent authority would be limited to the lesser of \$25 million or 5 percent of tier 1 capital in the case of an investor that is a bank holding company, or 1 percent of tier 1 capital if the investor is a member bank. Limits on individual investments for an Edge corporation would be \$25 million or the lesser of 1 percent of the parent bank's tier 1 capital or 5 percent of the Edge's tier 1 capital. The Board proposes, however, that authority would be delegated to the Director of Banking Supervision and Regulation to approve higher investment limits on a case-by-case basis or as part of an investment program as described above.

The Board seeks comment on these proposed limits, as well as whether general consent limits should be established for investments in joint ventures that are lower than the limits on investments in subsidiaries. The Board notes that these limits reflect only the investments that may be made under general consent authority; larger investments may continue to be made with 30 days' prior notice.

#### Aggregate Limits

The above limits are intended to address the fact that individual foreign investments above a certain size may be a source of potential concern, and therefore prior review of such investments should be required. In addition, the Board is also concerned with any rapid increase in an organization's foreign investments overall, made without prior review. Accordingly, it is proposed that when the cumulative investments made under

general consent reach a certain amount over a given period, new or additional investments would become subject to prior review. Investments by all affiliates of a bank holding company would be taken into account in determining compliance of the holding company with the aggregate limits; investments of subsidiaries of a bank or of an Edge, respectively, would be aggregated in determining compliance with their limits. Under the proposed liberalized general consent procedures, the new aggregate limit for all investments during any 12-month period for investors meeting the well-capitalized and well-managed tests would be:

Bank holding companies:	20 percent of tier 1 capital.
Bank subsidiaries:	the lesser of 10 percent of tier 1 capital of the bank or 50 percent of the bank subsidiary's tier 1 capital.

The Board considers that, because the bank would have the exposure on a consolidated basis for investments by either the bank or the Edge, these investments should have a combined aggregate limit. However, the Board proposes that this limit could be waived, in whole or in part by the Director of the Division of Banking Supervision and Regulation, under delegated authority, based upon a review of the financial strength of the investor and its investment strategy and business plans.

For bank holding companies, banks or Edge corporations that are adequately capitalized but do not meet the well-capitalized and well-managed standards, the Board proposes that the aggregate limits on all investments made under authority of general consent in any 12-month period would be half that applicable to well-capitalized and well-managed organizations (i.e., 10 percent of tier 1 capital for bank holding companies, 5 percent of tier 1 capital for banks, and, for Edge corporations, the lesser of 5 percent of the parent bank's tier 1 capital or 10 percent of the Edge's tier 1 capital).

#### Application of Limits to the Edge Corporation

The Board notes that an argument can be made that, in cases where the investment is made by the Edge corporation, the well-capitalized and well-managed tests should be based on a review of the parent bank, not the Edge corporation. In considering these proposals, the Board believes that the well-capitalized and well-managed tests for the Edge corporation itself should be retained as one of the bases for determining limits applicable to general consent investments. This approach would help to ensure the safety and soundness of the Edge

corporation in its own right and is consistent with the statutory (and supervisory) rationale underlying Edge corporations. As discussed above, Congress limited the amount of capital that banks could invest in Edge corporations, which in turn could invest in activities otherwise prohibited to banks that were perceived to be higher risk. Congress also subjected Edge corporations to regulation and examination by the Federal Reserve. For these reasons, the Board considers that Edge corporations should themselves be operating satisfactorily and not be a source of potential weakness to the U.S. parent bank. The Board therefore is proposing limits that are tied to the condition of the Edge. The Board seeks comment on this approach generally.

#### Preclearance of Investment Program

The Board proposes to establish a procedure that would permit U.S. banking organizations to obtain preclearance of an investment program even though one or more of the investments would be in excess of the individual or aggregate general consent investment limits and would be made over a period of time longer than one year. The Board believes such a procedure would be useful to banking organizations that may wish to engage in a specific investment program with respect to an individual company, a market segment, a region, or worldwide. Providing a preclearance mechanism would serve to ensure that the regulatory process would not impede the organization's ability to pursue its business plans.

For example, an organization that is well managed and well capitalized might contemplate bidding on a large privatization that would require the organization to commit in advance to making an investment in excess of the general consent limit if selected. Obtaining preclearance would enable the organization to make such a commitment. The Board proposes that the preclearance authority would be delegated to the Director of the Division of Banking Supervision and Regulation.

Comment is requested on whether such a preclearance program would be useful to U.S. banking organizations and whether it should be available to all banking organizations.

## **Authorization to Invest More than Ten Percent of a Bank's Capital in its Edge and Agreement Corporation Subsidiaries**

Prior to September 30, 1996, section 25A of the Federal Reserve Act prohibited member banks from investing more than 10 percent of capital and surplus in the stock of Edge and agreement corporation subsidiaries. With the enactment of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 on September 30, 1996, member banks may now invest, with the Board's prior approval, up to 20 percent of capital and surplus in the stock of such subsidiaries.

The Board may not approve the investment of more than 10 percent of capital and surplus in the stock of Edge and agreement corporation subsidiaries unless the Board determines that the investment of an additional amount by the bank would not be unsafe or unsound. As discussed above, due to the accumulation of retained earnings in Edge corporations, some U.S. banking organizations now have over 20 percent of the member bank's consolidated capital resident in Edge corporation subsidiaries.

Accordingly, the Board proposes to implement the new statutory provision by adding to Regulation K an application requirement to obtain the Board's approval of an increase in invested capital in the stock of Edge and agreement corporations above 10 percent of the parent bank's capital, as well as a general description of the types of considerations that would be taken into account in reaching a decision on such an application. Criteria that the Board considers would be appropriate to take into account would include: the composition of the assets of the bank's Edge and agreement corporations; the total capital invested by the bank in its Edge and agreement corporations when combined with retained earnings of the Edge and agreement corporations, as a percentage of the bank's capital; whether the bank, bank holding company, and Edge and agreement corporations are well capitalized and well managed; and whether the bank is adequately capitalized after deconsolidating and deducting the aggregate investment in and assets of all Edge or agreement corporations and all foreign bank subsidiaries.

The Board seeks comment on whether the above criteria are appropriate in determining whether investments of up to 20 percent of the parent bank's capital and surplus in Edge and agreement corporation subsidiaries would not be unsafe or unsound. Additionally, the Board seeks comment on whether only the well-capitalized and well-managed criteria should apply where the total Edge and agreement corporation capital (including retained earnings) on a pro forma basis would not exceed 20

percent of the bank's capital.

## **Other Revisions to Subpart A**

### Harmonization of Regulation K with Other Regulatory Changes

As a result of the substantial liberalizations made in the recent revisions to other Board regulations, particularly Regulation Y, certain activities on the laundry list of permissible activities in Regulation K are now more restrictive than those authorized domestically. As noted above, Regulation K traditionally has permitted U.S. banking organizations to conduct a wider range of financial activities abroad than may be permitted domestically in order to compete more effectively abroad. Accordingly, in addition to the expanded activities discussed above, the Board proposes removing certain restrictions on the laundry list of permissible activities to reflect recent liberalizations in other regulations.

### Leasing Activities

Regulation K currently requires that leasing activities conducted under authority of Regulation K serve as the functional equivalent of an extension of credit to the lessee. The Regulation Y revisions removed that limitation with respect to high residual value leasing. Accordingly, Regulation K would be interpreted consistent with this authority.

### Swaps Activities

The Regulation K proposal would also remove the requirement that commodity-related swaps must provide an option for cash settlement that must be exercised upon settlement. Regulation Y now authorizes investment as principal in commodity derivatives where the contract either: (i) requires cash settlement, or (ii) allows for assignment, termination or offset prior to expiration and reasonable efforts are made to avoid delivery. The Regulation K restriction would be relaxed to the same extent.

### Data Processing

No changes are proposed to the provision authorizing data processing. The Board notes, however, that this authority extends only to the processing of information and does not authorize general manufacture of hardware for such services.

### Loans to Officers at Foreign Branches

Regulation K currently places certain restrictions on

mortgage loans to officers of foreign branches. However, the Board has liberalized its Regulation O, which governs loans to executive officers, such that the provisions in Regulation K now are more restrictive. The more restrictive provision in Regulation K would be eliminated.

#### Changes with Respect to Edge and Agreement Corporations

The Board proposes adding provisions to Regulation K that would outline procedures under which Edge and agreement corporations could be liquidated on a voluntary basis.

#### Liquidation Procedures

The Board is proposing to provide procedures for the liquidation of Edge corporations and to clarify certain matters regarding the appointment of receivers for Edge corporations. Under paragraph 17 of the Edge Act (12 U.S.C. 623), an Edge corporation may go into voluntary liquidation by a vote of its shareholders owning two-thirds of its stock. Staff proposes to add a new ?211.13 to Regulation K that would provide for 45 day's prior notice to the Board of an Edge corporation's intent to dissolve. This notice would create greater certainty as to the date that the Edge corporation would cease business and permit the Board to take any necessary supervisory actions. Under paragraph 18 of the Edge Act (12 U.S.C. 624), the Board is authorized to appoint a receiver for an Edge corporation if it determines that the corporation is insolvent. The proposal would specify the grounds for determining that an Edge corporation is insolvent and clarify the powers of the receiver.

#### Additional Areas of Liberalization

The Board believes there are other areas that should be liberalized in order to reduce regulatory burden and enable U.S. banking organizations to compete more effectively with foreign banks.

#### Authorizing Foreign Branches of Operating Subsidiaries of Member Banks

The Board proposes clarifying that a member bank may establish foreign branches through its operating subsidiaries with the Board's approval, provided that the foreign branches of the operating subsidiary would engage only in activities that are permissible directly for the member bank parent.<sup>23/</sup>

<sup>23/</sup> The establishment of foreign branches of operating subsidiaries would be subject to the prior notice and general

The Board has previously approved the establishment of foreign branches by an operating subsidiary of a member bank. The Board determined that the ability of an operating subsidiary to establish foreign branches is incidental to the member bank's authority to establish such branches, subject to the condition stated above. Accordingly, this proposed addition would codify the Board's determination and allow other member banks to establish foreign branches of operating subsidiaries on the same basis as outlined above.

#### FCM Activities

Regulation K currently states that investors must seek prior Board approval for futures commission merchant (FCM) activities conducted on any exchange or clearing house that requires members to guarantee or otherwise contract to cover losses suffered by other members (a mutual exchange). This requirement has been eliminated for subsidiaries of bank holding companies, due to the revision of Regulation Y. The Board also seeks comment on whether to eliminate the requirement for prior notice where: (i) the activity is conducted through a separately incorporated subsidiary of the bank;<sup>24/</sup> and (ii) the parent bank does not provide a guarantee or otherwise become liable to the exchange or clearing house for an amount in excess of the applicable general consent limits.<sup>25/</sup> The Board believes that in these circumstances the potential exposure of the parent bank to a mutual exchange or clearing house would be sufficiently limited, such that prior approval would no longer be necessary. Eliminating the requirement for prior review of these activities would reduce the prior notice and application requirements associated with FCM activities.

#### Additional Delegation of Authority

The Board proposes delegating additional authority to the Director of the Division of Banking Supervision and Regulation in order to decrease processing periods in appropriate

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consent provisions of Regulation K.

<sup>24/</sup> If the investment is made through an Edge corporation, the investment in the subsidiary would be limited to no more than 2 percent of the parent bank's tier 1 capital.

<sup>25/</sup> This proposal is generally consistent with the FCM requirements under Regulation Y, except that it would place a limit on the amount of exposure to the exchange or clearing house, tied to the bank's tier 1 capital.



circumstances. Under the proposal, authority would be delegated in the areas of: (1) indicating no objection to the establishment of foreign branches by prior notice; (2) authorizing a banking organization to exceed its aggregate general consent investment limits based upon the financial and managerial strength of the organization and the soundness of its investment strategy and future plans; and (3) allowing organizations that are not well-capitalized and well-managed to invest under a reduced general consent limit in appropriate circumstances.

### **Subpart B: Foreign Banking Organizations**

Subpart B of Regulation K governs the U.S. activities of foreign banking organizations. It implements the IBA and provisions of the BHC Act that affect foreign banks.

This proposed revision of Subpart B seeks to eliminate unnecessary regulatory burden, increase transparency, and streamline the application/notice process for foreign banks operating in the United States based on the Board's recent experience with foreign bank applications. In addition, the proposal implements certain application related provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (the 1996 Act).

If adopted, the proposal would liberalize the standards under which certain foreign banking organizations qualify for exemptions from the nonbanking prohibitions of section 4 of the BHC Act. Comment is also being requested on a change in the scope of an existing exemption that would better conform the exemption to the policy of national treatment.

The proposal also implements several provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Interstate Act) that affect foreign banks. Finally, several technical changes to various other provisions in Subpart B are being proposed.

### **Streamlining the Regulatory Process**

The Board is required to approve the establishment by foreign banks of branches, agencies, commercial lending companies, and representative offices in the United States. This authority is contained in the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), which amended the IBA, and was intended to close perceived gaps in the supervision and regulation of foreign banks. Prior to FBSEA, there was no federal approval required for the establishment of most types of direct U.S. offices of foreign banks nor were uniform standards applicable to these offices.

In the six years since the enactment of FBSEA, the Board has gained substantial experience with the issues presented by applications by foreign banks to establish direct offices. The proposed revisions would streamline the applications process based on experience gained over this period. In addition, the proposal implements new discretionary authority and time limits contained in the 1996 Act.

#### Adoption of Single Supervision Standard for Approval of Representative Offices

Under FBSEA, in order to approve an application by a foreign bank to establish a branch, agency, or commercial lending company, the Board generally is required to determine, among other things, that the applicant bank, and any parent bank, are subject to comprehensive supervision or regulation on a consolidated basis by their home country authorities (the consolidated comprehensive supervision or CCS determination<sup>26/</sup>). A lesser supervision standard, however, applies under FBSEA to representative office applications. While the Board is required to "take into account" home country supervision in evaluating an application by a foreign bank to establish a representative office, a CCS determination is not required to approve such an application. The law simply requires the Board to consider the extent to which applicant bank is subject to CCS. A lesser standard applies because representative offices do not conduct a banking business, such as taking deposits or making loans, and therefore present less risk to U.S. customers and markets than do branches or agencies.

Regulation K currently restates the statutory "take into account" standard but does not define a minimum supervision standard that a foreign bank must meet in order to establish a representative office. Instead, the Board has developed standards in the context of specific cases. To date, the Board has used two different supervision standards in approving applications by foreign banks to establish representative offices.<sup>27/</sup> Under the first standard, the Board has permitted a

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<sup>26/</sup> As discussed later in the summary, the 1996 Act amended FBSEA to allow the Board, under certain conditions, to approve an application if the bank is not subject to CCS.

<sup>27/</sup> Wherever the record submitted by an applicant in a representative office case is sufficient to support a CCS finding, the Board generally has do so. See, e.g., Caisse Nationale de Credit Agricole, 81 Fed. Res. Bull. 1055 (1995). The two representative office standards have been applied in those cases where the record is not sufficient to support a CCS

foreign bank to establish a representative office able to exercise all powers available under applicable law and regulation on the basis of a finding that the home country supervisors exercise a significant degree of supervision over the bank.<sup>28/</sup> The second standard is more flexible. In cases in which a foreign bank has committed to limit the scope of activities of its proposed representative office to those posing only the most minimal risk to U.S. customers and markets (such as by agreeing not to solicit deposits from retail customers or possibly any customers), the Board has approved the establishment of the office on the basis of a finding that the foreign bank is subject to a supervisory framework that is consistent with approval of the application, taking into account the limited activities of the proposed office and the operating record of the bank.<sup>29/</sup>

Based on experience in dealing with representative office applications, the Board believes that the existence of two standards can be confusing and is unnecessary, particularly in light of the generally minimal risk presented to U.S. customers or markets by representative offices. Consequently, the Board is proposing that ?211.24(d)(2) of Regulation K be amended to establish only one flexible standard. Under the proposal, assuming all other factors were consistent with approval, the Board could approve an application to establish a representative office if it were able to make a finding that the applicant bank was subject to a supervisory framework that is consistent with the activities of the proposed office, taking into account the nature of such activities and the operating record of the applicant.

The record necessary to support the required finding would depend on the nature of the activities the applicant proposed to conduct in the representative office. Approval of a representative office that could conduct all permissible activities would require a record demonstrating that the applicable supervisory framework was consistent with level of risk presented by such activities. If the proposal is adopted, the Board expects that most applicants would be able to conduct all permissible activities. In those instances in which the Board had particular concerns regarding the consistency of the applicant's home country supervision with the proposed activities

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finding.

<sup>28/</sup> See, e.g., Citizens National Bank, 79 Fed. Res. Bull. 805 (1993).

<sup>29/</sup> See, e.g., Promstroybank of Russia, 82 Fed. Res. Bull. 599 (1996).

of the office, however, the applicant could commit to restrict the activities. A less comprehensive record would be required where the applicant has committed to limit the activities of the office to those posing minimal risk to U.S. customers.

The Board intends that the publishing of a single flexible standard will, in most cases, simplify the application process. The Board requests comment on the elimination of the significant degree of supervision standard and adoption of the proposed single standard.

#### Reduced Filing Requirements for the Establishment of U.S. Offices

A major thrust of the proposed revisions is reduction of burden in the application process by streamlining existing application procedures for the establishment of new U.S. offices of foreign banks. Under the current Subpart B, the establishment by a foreign bank of a U.S. branch, agency, commercial lending company subsidiary, or representative office generally requires the Board's specific approval. Once the Board has approved the establishment of a foreign bank's first office under the standards set out in FBSEA, additional offices with the same or lesser powers may be approved by the Reserve Banks under delegated authority.<sup>30/</sup> Prior notice and general consent procedures are currently available for the establishment of certain kinds of representative offices. The Board is now proposing that additional types of applications be processed under prior notice and general consent procedures.

#### Prior Notice Available After First CCS Determination

The proposal would amend ?211.24(a) to provide that any foreign bank which the Board has determined to be subject to CCS in a prior application under FBSEA may establish additional branches, agencies, commercial lending company subsidiaries, and representative offices pursuant to a 45 day prior notice procedure. This time frame would allow for review of whether any material changes had occurred with respect to home country supervision, a determination of whether the bank continues to meet capital requirements, and a review of any other relevant factors. If this proposal is adopted, the current delegation to the Reserve Banks for such applications would be deleted as no longer necessary. This procedure would also be available even if the CCS determination had been made in connection with an application for an office with lesser powers than the office the foreign bank seeks to establish.

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<sup>30/</sup> See 12 CFR 265.11(d)(11).

Prior Notice Available for Representative Offices Established by Foreign Banks Subject to the BHC Act or Previously Approved to Establish a Representative Office Under FBSEA

Many foreign banks have a U.S. banking presence and therefore are subject to the provisions of the BHC Act, but have not received a CCS determination under FBSEA. The proposal also seeks to reduce the burden on such banks applying to establish representative offices. If a foreign bank is subject to the provisions of the BHC Act through ownership of a bank or commercial lending company or operation of a branch or agency, it is already subject to supervision and oversight through the Board's Foreign Banking Organization (FBO) program. Through the FBO program, the Board gains knowledge of the bank, its policies and procedures, and a general view on home country supervision. In these instances, the Board believes that an expedited procedure may be adopted for the establishment of representative offices by these banks, even where the foreign bank had not previously been reviewed under the standards of FBSEA.

In addition, the proposal would permit the establishment by prior notice of additional representative offices by any foreign bank not subject to the BHC Act but previously approved by the Board to establish a representative office, regardless of the type of supervision finding made by the Board in the prior case. Such applications are currently delegated to the Reserve Banks. The Board sees no reason to continue require full application from such banks. The Board is proposing that ?211.24(a) be amended to permit banks in these two categories to use the 45-day prior notice procedure for opening a representative office, rather than requiring them to use the application procedure.

New General Consent Authority

The proposal would permit the establishment by general consent of a representative office by a foreign bank that is both subject to the BHC Act and has been previously determined by the Board to be subject to CCS. Establishment of a representative office by such a foreign bank is currently subject to the prior notice procedure. The proposal is based on an assessment that a foreign bank that is subject to supervision under the FBO program and has been judged subject to CCS should generally qualify to establish a representative office.

Finally, the Board is proposing that a foreign bank that is subject to the BHC Act could establish a regional administrative office by general consent, whether or not the Board had determined the bank to be subject to CCS. Regional administrative offices currently can be established using the

prior notice procedure.

#### Suspension of Prior Notice and General Consent Procedures

The proposal also provides that the Board, upon notice, may modify or suspend the prior notice and general consent procedures described above for any foreign bank. For example, modification or suspension of these procedures might be appropriate if the composite rating of the foreign bank's combined U.S. operations was less than satisfactory<sup>31/</sup> or if the foreign bank were subject to supervisory action. In general, the Board envisions that these procedures would be available for the establishment of offices by foreign banks only where the establishment does not present material issues.

These proposals should reduce the burden and delay associated with the establishment of new U.S. offices by certain categories of foreign banks without compromising the Board's ability to make the determinations necessary in connection with the establishment of such offices.

#### After-the-Fact Approvals

In implementing FBSEA in 1993, the Board recognized that it would be impractical to require prior approval for the establishment of foreign bank offices acquired in certain types of overseas transactions, such as a merger of two foreign banks, and provided for an after-the-fact approval in such cases. The regulation currently requires the foreign banks involved to commit to file an application to retain the acquired U.S. office as soon as possible after the occurrence of such transactions.

Since the enactment of FBSEA, a number of applicants using the after-the-fact procedure have chosen to wind down and close acquired offices or consolidate them with existing offices, in each case within a reasonable time frame. In most instances, no regulatory purpose was served by requiring the filing of an application. The regulation currently does not address this possibility. The proposal would amend the rules to contemplate both after-the-fact applications to retain, as well as decisions to wind-down and close, U.S. offices acquired in a transaction eligible for the after-the fact approval process. Where the foreign bank chooses to close the acquired U.S. office, the Board could impose appropriate conditions on the U.S. operations until the winding-down is completed.

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<sup>31/</sup> See 12 CFR 225.2(s) (definition of "well-managed" foreign banking organization).

## Implementation of the 1996 Act

As noted above, FBSEA generally requires the Board to determine that a foreign bank applicant is subject to CCS in order to approve the establishment of a branch, agency, or commercial lending company. The 1996 Act gave the Board discretion to approve the establishment of such offices by a foreign bank where the application record is insufficient to support a finding that the bank is subject to CCS, provided the Board finds that the home country supervisor is actively working to establish arrangements for the consolidated supervision of the bank, and all other factors are consistent with approval. This discretion gives the Board flexibility to approve applications on an exceptional basis where the home country authorities are making progress in upgrading the bank supervisory regime but the record may not yet be sufficient to support a full CCS finding. The Board has stated that this authority should be viewed as a limited exception to the general requirement relating to CCS.<sup>32/</sup> The statutory standards are included in the proposed revision.

The proposal also would incorporate into Regulation K the statutory time limits in the 1996 Act for Board action on applications for branches, agencies, and commercial lending companies. The 1996 Act provided that the Board must act on such an application within 180 days of its receipt. The time period may be extended once for an additional 180 days, provided notice of the extension and the reasons for it are provided to the applicant and the licensing authority; the applicant may also waive the time periods. Although the regulation will reflect these statutory time periods, the Board proposes to maintain existing internal time schedules that would require faster processing where possible.

### New Discretionary Factor

In light of the increasing attention being paid to the problem of money laundering, the Board currently requests that foreign banks applying to establish U.S. offices provide information on the measures taken to prevent the bank from being used to launder money, the legal regime to prevent money laundering in the home country, and the extent of the home country's participation in multilateral efforts to combat money laundering. The Board considers this information in reaching its decision on applications. In light of this practice, the

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<sup>32/</sup> The Board first exercised its discretion under the 1996 Act when it approved an application by a Korean bank to establish a state-licensed branch in New York City. See Housing & Commercial Bank, 83 Fed. Res. Bull. 935 (1997).

proposed revision includes as a new discretionary standard for the establishment of U.S. offices by foreign banks that the Board may consider the adequacy of measures for the prevention of money laundering.

## **Qualifications of Foreign Banks for Nonbank Exemptions**

### Changes to the QFBO Test

Regulation K implements statutory exemptions from the BHC Act for certain activities of foreign banks. These exemptions are available to qualifying foreign banking organizations (QFBOs) and are found in sections 2(h) and 4(c)(9) of the BHC Act. Section 2(h) allows a foreign company principally engaged in banking business outside the United States to own foreign affiliates that engage in impermissible nonfinancial activities in the United States, subject to certain requirements. These include that the foreign affiliate must derive most of its business from outside the United States and it may engage in the United States only in the same lines of business it conducts outside the United States. Section 4(c)(9) allows the Board to grant foreign companies an exemption from the nonbank activity restrictions of the BHC Act where the exemption would not be substantially at variance with the BHC Act and would be in the public interest. Under this exemption, the Board has exempted, among other things, all foreign activities of QFBOs from the nonbanking prohibitions of the BHC Act.

In order to qualify as a QFBO, a foreign banking organization must demonstrate that more than half of its business is banking and more than half of its banking business is outside the United States. Banking business is defined to include the activities permissible for a U.S. banking organization to conduct, directly or indirectly, outside of the United States.<sup>33/</sup>

Under the current regulations, however, such activities can be counted as banking business for the purposes of the QFBO test only if they are conducted in the foreign bank ownership chain;

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<sup>33/</sup> These activities include, in addition to traditional banking activities, underwriting various types of insurance (credit life, life, annuity, pension fund-related, and other types of insurance where the associated risks are actuarially predictable); underwriting, distributing, and dealing in debt and equity securities outside the United States; providing data processing, investment advisory, and management consulting services; and organizing, sponsoring, and managing a mutual fund.



that is, by the foreign bank or a subsidiary of the foreign bank. Activities conducted by a parent holding company or sister affiliate do not count toward qualification.

Removal of the Banking Chain Requirement                      from One Prong of  
the QFBO Test

In connection with the 1991 revisions to Regulation K, a number of commenters suggested that the Board eliminate the requirement that banking activities be conducted in the bank ownership chain. The Board did not adopt this suggestion in 1991 because it was concerned that to do so could have allowed a foreign financial conglomerate with no substantial commercial bank to conduct full-scope banking operations in the United States. The Board determined that the intent of the BHC Act was to grant exemptions only to those foreign organizations that were substantially engaged in commercial banking.

The Board has reconsidered the QFBO test in light of this background and believes that the test can be liberalized without extending the BHC Act exemptions to foreign firms that are not engaged substantially in commercial banking. As noted above, the QFBO test has two prongs: first, more than half of the organization's activities must be banking, and second, more than half its banking business must be outside the United States. Under the proposed revision, the requirement that all activities must be conducted under the bank ownership chain to count as "banking" would be eliminated from the first prong. By eliminating the banking chain requirement for this prong of the test, a foreign banking organization that has substantial life insurance activities outside of the banking chain would be able to count such activities toward meeting this prong of the QFBO test. The Board understands that, in at least some recent instances where foreign banking organizations failed the current QFBO test, these organizations would have been able to pass the test under the proposed re-formulation.

The banking chain requirement has not been eliminated, however, for purposes of determining whether a foreign banking organization's banking operations outside of the United States are larger than those in the United States. Eliminating the banking chain requirement for this part of the test would enable a foreign organization engaged primarily in certain financial activities, such as life insurance, outside of the United States to meet the QFBO test even if its U.S. commercial banking operations were larger than the commercial banking operations of its foreign bank or banks. The exemptions under sections 2(h)

and 4(c)(9) of the BHC Act, which this section of Regulation K implements, are intended to limit the extraterritorial effect of the BHC Act on foreign banks and to prevent foreign financial companies that own U.S. banks from obtaining competitive advantages. Accordingly, the proposal retains the banking chain requirement for this prong of the QFBO test. The Board believes that this approach would give appropriate flexibility to foreign banking organizations that operate under different economic and regulatory environments while still addressing the intent of the BHC Act to give exemptions only to true foreign banks that conduct more banking business outside the United States than in the United States.

Request for Comments with Respect to the                      Expansion of the  
Activities That May be Counted as Banking

The QFBO test in Regulation K permits foreign banking organizations to count only those assets, revenues, or net income related to activities which are permissible for a U.S. banking organization to conduct outside of the United States. Under the current test, a predominantly financial organization that engages to a significant extent in activities not permissible for a U.S. bank abroad -- for example, property and casualty insurance -- could fail to meet the QFBO test.

In formulating the QFBO test, the Board has sought to balance the potentially competing goals of avoiding the extraterritorial application of U.S. law on the one hand and ensuring competitive equality with U.S. banking organizations on the other. In this regard, the Board does not intend the QFBO exemptions to permit foreign commercial and industrial firms to conduct a commercial banking business in the United States. This view, however, is not necessarily inconsistent with granting the QFBO exemptions to a foreign banking organization that is engaged to a significant extent in financial activities not permissible for a U.S. bank abroad. For this reason, the Board is requesting comment with respect to whether and how to expand the list of activities that would be considered banking for purposes of the QFBO test.

Comment is requested on both of these proposals and on any other issues arising under the QFBO rules.

Applications for Special Determination of Eligibility for QFBO  
Treatment

Regulation K permits a foreign banking organization that ceases to qualify as a QFBO to request a special determination of eligibility. The proposal would permit a foreign banking organization that has applied for a specific

determination of eligibility to continue to conduct its business as if it were a QFBO, except with respect to making investments in U.S. companies under section 2(h) of the BHC Act for which Board consent would be required. The proposal reflects the approach taken in a prior case considered by the Board.

Comment Requested on Limiting the Ability of Foreign Banks to Conduct Unregulated Activities Abroad through U.S. Companies in the Interests of National Treatment

Regulation K currently exempts from the BHC Act any activity conducted by a QFBO outside the United States. There appears to be a growing trend by foreign banks under this exemption toward using U.S. companies operating under section 4(c)(8) of the BHC Act to hold foreign subsidiaries that such foreign banks regard as unrestricted in their activities.

Under the BHC Act, a U.S. bank holding company may own foreign subsidiaries only under the authority of Regulation K, which sets limits on the activities that can be conducted in such subsidiaries. In the past, in response to inquiries, Board staff has provided advice that the activities of foreign subsidiaries of section 4(c)(8) companies owned by foreign banking organizations should be operated subject to these same limitations. Nonetheless, it appears that some foreign banking organizations have interpreted the general exemption in Regulation K for all non-U.S. activities of foreign banking organizations as also extending to the foreign subsidiaries of section 4(c)(8) companies. The question is raised of whether this provides an unfair competitive advantage to foreign banks in using and marketing the name and operations of the regulated U.S. company.

Given the fact that the foreign activities of a QFBO are exempt under Regulation K, the Board recognizes the ability to own a foreign subsidiary through a section 4(c)(8) company may not be viewed as a material competitive advantage for foreign banks. Even if the ownership of impermissible foreign subsidiaries through section 4(c)(8) companies were to be prohibited, a foreign bank could comply simply by moving the ownership from the U.S. company to a true foreign subsidiary.

The purpose of the exemption in Regulation K, however, was to permit foreign banking organizations to conduct their non-U.S. activities outside the scope of U.S. regulation because there was no U.S. interest served by regulating such activities. The Board, however, does have a regulatory interest in section 4(c)(8) companies. The exemption was not intended to allow U.S. companies regulated under section 4(c)(8) of the BHC Act and owned by foreign banking organizations to engage in

unrestricted foreign activities. Accordingly, the Board is requesting comment on limiting the availability of the exemption in Regulation K to activities conducted by true foreign subsidiaries of foreign banks, and preventing the use of such exemption by foreign-owned but U.S.-regulated companies such as those operating under section 4(c)(8).

### **Implementation of New Interstate Rules**

In addition to application procedures and rules on nonbanking activities, Regulation K implements the restrictions on interstate operations of foreign banks provided in the IBA and the BHC Act. The Interstate Act amended the IBA and the BHC Act to remove geographic restrictions on interstate acquisitions of banks by foreign banks, permitted foreign banks to branch interstate by merger and de novo on the same basis as domestic banks with the same home state as the foreign bank, and modified the definition of a foreign bank's home state for purposes of interstate branching. The Interstate Act became fully effective in June 1997.

In May 1996, the Board published a final rule to implement certain of the changes made by the Interstate Act. The rule required certain foreign banks to select a home state for the first time, or have a home state designated by the Board, removed obsolete provisions of Regulation K that restricted the ability of a foreign bank to effect major bank mergers through U.S. subsidiary banks located outside the foreign bank's home state, and deleted certain other obsolete rules governing home state selection.

This proposal would implement and interpret certain other changes made by the Interstate Act. The proposal would permit foreign banks to make additional changes in home state under certain circumstances and clarify the extent to which a foreign bank changing its home state is required to conform its existing network of bank subsidiaries and banking offices.

In addition, the proposal sets forth the additional standards for approval of applications by foreign banks to establish interstate branches. It also would clarify that the "upgrade" of agencies and limited branches to full branches requires Board approval and that the Board will approve such upgrades (absent a merger transaction) only if the host state has enacted laws permitting de novo interstate branching. Finally, the proposal deletes the Board's home state attribution rule, which provides that a foreign bank (or other company) and all other foreign banks which it controls must have the same home state.

#### Changes of Home State

In 1980, the Board allowed foreign banks a single change of home state as a compromise between the need for comparable treatment with domestic banks and Congress' intent, in adopting the IBA, that foreign banks be allowed some flexibility to change home state. The basic framework for interstate banking, however, has changed substantially since 1980, when domestic banks generally could not branch interstate and rarely, if ever, could change home states. Domestic and foreign banks may now branch into other states either de novo or by merger in certain circumstances; interstate branching by merger between banks is now possible in all states other than Montana and Texas, and de novo interstate branching is permitted in 13 states. As a result, many domestic banks with interstate branches now have significant opportunities to change home state, although these opportunities are not available to all banks under all circumstances.

In light of these changes, the proposal gives foreign banks additional opportunities to change home state in a way that affords comparable treatment to foreign and domestic banks. The proposal would retain the ability of foreign banks under current rules to change their home state once by filing a notice with the Board. Changes made by foreign banks prior to the entry into effect of the proposed amendments would count toward this one-time limit. The proposal would also establish a new procedure for foreign banks to change home state an unlimited number of times, by applying for the prior approval of the Board for each such change. A foreign bank applying to change its home state under the new procedure would be required to show that a domestic bank with the same home state would be able to make the same change.

The new procedure advances the policy of national treatment underlying the IBA by allowing foreign banks to take advantage of changes in laws concerning interstate branching in order to change home state, when and to the extent those laws make it possible for domestic banks to change home state as well. The new procedure also seeks to prevent foreign banks from gaining an unfair competitive advantage over domestic banks by changing home state in circumstances where a domestic bank would be unable to do so. Although the Interstate Act made it possible for domestic banks to change home state in some cases, there are other cases where such changes in home state may be difficult or impossible. Accordingly, the new procedure would allow foreign banks to change home state only in cases where a domestic bank could effect the same change.

The Board would have discretion to grant the request of a foreign bank to change home state under the new proposed

procedure. In evaluating these applications, the Board would consider whether the proposed change of home state would be consistent with competitive equity between foreign and domestic banks. Relevant factors in this regard include the degree to which a national or state bank would be able to make the same change of home state while retaining its existing operations outside the new home state.

Changes in home state would generally have no impact on which Reserve Bank will supervise the operations of a foreign bank nor on which Reserve Bank will receive a foreign bank's reports and applications.

#### Conforming U.S. Operations Upon Change in Home State

Regulation K currently requires a foreign bank that changes its home state to conform its banking operations outside the new home state to what would have been permissible at the time of the bank's original home state selection. The requirement, adopted in 1980, implemented section 5 of the IBA which sought to prevent foreign banks from using a home state change to acquire and maintain subsidiary banks or branches in more than one state in circumstances where a domestic bank or bank holding company would be unable to do so.

The Interstate Act liberalized the rules on interstate branches and eliminated the geographic restrictions on the purchases of banks by domestic bank holding companies and foreign banks under the BHC Act and the IBA. Consequently, the Board is proposing that the provisions on conforming operations upon a foreign bank's change of home state be revised to reflect changes made by the Interstate Act. For example, with respect to subsidiary banks, a foreign bank would no longer be required to divest a subsidiary bank outside its new home state; the Interstate Act authorizes interstate acquisitions of bank subsidiaries.

With respect to conforming branches outside the foreign bank's new home state, the proposed amendment would reflect the liberalized interstate branching rules applicable to foreign and domestic banks as a result of the Interstate Act. A foreign bank changing its home state would be permitted to retain all branches which the foreign bank could establish (under current law) if it already had its new home state. This relaxation is appropriate given that domestic, as well as foreign banks, now have significant opportunities to establish and retain interstate branches.

The proposal would not change the current rule which allows a foreign bank to retain branches grandfathered under the

IBA, and limited branches (that is, branches that "limit" their deposit-taking to only those deposits that an Edge corporation may accept).

#### Additional Standards for Interstate Offices

The proposal also contains the additional standards required by the Interstate Act for approval by the Board of the establishment by a foreign bank of branches located outside of the bank's home state. These standards are designed to insure that foreign banks seeking to establish interstate branches meet requirements comparable to those imposed on domestic banks seeking to operate interstate.

#### Upgrading of Agencies and Limited Branches to Full Branches

Section 5 of the IBA, as amended by the Interstate Act, allows a foreign bank to establish full branches outside its home state only if a domestic bank with the same home state could establish branches in the same host state under the Interstate Act. The Interstate Act allows interstate branching by merger with an existing bank or branch (the merger provisions) or through de novo branching (the de novo provisions). The merger provisions further distinguish between interstate mergers of entire banks and interstate acquisition of individual branches.

Some foreign bank trade groups have argued that a foreign bank with interstate offices, including agencies and limited branches, should be permitted to convert such agencies and limited branches outside the home state into full-service branches. The argument is based on the fact that domestic banking organizations can consolidate their existing interstate subsidiary banks and establish interstate branches through the merger provisions. Accordingly, the argument goes, in order to provide national treatment, foreign banks should be able to "consolidate" their own existing interstate operations into full-service branches.

The Board has several concerns with this argument. In an interstate merger of bank subsidiaries, different legal entities are merged into one; operations are retained as branches of the surviving bank. In the case of a foreign bank's interstate network of offices, each office is already part of one legal entity; there is no merger. Moreover, in an interstate merger transaction, all existing subsidiary banks would generally have full deposit-taking authority; the merger does not increase the ability of the merged entities to take deposits. In the case of foreign banks, however, many of the interstate offices do not

have full deposit powers<sup>34/</sup> and granting the request would allow foreign banks substantially to increase their deposit powers. Finally, unlike foreign banks, domestic banks did not have the opportunity to establish agencies and limited branches outside their home states prior to enactment of the Interstate Act. One possible issue is whether the existing networks of such interstate offices of foreign banks, established at a time when such interstate offices were unavailable to domestic banks, would give foreign banks an unfair advantage over domestic banks if the Board decides that such offices can be upgraded to full branches under the merger provisions.<sup>35/</sup>

On balance, the Board believes it should approve upgrades of agencies and limited branches to full branches only if the host state permits de novo interstate branching. Comment is being requested on whether foreign banks wishing to upgrade their out-of-home-state offices should be permitted to do so only if a domestic bank with the same home state as the foreign bank could open a de novo branch, or whether there are other circumstances in which a foreign bank should be permitted to upgrade its offices.

In connection with this issue, the Board is proposing a change in the current definition of "change in status" in Regulation K. Regulation K requires the prior approval of the Board under the FBSEA for any "change in the status" of a U.S. office. The current definition of change in status in Regulation K does not expressly include upgrades from limited to full branches because foreign banks generally were unable to effect such upgrades without changing home state until the Interstate Act gave foreign banks the ability to establish full branches on an interstate basis.

As discussed above, upgrading a limited branch of a foreign bank to a full branch implicates policy concerns similar to those raised by changes in the status of an office requiring prior Board approval under FBSEA. Thus, the Board proposes to expand the definition of "change in status" to include

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<sup>34/</sup> Limited branches may take only Edge-type deposits; agencies may accept only foreign-source deposits.

<sup>35/</sup> It could be argued that the ability of foreign banks to maintain agency, limited branch, and representative office networks outside their home states since 1978 gave foreign banks a slight competitive advantage, and that foreign banks wishing to upgrade their out-of-home-state offices should be allowed to do so only if a domestic bank could open a de novo branch under the Interstate Act.



upgrades from a limited branch to a full branch, such that prior approval of the Board under FBSEA would be necessary for such upgrades. Where a foreign bank proposes to upgrade a limited branch to a full branch outside its home state, the prior approval of the Board under the interstate branching provisions of section 5 of the IBA also would be required as a result of this rule change.

#### Home State Attribution Rule Deleted

Regulation K currently provides that a foreign banking organization and all its affiliates are entitled to only one home state. This would be true even if the foreign banking organization owned several different foreign banks with operations in the United States.

At the time the rule was adopted, domestic banks generally could not branch into states other than the ones in which they were located, nor could bank holding companies generally acquire banks outside their home state. In that context, the Regulation K provision was structured to prevent affiliated groups of foreign banks from gaining an unfair advantage over domestic banks by having each of the affiliated foreign banks select a different home state. Having done so, the foreign banks would be able to open and operate branches in more than one state. The rule sought to prevent this by stating that a foreign banking organization and any foreign bank that it controls would be entitled to only one home state.

The Interstate Act has substantially changed the rules on interstate expansion since this provision was originally adopted. Under current law, a bank holding company may own many banks in different states; each of these banks is entitled to its own home state regardless of the home states of its affiliates. Consequently, the Board proposes that Regulation K be amended to eliminate the requirement that a foreign bank and all its affiliates are entitled to only one home state. The proposal would preserve national treatment for foreign banks and would not put U.S. banking organizations at any competitive disadvantage.<sup>36/</sup>

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<sup>36/</sup> Section 5 of the IBA provides that a foreign bank may not establish a branch "directly or indirectly" outside its home state. Staff does not believe that this provision affects the ability of several foreign bank affiliates to maintain different home states. Rather, in light of Congress's intent to provide foreign banks with national treatment in interstate expansion, staff believes this prohibition on "indirect" establishment of branches refers to preventing one foreign bank from acting as the branch of another foreign bank, without the latter having met the

The Board requests comment on the specific proposals with respect to the Interstate Act as well as any other comments on appropriate or desirable changes.

## **Additional Matters**

### Temporary Additional Office Location

From time to time over the past six years, the Board has received requests from foreign banks that desire to have an additional temporary location, usually as an interim measure before moving into new office space that can accommodate the entire staff of the branch or agency. These requests typically occur when the office is expanding into new areas or otherwise adding staff. The Board is proposing that prior approval under FBSEA would not be required where a foreign bank temporarily, for a period not to exceed 12 months, relocates part of the staff of a branch or agency pending movement of the entire office to a new location as long as there is not direct public access with respect to any branch or agency function. Any foreign bank taking advantage of this authority would be required to advise the Board prior to the relocation, make certain commitments, and provide periodic information, as requested.

### Changes to Definition Section

The revision makes certain technical changes in the definition section of Subpart B, including in the definitions of "appropriate Federal Reserve Bank," "foreign banking organization," and "regional administrative office."

### Conforming Changes to Termination Provisions

The Board proposes to amend the provisions of Subpart B dealing with termination of a U.S. office of a foreign bank to add as a grounds for termination a finding that the home country supervisor of a foreign bank is not making demonstrable progress in establishing arrangements for the comprehensive supervision or regulation of such foreign bank on a consolidated basis.

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requirements of the IBA, including section 5.

## Permissible U.S. Securities Activities for Foreign Banking Organization

Subpart B currently provides that a foreign banking organization may not own or control shares of a foreign company that directly underwrites, sells or distributes, or that owns or controls more than five percent of the shares of a company that underwrites, sells or distributes, securities in the United States, except to the extent permitted bank holding companies. The current five percent limitation is intended to limit any competitive advantage the foreign banking organization might have by virtue of owning a larger interest in an impermissible U.S. securities company than is permitted to a U.S. bank holding company. Based on recent experience, the Board is proposing that the five percent limit be raised to ten percent. In the Board's view, a less than ten percent ownership interest would not generally permit the foreign banking organization to exert a significant influence over a securities company in order to gain a competitive advantage over U.S. bank holding companies.

### New Delegations

Staff is proposing adding several new delegations related to Subpart B of Regulation K to the Board's delegation rules. The following authority would be delegated to the Director of the Division of Banking Supervision and Regulation:

- ? Together with the appropriate Federal Reserve Bank, authority to waive or suspend the prior notice period in connection with the establishment of any particular new foreign bank office in the United States or to require that an application be filed in lieu of a prior notice;
- ? Authority to suspend a particular foreign banking organization's ability to establish additional offices by general consent or prior notice would also be delegated to the Director of the Division of Banking Supervision and Regulation.
- ? Authority to determine that the temporary operation by a foreign bank of a second location of an existing office does not constitute the establishment of a new office.

The following authority would be delegated to the General Counsel.

- ? Authority not to require an application in the event of

a merger or acquisition transaction involving two foreign banks that would otherwise qualify for after-the-fact approval where the foreign bank in question commits promptly to wind down the acquired U.S. operations; and

- ? Authority to approve routine requests for exemptive authority under section 4(c)(9) of the BHC Act.

### Reduction of Reporting Requirements

Foreign banking organizations currently are required to report certain acquisitions of shares in companies engaged in activities in the United States on a quarterly basis. The Board is proposing that such reports be required only on an annual basis.

### **Subpart C: Export Trading Companies**

Subpart C of the Regulation K sets out the rules governing investments and participation in export trading companies (ETCs) by bank holding companies and other eligible investors.

ETCs are companies in which bank holding companies and certain other eligible investors may invest for the purpose of promoting U.S. exports. Currently, an eligible investor must give the Board 60 days prior written notice of an investment of any amount in an ETC. To ease regulatory burden, the Board is proposing a general consent procedure whereby an eligible investor that is well capitalized and well managed may invest in an ETC without submitting prior notice. An eligible investor that makes such an investment would have to provide certain information to the Board in a post-investment notice. The terms well capitalized and well managed would have the same meanings as in the Board's Regulation Y.

The Board is also proposing that eligible investors be able, under general-consent authority, to reinvest an amount equal to dividends received from the ETC in the prior year and to acquire an ETC from an affiliate at net asset value. Both provisions are based on the general-consent provisions of subpart A.

The proposed revision of subpart C would also move all defined terms into a new definitions section; remove an obsolete provision relating to the calculation of an ETC's revenues; and make certain minor, technical amendments.

## **Request for Comment**

The Board seeks comment on all of these proposals, including any changes not noted above but that are set forth in the draft regulations.

## **Initial Regulatory Flexibility Analysis**

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires an initial regulatory flexibility analysis with any notice of proposed rulemaking. A description of the reasons why the action by the agency is being considered and a statement of the objectives of, and the legal basis for, the proposed rule are contained in the supplementary information above. The overall effect of the proposed rule would be to reduce regulatory burden. The rule should not have a significant economic impact on a substantial number of small business entities consistent with the spirit and purpose of the Regulatory Flexibility Act.

## **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.) and its implementing regulation (5 CFR 1320, app. A.1), the Board reviewed the proposed 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 the Board displays a currently valid OMB control number. The Board's OMB control numbers for the collections revised by this proposal are 7100-0107 (the International Applications and Prior Notifications under Subparts A and C of Regulation K; FR K-1), 7100-0110 (the Notification Required Pursuant to Section 211.23(h) of Regulation K on Acquisitions by Foreign Banking Organizations; FR 4002), and 7100-0284 (the International Applications and Prior Notifications under Subpart B of Regulation K; FR K-2).

The collections of information that are proposed to be revised by this rulemaking are authorized by sections 25 and 25A of the Federal Reserve Act (12 U.S.C. 601-604a, 611-631), sections 4(c)(13), 4(c)(14), and 5(c) of the BHC Act (12 U.S.C. 1843(c)(13), 1843(c)(14), 1844(c)), and sections 7, 8(a), and 10 of the IBA (12 U.S.C. 3105, 3106(a), 3107). These information collections are required to evidence compliance with the requirements of Regulation K. The respondents are for-profit financial institutions, including small businesses.

The current estimated annual burden for the 7100-0107 is 440 hours. The proposed rule would result in an estimated 25

percent reduction in the number of applications filed. The proposal would permit well-capitalized and well-managed U.S. banking organizations making investments pursuant to general consent authority to file an abbreviated post-investment notice with the Board. This notice would take the place of the requirements relating to prior notice or application to the Board that would be required under existing Regulation K procedures before any such investment could be made. The current estimated annual burden for the 7100-0110 is 80 hours. It is estimated that the proposed rule would reduce the burden by 50 percent due to a decrease in the frequency of reports to be filed for certain foreign banking organizations. The current estimated annual burden for the 7100-0284 is 1,000 hours. It is estimated that the proposed rule would reduce the burden by 10 percent due to a decrease in the average number of hours required to complete an application. The Board estimates there would be no cost burden in addition to the annual hour burden.

For the 7100-0107 and the 7100-0284, the applying organization has the opportunity to request confidentiality for information that it believes will qualify for an exemption under the Freedom of Information Act (5 U.S.C. 552(b)). For the 7100-0110, the information may be deemed confidential if the respondent requests confidential treatment and is able to demonstrate the need for confidentiality under one or more of the exemptions provided by FOIA (5 U.S.C. 552(b)).

Comments are invited on: a. whether the proposed revised collections of information are 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 revised information collections, 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 collections of information should be sent to Mary M. McLaughlin, Chief, Financial Reports Section, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments to be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-00107, 7100-0110, or 7100-0284), Washington, DC 20503.

## **List of Subjects**

### 12 CFR Part 211

Exports, Federal Reserve System, Foreign banking, Holding

companies, Investments, Reporting and recordkeeping requirements.

12 CFR Part 265

Authority delegations (Government agencies), Banks, banking, Federal Reserve System.

For the reasons set out in the preamble, the Board of Governors proposes to amend 12 CFR parts 211 and 265 as set forth below:

**PART 211 - INTERNATIONAL BANKING OPERATIONS (REGULATION K)**

1. The authority citation for part 211 continues to read as follows:

**Authority:** 12 U.S.C. 221 et seq., 1818, 1835a, 1841 et seq., 3101 et seq., 3109 et seq.

2. Subparts A, B, and C (?? 211.1 through 211.34) are revised to read as follows:

**PART 211 - INTERNATIONAL BANKING OPERATIONS (REGULATION K)**

**Subpart A - International Operations of U.S. Banking Organizations**

Sec.

211.1 Authority, purpose, and scope.

211.2 Definitions.

211.3 Foreign branches of U.S. banking organizations.

211.4 Permissible investments and activities of foreign branches of member banks.

211.5 Edge and agreement corporations.

211.6 Permissible activities of Edge and agreement corporations in the United States.

211.7 Investments and activities abroad.

211.8 Investment procedures.

211.9 Permissible activities abroad.

211.10 Lending limits and capital requirements.

211.11 Supervision and reporting.

211.12 Reports of crimes and suspected crimes.

211.13 Liquidation of Edge and agreement corporations.

**Subpart B - Foreign Banking Organizations**

211.20 Authority, purpose, and scope.

211.21 Definitions.

211.22 Interstate banking operations of foreign banking

organizations.

211.23 Nonbanking activities of foreign banking organizations.

211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.

211.25 Termination of offices of foreign banks.

211.26 Examination of offices and affiliates of foreign banks.

211.27 Disclosure of supervisory information to foreign supervisors.

211.28 Provisions applicable to branches and agencies: limitation on loans to one borrower.

211.29 Applications by state branches and state agencies to conduct activities not permissible for federal branches.

211.30 Criteria for evaluating U.S. operations of foreign banks not subject to consolidated supervision.

### **Subpart C - Export Trading Companies**

211.31 Authority, purpose, and scope.

211.32 Definitions.

211.33 Investments and extensions of credit.

211.34 Procedures for filing and processing notices.

### **SUBPART A - INTERNATIONAL OPERATIONS OF U.S. BANKING ORGANIZATIONS**

#### **? 211.1 Authority, purpose, and scope.**

(a) Authority. This subpart is issued by the Board of Governors of the Federal Reserve System (Board) under the authority of the Federal Reserve Act (FRA) (12 U.S.C. 221 et seq.); the Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. 1841 et seq.); and the International Banking Act of 1978 (IBA) (12 U.S.C. 3101 et seq.).

(b) Purpose. This subpart sets out rules governing the international and foreign activities of U.S. banking organizations, including procedures for establishing foreign branches and Edge and agreement corporations to engage in international banking, and for investments in foreign organizations.

(c) Scope. This subpart applies to:

(1) Corporations organized under section 25A of the FRA (12 U.S.C. 611-631) (Edge corporations);

(2) Corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601-604a),



(agreement corporations);

(3) Member banks with respect to their foreign branches and investments in foreign banks under section 25 of the FRA (12 U.S.C. 601-604a);<sup>37/</sup> and

(4) Bank holding companies with respect to the exemption from the nonbanking prohibitions of the BHC Act afforded by section 4(c)(13) of that act (12 U.S.C. 1843(c)(13)).

## ? 211.2 Definitions.

Unless otherwise specified, for the purposes of this subpart:

(a) An affiliate of an organization means:

(1) Any entity of which the organization is a direct or indirect subsidiary; or

(2) Any direct or indirect subsidiary of the organization or such entity.

(b) Capital Adequacy Guidelines means the "Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure" (12 CFR 208, app. A) and the "Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure" (12 CFR 225, app. A).

(c) Capital and surplus means, unless otherwise provided in this part:

(1) Tier 1 and tier 2 capital included in an organization's risk-based capital (under the Capital Adequacy Guidelines); and

(2) The balance of allowance for loan and lease losses not included in an organization's tier 2 capital for calculation of risk-based capital, based on the organization's most recent consolidated Report of Condition and Income.

(d) Directly or indirectly, when used in reference to activities or investments of an organization, means activities or investments of the organization or of any subsidiary of the

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<sup>37/</sup> Section 25 of the FRA (12 U.S.C. 601-604a), which refers to national banking associations, also applies to state member banks of the Federal Reserve System by virtue of section 9 of the FRA (12 U.S.C. 321).

organization.

(e) Eligible country means any country:

(1) For which an allocated transfer risk reserve is required pursuant to ? 211.43 and that has restructured its sovereign debt held by foreign creditors; and

(2) Any other country that the Board deems to be eligible.

(f) An Edge corporation is engaged in banking if it is ordinarily engaged in the business of accepting deposits in the United States from nonaffiliated persons.

(g) Engaged in business or engaged in activities in the United States means maintaining and operating an office (other than a representative office) or subsidiary in the United States.

(h) Equity means an ownership interest in an organization, whether through:

(1) Voting or nonvoting shares;

(2) General or limited partnership interests;

(3) Any other form of interest conferring ownership rights, including warrants, debt, or any other interests that are convertible into shares or other ownership rights in the organization; or

(4) Loans that provide rights to participate in the profits of an organization, unless the investor receives a determination that such loans should not be considered equity in the circumstances of the particular investment.

(i) Foreign or foreign country refers to one or more foreign nations, and includes the overseas territories, dependencies, and insular possessions of those nations and of the United States, and the Commonwealth of Puerto Rico.

(j) Foreign bank means an organization that:

(1) Is organized under the laws of a foreign country;

(2) Engages in the business of banking;

(3) Is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations;

(4) Receives deposits to a substantial extent in the regular course of its business; and

(5) Has the power to accept demand deposits.

(k) Foreign branch means an office of an organization (other than a representative office) that is located outside the country where the organization is legally established, at which a banking or financing business is conducted.

(l) Foreign person means an office or establishment located outside the United States, or an individual residing outside the United States.

(m) Investment means:

(1) The ownership or control of equity;

(2) Binding commitments to acquire equity;

(3) Contributions to the capital and surplus of an organization; or

(4) The holding of an organization's subordinated debt when the investor and the investor's affiliates hold more than 5 percent of the equity of the organization.

(n) Investor means an Edge corporation, agreement corporation, bank holding company, or member bank.

(o) Joint venture means an organization that has 25 percent or more of its voting shares held directly or indirectly by the investor or by an affiliate of the investor, but which is not a subsidiary of the investor.

(p) Loans and extensions of credit means all direct and indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds.

(q) Organization means a corporation, government, partnership, association, or any other entity.

(r) Person means an individual or an organization.

(s) Portfolio investment means an investment in an organization other than a subsidiary or joint venture.

(t) Representative office means an office that:

(1) Engages solely in representational and administrative

functions (such as soliciting new business or acting as liaison between the organization's head office and customers in the United States); and

(2) Does not have authority to make any business decision (other than decisions relating to its premises or personnel) for the account of the organization it represents, including contracting for any deposit or deposit-like liability on behalf of the organization.

(u) Subsidiary means an organization that has more than 50 percent of its voting shares held directly or indirectly, or that is otherwise controlled or capable of being controlled, by the investor or an affiliate of the investor under any authority. Among other circumstances, an investor is considered to control an organization if:

(1) The investor or an affiliate is a general partner of the organization; or

(2) If the investor and its affiliates directly or indirectly own or control more than 50 percent of the equity of the organization.

(v) Tier 1 capital has the same meaning as provided under the Capital Adequacy Guidelines.

(w) Well capitalized means:

(1) In relation to a parent member or insured bank, that the standards set out in ? 208.33(b)(1) of Regulation H (12 CFR 208.33(b)(1)) are satisfied;

(2) In relation to a bank holding company, that the standards set out in ? 225.2(r)(1) of Regulation Y (12 CFR 225.2(r)(1)) are satisfied; and

(3) In relation to an Edge or agreement corporation, that it has tier 1 and total risk-based capital ratios of 6.0 and 10.0 percent, respectively, or greater.

(x) Well managed means that the Edge or agreement corporation, any parent insured bank, and the bank holding company have received a composite rating of 1 or 2 at their most recent examination or review and are not subject to any supervisory enforcement action.

### **? 211.3 Foreign branches of U.S. banking organizations.**

(a) General. (1) Definition of banking organization. For

purposes of this section, a banking organization is defined as a member bank and its affiliates.

(2) A banking organization is considered to be operating a branch in a foreign country if it has an affiliate that is a member bank, Edge or agreement corporation, or foreign bank that operates an office (other than a representative office) in that country.

(3) For purposes of this subpart, a foreign office of an operating subsidiary of a member bank shall be treated as a foreign branch of the member bank and may engage only in activities permissible for a branch of a member bank.

(4) At any time upon notice, the Board may modify or suspend branching authority conferred by this section with respect to any banking organization.

(b)(1) Establishment of foreign branches. (i) Foreign branches may be established by any member bank having capital and surplus of \$1,000,000 or more, an Edge corporation, an agreement corporation, any subsidiary the shares of which are held directly by the member bank, or any other subsidiary held pursuant to this subpart.

(ii) The Board grants its general consent under section 25 of the FRA (12 U.S.C. 601-604a) for a member bank to establish a branch in the Commonwealth of Puerto Rico and the overseas territories, dependencies, and insular possessions of the United States.

(2) Prior notice. Unless otherwise provided in this section, the establishment of a foreign branch requires 30 days' prior written notice to the Board.

(3) Branching into additional foreign countries. After giving the Board 12 days' prior written notice, a banking organization that operates branches in two or more foreign countries may establish a branch in an additional foreign country.

(4) Additional branches within a foreign country. No prior notice is required to establish additional branches in any foreign country where the banking organization operates one or more branches.

(5) Branching by nonbanking organizations. No prior notice is required for an organization that is not an Edge or agreement corporation, member bank, or foreign bank to establish branches within a foreign country or in additional foreign countries.

(6) Expiration of branching authority. Authority to establish branches, when granted following prior written notice to the Board, shall expire one year from the earliest date on which the authority could have been exercised, unless extended by the Board.

(7) Reporting. Any banking organization that opens, closes, or relocates a branch shall report such change in a manner prescribed by the Board.

(8) Reserves of foreign branches of member banks. Member banks shall maintain reserves against foreign branch deposits when required by Regulation D (12 CFR part 204).

**? 211.4 Permissible investments and activities of foreign branches of member banks.**

In addition to its general banking powers, and to the extent consistent with its charter, a foreign branch of a member bank may engage in the following activities, so far as usual in connection with the business of banking in the country where it transacts business:

(a) Guarantees. Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events,<sup>38/</sup> if the guarantee or agreement specifies a maximum monetary liability; but, except to the extent that the member bank is fully secured, it may not have liabilities outstanding for any person on account of such guarantees or agreements which, when aggregated with other unsecured obligations of the same person, exceed the limit contained in section 5200(a)(1) of the Revised Statutes (12 U.S.C. 84) for loans and extensions of credit;

(b) Government obligations. (1) Underwrite, distribute, buy, sell, and hold obligations of:

(i) The national government of any country rated as investment grade by at least two established international rating agencies;

(ii) An agency or instrumentality of such national

<sup>38/</sup> Readily ascertainable events include, but are not limited to, nonpayment of taxes, rentals, customs duties, or costs of transport and loss or nonconformance of shipping documents.

government where supported by the taxing authority, guarantee, or full faith and credit of that government; and

(iii) The national government and the political subdivisions of the country in which the branch is located;

(2) No member bank, under authority of this paragraph (b), may hold or be under commitment with respect to, such obligations for its own account in relation to any one country in an amount exceeding the greater of:

(i) 10 percent of its tier 1 capital; or

(ii) 10 percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or the date of acquisition of the branch, in the case of a branch that has not been so reported).

(c) Other investments. (1) Invest in:

(i) The securities of the central bank, clearinghouses, governmental entities other than those authorized under paragraph (a)(2)(i) of this section, and government-sponsored development banks of the country in which the foreign branch is located;

(ii) Other debt securities eligible to meet local reserve or similar requirements; and

(iii) Shares of automated electronic-payments networks, professional societies, schools, and the like necessary to the business of the branch.

(2) The total investments of a bank's branches in a country under this paragraph (c) (exclusive of securities held as required by the law of that country or as authorized under section 5136 of the Revised Statutes (12 U.S.C. 24, Seventh) may not exceed 1 percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or on the date of acquisition of the branch, in the case of a branch that has not so reported);

(d) Real estate loans. Take liens or other encumbrances on foreign real estate in connection with its extensions of credit, whether or not of first priority and whether or not the real estate has been improved;

(e) Insurance. Act as insurance agent or broker;

(f) Employee benefits program. Pay to an employee of the branch, as part of an employee benefits program, a greater rate

of interest than that paid to other depositors of the branch;

(g) Repurchase agreements. Engage in repurchase agreements involving securities and commodities that are the functional equivalents of extensions of credit;

(h) Investment in subsidiaries. With the Board's prior approval, acquire all of the shares of a company (except where local law requires other investors to hold directors' qualifying shares or similar types of instruments) that engages solely in activities:

(1) In which the member bank is permitted to engage; or

(2) That are incidental to the activities of the foreign branch; and

(i) Other activities. With the Board's prior approval, engage in other activities that the Board determines are usual in connection with the transaction of the business of banking in the places where the member bank's branches transact business.

#### **? 211.5 Edge and agreement corporations.**

(a) Organization. (1) Board authority. The Board shall have the authority to approve:

(i) The establishment of Edge corporations; and

(ii) Investments in Edge and agreement corporations.

(2) Permit. A proposed Edge corporation shall become a body corporate when the Board issues a permit approving its proposed name, articles of association, and organization certificate.

(3) Name. The name shall include international, foreign, overseas, or a similar word, but may not resemble the name of another organization to an extent that might mislead or deceive the public.

(4) Federal Register notice. The Board shall publish in the Federal Register notice of any proposal to organize an Edge corporation and shall give interested persons an opportunity to express their views on the proposal.

(5) Factors considered by Board. The factors considered by the Board in acting on a proposal to organize an Edge corporation include:



- (i) The financial condition and history of the applicant;
- (ii) The general character of its management;
- (iii) The convenience and needs of the community to be served with respect to international banking and financing services; and
- (iv) The effects of the proposal on competition.

(6) Authority to commence business. After the Board issues a permit, the Edge corporation may elect officers and otherwise complete its organization, invest in obligations of the U.S. government, and maintain deposits with depository institutions, but it may not exercise any other powers until at least 25 percent of the authorized capital stock specified in the articles of association has been paid in cash, and each shareholder has paid in cash at least 25 percent of that shareholder's stock subscription.

(7) Expiration of unexercised authority. Unexercised authority to commence business as an Edge corporation shall expire one year after issuance of the permit, unless the Board extends the period.

(8) Amendments to articles of association. No amendment to the articles of association shall become effective until approved by the Board.

(9) Shareholders' meeting. An Edge corporation shall provide in its bylaws that:

(i) A shareholders' meeting shall be convened at the request of the Board within five days after the Board gives notice of the request to the Edge corporation;

(ii) Any shareholder or group of shareholders that owns or controls 25 percent or more of the shares of the Edge corporation shall attend such a meeting in person or by proxy; and

(iii) Failure by a shareholder or authorized representative to attend such meeting in person or by proxy may result in removal or barring of such shareholder or representative from further participation in the management or affairs of the Edge corporation.

(b) Nature and ownership of shares. (1) Shares. Shares of stock in an Edge corporation may not include no-par-value shares and shall be issued and transferred only on its books and in compliance with section 25A of the FRA (12 U.S.C. 611 et seq.)

and this subpart.

(2) Contents of share certificates. The share certificates of an Edge corporation shall:

(i) Name and describe each class of shares, indicating its character and any unusual attributes, such as preferred status or lack of voting rights; and

(ii) Conspicuously set forth the substance of:

(A) Any limitations upon the rights of ownership and transfer of shares imposed by section 25A of the FRA (12 U.S.C. 611 et seq.); and

(B) Any rules that the Edge corporation prescribes in its bylaws to ensure compliance with this paragraph (b).

(3) Change in status of shareholder. Any change in status of a shareholder that causes a violation of section 25A of the FRA (12 U.S.C. 611 et seq.) shall be reported to the Board as soon as possible, and the Edge corporation shall take such action as the Board may direct.

(c) Ownership of Edge corporations by foreign institutions.

(1) Prior Board approval. One or more foreign or foreign-controlled domestic institutions referred to in section 25A(11) of the FRA (12 U.S.C. 619) may apply for the Board's prior approval to acquire directly or indirectly a majority of the shares of the capital stock of an Edge corporation.

(2) Conditions and requirements. Such an institution shall:

(i) Provide the Board information related to its financial condition and activities and such other information as the Board may require;

(ii) Ensure that any transaction by an Edge corporation with an affiliate<sup>39/</sup> is on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions by the Edge corporation with nonaffiliated persons, and does not involve more than the normal risk of repayment or present other unfavorable features;

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<sup>39/</sup> For purposes of this paragraph (c)(2)(ii), affiliate means any organization that would be an affiliate under section 23A of the FRA (12 U.S.C. 371c) if the Edge corporation were a member bank.

(iii) Ensure that the Edge corporation will not provide funding on a continual or substantial basis to any affiliate or office of the foreign institution through transactions that would be inconsistent with the international and foreign business purposes for which Edge corporations are organized; and

(iv) Invest no more than 10 percent of the institution's capital and surplus in the aggregate amount of stock held in all Edge and agreement corporations (or, with the Board's prior approval, up to 20 percent of the investor's capital and surplus).

(3) Foreign institutions not subject to the BHC Act. In the case of a foreign institution not subject to section 4 of the BHC Act (12 U.S.C. 1843), that institution shall:

(i) Comply with any conditions that the Board may impose that are necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices in the United States; and

(ii) Give the Board 30 days' prior written notice before engaging in any nonbanking activity in the United States, or making any initial or additional investments in another organization, that would require prior Board approval or notice by an organization subject to section 4 of the BHC Act (12 U.S.C. 1843); in connection with such notice, the Board may impose conditions necessary to prevent adverse effects that may result from such activity or investment.

(d) Change in control. (1) Prior notice. (i) Any person shall give the Board 60 days' prior written notice before acquiring, directly or indirectly, 25 percent or more of the voting shares, or otherwise acquiring control, of an Edge corporation.

(ii) The Board may extend the 60-day period for an additional 30 days by notifying the acquiring party.

(iii) A notice under this paragraph (d) need not be filed where a change in control is effected through a transaction requiring the Board's approval under section 3 of the BHC Act (12 U.S.C. 1842).

(2) Board review. In reviewing a notice filed under this paragraph (d), the Board shall consider the factors set forth in paragraph (a)(5) of this section, and may disapprove a notice or impose any conditions that it finds necessary to assure the safe and sound operation of the Edge corporation, to assure the

international character of its operation, and to prevent adverse effects, such as decreased or unfair competition, conflicts of interest, or undue concentration of resources.

(e) Domestic branches. (1) Prior notice. (i) An Edge corporation may establish branches in the United States 30 days after the Edge corporation has given notice to its Reserve Bank, unless the Edge corporation is notified to the contrary within that time.

(ii) The notice to the Reserve Bank shall include a copy of the notice of the proposal published in a newspaper of general circulation in the communities to be served by the branch.

(iii) The newspaper notice may appear no earlier than 90 calendar days prior to submission of notice of the proposal to the Reserve Bank. The newspaper notice shall provide an opportunity for the public to give written comment on the proposal to the appropriate Federal Reserve Bank for at least 30 days after the date of publication.

(2) Factors considered by Board. The factors considered in acting upon a proposal to establish a branch are enumerated in paragraph (a)(5) of this section.

(3) Expiration of authority. Authority to establish a branch under prior notice shall expire one year from the earliest date on which that authority could have been exercised, unless the Board extends the period.

(f) Agreement corporations. (1) General. With the prior approval of the Board, a member bank or bank holding company may invest in a federally or state-chartered corporation that has entered into an agreement or undertaking with the Board that it will not exercise any power that is impermissible for an Edge corporation under this subpart.

(2) Factors considered by Board. The factors considered in acting upon a proposal to establish an agreement corporation are enumerated in paragraph (a)(5) of this section.

(g) Reserve requirements and interest rate limitations. The deposits of an Edge or agreement corporation are subject to Regulations D and Q (12 CFR parts 204, 217) in the same manner and to the same extent as if the Edge or agreement corporation were a member bank.

(h) Liquid funds. Funds of an Edge or agreement corporation that are not currently employed in its international or foreign business, if held or invested in the United States,

shall be in the form of:

(i) Cash;

(ii) Deposits with depository institutions, as described in Regulation D (12 CFR part 204), and other Edge and agreement corporations;

(iii) Money-market instruments (including repurchase agreements with respect to such instruments), such as banker's acceptances, federal funds sold, and commercial paper; and

(iv) Short- or long-term obligations of, or fully guaranteed by, federal, state, and local governments and their instrumentalities.

**? 211.6 Permissible activities of Edge and agreement corporations in the United States.**

(a) Activities incidental to international or foreign business. An Edge corporation may engage, directly or indirectly, in activities in the United States that are permitted by section 25A(6) of the FRA (12 U.S.C. 615) and are incidental to international or foreign business, and in such other activities as the Board determines are incidental to international or foreign business. The following activities will ordinarily be considered incidental to an Edge corporation's international or foreign business:

(1) Deposits from foreign governments and foreign persons.

An Edge corporation may receive in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposits) from foreign governments and their agencies and instrumentalities, and from foreign persons.

(2) Deposits from other persons. An Edge corporation may receive from any other person in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposit) if such deposits:

(i) Are to be transmitted abroad;

(ii) Consist of funds to be used for payment of obligations to the Edge corporation or collateral securing such obligations;

(iii) Consist of the proceeds of collections abroad that are to be used to pay for exported or imported goods or for other costs of exporting or importing or that are to be periodically transferred to the depositor's account at another financial institution;

(iv) Consist of the proceeds of extensions of credit by the Edge corporation;

(v) Represent compensation to the Edge corporation for extensions of credit or services to the customer;

(vi) Are received from Edge or agreement corporations, foreign banks, and other depository institutions (as described in Regulation D (12 CFR part 204)); or

(vii) Are received from an organization that by its charter, license, or enabling law is limited to business that is of an international character, including foreign sales corporations, as defined in 26 U.S.C. 922; transportation organizations engaged exclusively in the international transportation of passengers or in the movement of goods, wares, commodities, or merchandise in international or foreign commerce; and export trading companies established under subpart C of this part.

(3) Borrowings. An Edge corporation may:

(i) Borrow from offices of other Edge and agreement corporations, foreign banks, and depository institutions (as described in Regulation D (12 CFR part 204));

(ii) Issue obligations to the United States or any of its agencies or instrumentalities;

(iii) Incur indebtedness from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency or instrumentality thereof that the Edge corporation is obligated to repurchase; and

(iv) Issue long-term subordinated debt that does not qualify as a deposit under Regulation D (12 CFR part 204).

(4) Credit activities. An Edge corporation may:

(i) Finance the following:

(A) Contracts, projects, or activities performed substantially abroad;

(B) The importation into or exportation from the United States of goods, whether direct or through brokers or other intermediaries;

(C) The domestic shipment or temporary storage of goods being imported or exported (or accumulated for export); and

(D) The assembly or repackaging of goods imported or to be exported;

(ii) Finance the costs of production of goods and services for which export orders have been received or which are identifiable as being directly for export;

(iii) Assume or acquire participations in extensions of credit, or acquire obligations arising from transactions the Edge corporation could have financed including acquisition of obligations of foreign governments;

(iv) Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events (including, but not limited to, events such as nonpayment of taxes, rentals, customs duties, or cost of transport and loss or nonconformance of shipping documents), so long as the guarantee or agreement specifies the maximum monetary liability thereunder and is related to a type of transaction described in paragraphs (a)(4)(i) and (ii) of this section; and

(v) Provide credit and other banking services for domestic and foreign purposes to foreign governments and their agencies and instrumentalities; foreign persons; and organizations of the type described in paragraph (a)(2)(vii) of this section.

(5) Payments and collections. An Edge corporation may receive checks, bills, drafts, acceptances, notes, bonds, coupons, and other instruments for collection abroad, and collect such instruments in the United States for a customer abroad; and may transmit and receive wire transfers of funds and securities for depositors.

(6) Foreign exchange. An Edge corporation may engage in foreign exchange activities.

(7) Fiduciary and investment advisory activities. An Edge corporation may:

(i) Hold securities in safekeeping for, or buy and sell securities upon the order and for the account and risk of, a person, provided such services for U.S. persons are with respect to foreign securities only;

(ii) Act as paying agent for securities issued by foreign governments or other entities organized under foreign law;

(iii) Act as trustee, registrar, conversion agent, or paying agent with respect to any class of securities issued to finance foreign activities and distributed solely outside the United States;

(iv) Make private placements of participations in its investments and extensions of credit; however, except to the extent permissible for member banks under section 5136 of the Revised Statutes (12 U.S.C. 24(Seventh)), no Edge corporation may otherwise engage in the business of underwriting, distributing, or buying or selling securities in the United States;

(v) Act as investment or financial adviser by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real-property interests and other investment assets,<sup>40/</sup> and by providing advice on mergers and acquisitions, provided such services for U.S. persons are with respect to foreign assets only; and

(vi) Provide general economic information and advice, general economic statistical forecasting services, and industry studies, provided such services for U.S. persons shall be with respect to foreign economies and industries only.

(8) Banking services for employees. Provide banking services, including deposit services, to the officers and employees of the Edge corporation and its affiliates; however, extensions of credit to such persons shall be subject to the restrictions of Regulation O (12 CFR part 215) as if the Edge corporation were a member bank.

(9) Other activities. With the Board's prior approval, engage in other activities in the United States that the Board determines are incidental to the international or foreign business of Edge corporations.

#### **? 211.7 Investments and activities abroad.**

(a) General policy. Activities abroad, whether conducted directly or indirectly, shall be confined to activities of a banking or financial nature and those that are necessary to carry on such activities. In doing so, investors<sup>41/</sup> shall at all times

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<sup>40/</sup> For purposes of this section, management of an investment portfolio does not include operational management of real property, or industrial or commercial assets.

<sup>41/</sup> For purposes of this section and '' 211.8 and 211.9, a direct subsidiary of a member bank is deemed to be an investor.



act in accordance with high standards of banking or financial prudence, having due regard for diversification of risks, suitable liquidity, and adequacy of capital. Subject to these considerations and the other provisions of this section, it is the Board's policy to allow activities abroad to be organized and operated as best meets corporate policies.

(b) Direct investments by member banks. A member bank's direct investments under section 25 of the FRA (12 U.S.C. 601 et seq.) shall be limited to:

(1) Foreign banks;

(2) Domestic or foreign organizations formed for the sole purpose of holding shares of a foreign bank;

(3) Foreign organizations formed for the sole purpose of performing nominee, fiduciary, or other banking services incidental to the activities of a foreign branch or foreign bank affiliate of the member bank; and

(4) Subsidiaries established pursuant to ? 211.4(h).

(c) Eligible investments. Subject to the limitations set out in paragraphs (b) and (d) of this section, an investor may directly or indirectly:

(1) Investment in subsidiary. Invest in a subsidiary that engages solely in activities listed in ? 211.9, or in such other activities as the Board has determined in the circumstances of a particular case are permissible; provided that, in the case of an acquisition of a going concern, existing activities that are not otherwise permissible for a subsidiary may account for not more than 5 percent of either the consolidated assets or revenues of the acquired organization;

(2) Investment in joint venture. Invest in a joint venture, provided that, unless otherwise permitted by the Board, not more than 10 percent of the joint venture's consolidated assets or revenues are attributable to activities not listed in ? 211.9; and

(3) Portfolio investments. Make portfolio investments in an organization, provided that:

(i) Individual limits. The total direct and indirect portfolio investments by the investor and its affiliates in an organization engaged in activities that are not permissible for joint ventures do not exceed:

(A) 40 percent of the total equity of the organization, when combined with shares in the organization held in trading or dealing accounts pursuant to ? 211.9(a)(15), and shares in the organization held under any other authority; and

(B) Where the investor is a well capitalized and well managed bank holding company, 2 percent of the investor's tier 1 capital in any one organization; or

(C) For any other investor, amounts permissible under ? 211.8(c)(2);

(ii) Aggregate limits. The total direct and indirect portfolio investments by the investor and its affiliates in all organizations engaged in activities that are not permissible for joint ventures (when combined with shares held under any authority other than ? 211.9(a)(15)<sup>42/</sup>) shall not exceed:

(A) 25 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(B) For any other investor, the lesser of 5 percent of the member bank's tier 1 capital or 25 percent of the investor's capital.

(iii) Loans and extensions of credit. Any loans and extensions of credit made by an investor or its affiliates to the organization are on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions between the investor or its affiliates and nonaffiliated persons; and

(iv) Protecting shareholder rights. Nothing in this paragraph (c)(3) shall prohibit an investor from otherwise exercising rights it may have as shareholder to protect the value of its investment.

(d) Investment limit. In calculating the amount that may be invested in any organization under this section and ?? 211.8 and 211.9, there shall be included any unpaid amount for which the investor is liable and any investments in the same organization held by affiliates under any authority.

(e) Divestiture. An investor shall dispose of an

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<sup>42/</sup> For investors that are not well capitalized and well managed, shares held in trading or dealing accounts pursuant to ' 211.9(a)(15) shall be included in calculating these limits.

investment promptly (unless the Board authorizes retention) if:

(1) The organization invested in:

(i) Engages in impermissible activities to an extent not permitted under paragraph (c) of this section; or

(ii) Engages directly or indirectly in other business in the United States that is not permitted to an Edge corporation in the United States, provided that an investor may:

(A) Retain portfolio investments in companies that derive no more than 10 percent of their total revenue from activities in the United States; and

(B) Hold up to 5 percent of the shares of a foreign company that engages directly or indirectly in business in the United States that is not permitted to an Edge corporation; or

(2) After notice and opportunity for hearing, the investor is advised by the Board that such investment is inappropriate under the FRA, the BHC Act, or this subpart.

(f) Debts previously contracted. Shares or other ownership interests acquired to prevent a loss upon a debt previously contracted in good faith are not subject to the limitations or procedures of this section, provided that such interests shall be disposed of promptly but in no event later than two years after their acquisition, unless the Board authorizes retention for a longer period.

(g) Investments made through debt-for-equity conversions.

(1) Permissible investments. A bank holding company may make investments through the conversion of sovereign- or private-debt obligations of an eligible country, either through direct exchange of the debt obligations for the investment, or by a payment for the debt in local currency, the proceeds of which, including an additional cash investment not exceeding in the aggregate more than 10 percent of the fair value of the debt obligations being converted as part of such investment, are used to purchase the following investments:

(i) Public-sector companies. A bank holding company may acquire up to and including 100 percent of the shares of (or other ownership interests in) any foreign company located in an eligible country, if the shares are acquired from the government of the eligible country or from its agencies or instrumentalities.

(ii) Private-sector companies. A bank holding company may

acquire up to and including 40 percent of the shares, including voting shares, of (or other ownership interests in) any other foreign company located in an eligible country subject to the following conditions:

(A) A bank holding company may acquire more than 25 percent of the voting shares of the foreign company only if another shareholder or group of shareholders unaffiliated with the bank holding company holds a larger block of voting shares of the company;

(B) The bank holding company and its affiliates may not lend or otherwise extend credit to the foreign company in amounts greater than 50 percent of the total loans and extensions of credit to the foreign company; and

(C) The bank holding company's representation on the board of directors or on management committees of the foreign company may be no more than proportional to its shareholding in the foreign company.

(2) Investments by bank subsidiary of bank holding company. Upon application, the Board may permit an indirect investment to be made pursuant to this paragraph (g) through an insured bank subsidiary of the bank holding company, where the bank holding company demonstrates that such ownership is consistent with the purposes of the FRA. In granting its consent, the Board may impose such conditions as it deems necessary or appropriate to prevent adverse effects, including prohibiting loans from the bank to the company in which the investment is made.

(3) Time limits for divestiture. (i) A bank holding company shall divest the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (g) within the longer of:

(A) Ten years from the date of acquisition of the investment, except that the Board may extend such period if, in the Board's judgment, such an extension would not be detrimental to the public interest; or

(B) Two years from the date on which the bank holding company is permitted to repatriate in full the investment in the foreign company.

(ii) Notwithstanding the provisions of paragraph (g)(3)(i) of this section:

(A) Divestiture shall occur within 15 years of the date of acquisition of the shares of, or other ownership interests in,

any company acquired pursuant to this paragraph (g); and

(B) A bank holding company may retain such shares or ownership interests if such retention is otherwise permissible at the time required for divestiture.

(ii) Report to Board. The bank holding company shall report to the Board on its plans for divesting an investment made under this paragraph (g) two years prior to the final date for divestiture, in a manner to be prescribed by the Board.

(iii) Other conditions requiring divestiture. All investments made pursuant to this paragraph (g) are subject to paragraph (e) of this section requiring prompt divestiture (unless the Board upon application authorizes retention), if the company invested in engages in impermissible business in the United States that exceeds in the aggregate 10 percent of the company's consolidated assets or revenues calculated on an annual basis; provided that such company may not engage in activities in the United States that consist of banking or financial operations (as defined in ? 211.23(f)(5)(iii)(B)), or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)), except under regulations of the Board or with the prior approval of the Board.

(4) Investment procedures. (i) General consent. Subject to the other limitations of this paragraph (g), the Board grants its general consent for investments made under this paragraph (g) if the total amount invested does not exceed the greater of \$25 million or 1 percent of the tier 1 capital of the investor.

(ii) All other investments shall be made in accordance with the procedures of ? 211.8(f) and (g), requiring prior notice or specific consent.

(5) Conditions. (i) Name. Any company acquired pursuant to this paragraph (g) shall not bear a name similar to the name of the acquiring bank holding company or any of its affiliates.

(ii) Confidentiality. Neither the bank holding company nor its affiliates shall provide to any company acquired pursuant to this paragraph (g) any confidential business information or other information concerning customers that are engaged in the same or related lines of business as the company.

#### **? 211.8 Investment procedures.**

(a) General provisions.<sup>43/</sup> Direct and indirect investments

<sup>43/</sup> When necessary, the provisions of this section relating to

shall be made in accordance with the general-consent, limited general-consent, prior-notice, or specific-consent procedures contained in this section.

(1) Minimum capital adequacy standards. Except as the Board may otherwise determine, in order for an investor to make investments pursuant to the procedures set out in this section, the investor, the bank holding company, and the member bank shall be in compliance with applicable minimum standards for capital adequacy set out in the Capital Adequacy Guidelines; provided that, if the investor is an Edge or agreement corporation, the minimum capital required is total and tier 1 capital ratios of 8 percent and 4 percent, respectively.

(2) Composite rating. Except as the Board may otherwise determine, in order for an investor to make investments under the general-consent or limited general-consent procedures of paragraphs (b) and (c) of this section, the investor and any parent insured bank must have received a composite rating of at least 2 at the most recent examination.

(3) Board's authority to modify or suspend procedures. The Board, at any time upon notice, may modify or suspend the procedures contained in this section with respect to any investor or with respect to the acquisition of shares of organizations engaged in particular kinds of activities.

(4) Long-range investment plan. Any investor may submit to the Board for its specific consent a long-range investment plan. Any plan so approved shall be subject to the other procedures of this section only to the extent determined necessary by the Board to assure safety and soundness of the operations of the investor and its affiliates.

(5) Prior specific consent for initial investment. An investor shall apply for and receive the prior specific consent of the Board for its initial investment under this subpart in its first subsidiary or joint venture, unless an affiliate previously has received approval to make such an investment.

(6) Expiration of investment authority. Authority to make investments granted under prior-notice or specific-consent procedures shall expire one year from the earliest date on which the authority could have been exercised, unless the Board

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general consent and prior notice constitute the Board's approval under section 25A(8) of the FRA (12 U.S.C. 616) for investments in excess of the limitations therein based on capital and surplus.

determines a longer period shall apply.

(7) Conditional approval. The Board may impose such conditions on authority granted by it under this section as it deems necessary, and may require termination of any activities conducted under authority of this subpart if an investor is unable to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

(b) General consent. The Board grants its general consent for a well capitalized and well managed investor to make investments, subject to the following:

(1) Well capitalized and well managed investor. In order to qualify for making investments under authority of this paragraph (b), both before and immediately after the proposed investment, the investor, any parent insured bank, and any parent bank holding company shall be well capitalized and well managed.

(2) Investment in subsidiaries. In the case of an investment in a subsidiary, the total amount invested in such subsidiary (in one transaction or a series of transactions) does not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 2 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) For any other investor, the lesser of 2 percent of the tier 1 capital of any parent insured bank or 10 percent of the investor's tier 1 capital.

(3) Investment in joint ventures. In the case of an investment in a joint venture, the total amount invested in such joint venture (in one transaction or a series of transactions) does not exceed:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of the tier 1 capital of any parent insured bank or 5 percent of the investor's tier 1 capital, for any other investor.

(4) Portfolio investments. A bank holding company may make portfolio investments conforming to the limits set out in ? 211.7(c)(3).

(5) Aggregate investment limits. (i) Investment limits. All investments made, directly or indirectly, during the previous 12-month period under authority of this section, when aggregated with the proposed investment, shall not exceed:

(A) In the case of a bank holding company, 20 percent of the investor's tier 1 capital;

(B) In the case of a member bank, 10 percent of the investor's tier 1 capital; or

(C) In the case of any other investor, the lesser of 10 percent of the tier 1 capital of any parent insured bank or 50 percent of the tier 1 capital of the investor.

(ii) Downstream investments. In determining compliance with the aggregate limits set out in this paragraph (b), an investment by an investor in a subsidiary shall be counted only once, notwithstanding that such subsidiary may, within 12 months of the date of making the investment, downstream all or any part of such investment to another subsidiary.

(6) Aggregating shares held in dealing accounts. In determining compliance with the limits set out in this paragraph (b), an investor shall combine the value of all shares of an organization held in trading or dealing accounts under ? 211.9(a)(15) with investments in the same organization.

(c) Limited general consent. The Board grants its general consent for an investor that is not well capitalized and well managed to make:

(1) Individual limit for investment in subsidiary or joint venture. Any investment in a subsidiary or joint venture, if the total amount invested (in one transaction or in a series of transactions) does not exceed the lesser of \$25 million or:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of any parent insured bank's tier 1 capital or 5 percent of the investor's tier 1 capital, for any other investor.



(2) Individual limit for portfolio investment. The Board grants its general consent for any investor not eligible to make portfolio investments under ? 211.7(c)(3)(i)(B) to make such investments subject to the limits set out in paragraph (c)(1) of this section.

(3) Aggregate limit. The amount of general-consent investments made by any investor subject to this section during the previous 12-month period, when aggregated with the proposed investment, shall not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 5 percent of the investor's tier 1 capital, where the investor is a member bank; and

(iii) The lesser of 5 percent of any parent insured bank's capital or 25 percent of the investor's capital, for any other investor.

(d) Other eligible investments under general consent. In addition to the authority granted under paragraphs (b) and (c) of this section, the Board grants its general consent for any investor to make the following investments:

(1) Investment in organization equal to cash dividends. Any investment in an organization in an amount equal to cash dividends received from that organization during the preceding 12 calendar months; and

(2) Investment acquired from affiliate. Any investment that is acquired from an affiliate at net asset value or through a contribution of shares.

(e) Investments ineligible for general consent. The following investments may not be made under authority of paragraphs (b) and (c) this section:

(1) Investment in a general partnership or unlimited liability company; and

(2) Investment in a foreign bank if:

(i) After the investment, the foreign bank would be an affiliate of a member bank; and

(ii) The foreign bank is located in a country in which the member bank and its affiliates have no existing banking presence.

(f) Notices relating to general-consent investments. Notice of investments made pursuant to general-consent authority under this section shall be provided to the Board by the end of the month following the month in which any such investment is made. The investor shall provide the Board with the following information relating to the investment:

(1) If the investment is in a joint venture, the respective responsibilities of the parties to the joint venture; and

(2) Where the investment is made in an organization that incurred a loss in the last year, a description of the reasons for the loss and the steps taken to address the problem.

(g) Prior notice. An investment that does not qualify for general consent under paragraphs (b), (c), or (d) of this section may be made after the investor has given the Board 30 days' prior written notice, such notice period to commence at the time the notice is received, provided that:

(1) The Board may waive the 30-day period if it finds the full period is not required for consideration of the proposed investment, or that immediate action is required by the circumstances presented; and

(2) The Board may suspend the 30-day period or act on the investment under the Board's specific-consent procedures.

(h) Specific consent. Any investment that does not qualify for either the general-consent or the prior-notice procedure may not be consummated without the specific consent of the Board.

#### **? 211.9 Permissible activities abroad.**

(a) Activities usual in connection with banking. The Board has determined that the following activities are usual in connection with the transaction of banking or other financial operations abroad:

(1) Commercial and other banking activities;

(2) Financing, including commercial financing, consumer financing, mortgage banking, and factoring;

(3) Leasing real or personal property, or acting as agent, broker, or advisor in leasing real or personal property, if the lease serves as the functional equivalent of an extension of credit to the lessee of the property;

(4) Acting as fiduciary;

(5) Underwriting credit life insurance and credit accident and health insurance;

(6) Performing services for other direct or indirect operations of a U.S. banking organization, including representative functions, sale of long-term debt, name-saving, holding assets acquired to prevent loss on a debt previously contracted in good faith, and other activities that are permissible domestically for a bank holding company under sections 4(a)(2)(A) and 4(c)(1)(C) of the BHC Act (12 U.S.C. 1843(a)(2)(A), (c)(1)(C));

(7) Holding the premises of a branch of an Edge corporation or member bank or the premises of a direct or indirect subsidiary, or holding or leasing the residence of an officer or employee of a branch or subsidiary;

(8) Providing investment, financial, or economic advisory services;

(9) General insurance agency and brokerage;

(10) Data processing;

(11) Organizing, sponsoring, and managing a mutual fund, if the fund's shares are not sold or distributed in the United States or to U.S. residents and the fund does not exercise managerial control over the firms in which it invests;

(12) Performing management consulting services, if such services, when rendered with respect to the U.S. market, shall be restricted to the initial entry;

(13) Underwriting, distributing, and dealing in debt securities outside the United States;

(14) Underwriting and distributing equity securities outside the United States as follows:

(i) An investor that is well capitalized and well managed may underwrite equity securities, provided that commitments by an investor and its affiliates for the shares of a single organization do not, in the aggregate, exceed:

(A) 15 percent of the bank holding company's tier 1 capital, where the investor is a subsidiary of a bank holding company (but not a subsidiary of an insured bank); or

(B) The lesser of 3 percent of any parent insured bank's tier 1 capital or 15 percent of the investor's tier 1 capital, for any other investor; and

(ii) An investor that is not well capitalized and well managed may underwrite equity securities, provided that commitments by the investor and its affiliates for the shares of an organization do not, in the aggregate, exceed \$60 million; and

(iii) For purposes of determining compliance with the limitations of this paragraph (a)(14), the investor may subtract portions of an underwriting that are covered by binding commitments obtained by the investor or its affiliates from sub-underwriters or other purchasers.

(15) Dealing in equity securities outside the United States as follows:

(i) Well capitalized and well managed investor. An investor that is well capitalized and well managed may deal in the shares of an organization, subject to the following:

(A) Limit on shares of a single issuer. Shares of an organization held in all trading or dealing accounts by the investor and its affiliates, when combined with all other equity interests in the organization held under any authority and shares held pursuant to ? 211.7(c)(3), do not, in the aggregate, exceed:

(1) 10 percent of the bank holding company's tier 1 capital, where the investor is a subsidiary of a bank holding company (but not a subsidiary of an insured bank); or

(2) The lesser of 2 percent of any parent insured bank's tier 1 capital or 10 percent of the tier 1 capital of the investor, for any other investor; and

(B) Aggregate dealing limit. Shares of all organizations held in all dealing or trading accounts under this subpart by an investor and its affiliates, when combined with all other equity interests in such organizations held under any other authority and shares held pursuant to ? 211.7(c)(3), may not exceed:

(1) 50 percent of the bank holding company's tier 1 capital, where the investor is a subsidiary of a bank holding company (but not a subsidiary of an insured bank); or

(2) The lesser of 10 percent of any parent insured bank's tier 1 capital or 50 percent of the tier 1 capital of the investor, for any other investor.

(ii) Other investors. An investor that is not well capitalized and well managed may deal in the shares of an organization, subject to the following:

(A) Limit on shares of a single issuer. Shares of an organization held in all trading or dealing accounts by the investor and its affiliates, when combined with all other equity interests in the organization held under any authority and shares held pursuant to ? 211.7(c)(3), do not, in the aggregate, exceed \$30 million for any investor; and:

(B) Aggregate dealing limit. Shares of all organizations held in all dealing or trading accounts under this subpart by an investor and its affiliates, when combined with all other equity interests in such organizations held under any other authority and shares held pursuant to ? 211.7(c)(3), may not exceed:

(1) 25 percent of the bank holding company's tier 1 capital, where the investor is a subsidiary of a bank holding company (but not a subsidiary of an insured bank); or

(2) The lesser of 5 percent of any parent insured bank's tier 1 capital or 25 percent of the tier 1 capital of the investor, for any other investor.

(iii) Determining compliance with limits. (A) Netting.  
(1) For purposes of determining compliance with the limitations of this paragraph (a)(15), the investor may use an internal hedging model that nets long and short positions in the same security, and offsets positions in a security by futures, forwards, options, and similar instruments referenced to the same security; and

(2) For purposes of determining compliance with the aggregate dealing limits of paragraphs (a)(15)(i)(B) and (a)(15)(ii)(B) of this section, the investor may use an internal hedging model that offsets its long positions in equity securities by futures, forwards, options, and similar instruments, on a portfolio basis;

(B) Underwriting commitments. Any shares acquired pursuant to an underwriting commitment for up to 90 days after the payment date for such underwriting shall not be subject to the percentage limitations of paragraphs (a)(15)(i) and (ii) of this section or the investment provisions of ?? 211.7 and 211.8.

(iv) Authority to deal in shares of U.S. organization. The authority to deal in shares under paragraphs (a)(15)(i) and (ii) of this section includes the authority to deal in the shares of a U.S. organization:

(A) With respect to foreign persons only; and

(B) Subject to the limitations on owning or controlling shares of a company in section 4 of the BHC Act (12 U.S.C. 1843) and Regulation Y (12 CFR part 225).

(v) Report to senior management. Any shares held in trading or dealing accounts for longer than 90 days shall be reported to the senior management of the investor.

(16) Operating a travel agency, but only in connection with financial services offered abroad by the investor or others;

(17) Underwriting life, annuity, pension fund-related, and other types of insurance, where the associated risks have been previously determined by the Board to be actuarially predictable, provided that:

(i) Investments in, and loans and extensions of credit (other than loans and extensions of credit fully secured in accordance with the requirements of section 23A of the FRA (12 U.S.C. 371c), or with such other standards as the Board may require) to, the company by the investor or its affiliates are deducted from the capital of the investor;

(ii) 50 percent of such capital deduction shall be from tier 1 capital; and

(iii) Activities conducted directly or indirectly by a subsidiary of a U.S. insured bank are excluded from the authority of this paragraph (a)(17), unless authorized by the Board.

(18) Providing futures commission merchant services (including clearing without executing and executing without clearing) for nonaffiliated persons with respect to futures and options on futures contracts for financial and nonfinancial commodities, provided that prior notice under ? 211.8(g) shall be provided to the Board before any subsidiaries of a member bank operating pursuant to this subpart may join a mutual exchange or clearinghouse, unless the potential liability of the investor to the exchange, clearinghouse, or other members of the exchange, as the case may be, is legally limited by the rules of the exchange or clearinghouse to an amount that does not exceed applicable general-consent limits under ? 211.8.

(19) Acting as principal or agent in commodity-swap transactions in relation to:

(i) Swaps on a cash-settled basis for any commodity, provided that the investor's portfolio of swaps contracts is hedged in a manner consistent with safe and sound banking practices; and

(ii) Contracts that require physical delivery of a commodity, provided that such contracts are entered into solely for the purpose of hedging the investor's position in the underlying commodity or derivative contracts based on the commodity.

(b) Regulation Y activities. An investor may engage in activities that the Board has determined in § 225.25(b) of Regulation Y (12 CFR 225.25(b)) are closely related to banking under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)); and

(c) Specific approval. With the Board's specific approval, an investor may engage in other activities that the Board determines are usual in connection with the transaction of the business of banking or other financial operations abroad and are consistent with the FRA or the BHC Act.

#### **§ 211.10 Lending limits and capital requirements.**

(a) Acceptances of Edge corporations. (1) Limitations. An Edge corporation shall be and remain fully secured for acceptances of the types described in section 13(7) of the FRA (12 U.S.C. 372), as follows:

(i) All acceptances outstanding in excess of 200 percent of its tier 1 capital; and

(ii) All acceptances outstanding for any one person in excess of 10 percent of its tier 1 capital.

(2) Exceptions. These limitations do not apply if the excess represents the international shipment of goods, and the Edge corporation is:

(i) Fully covered by primary obligations to reimburse it that are guaranteed by banks or bankers; or

(ii) Covered by participation agreements from other banks, as described in 12 CFR 250.165.

(b) Loans and extensions of credit to one person. (1) Loans and extensions of credit defined. Loans and extensions of

credit has the meaning set forth in ? 211.2(p)<sup>44/</sup> and, for purposes of this paragraph (b), also include:

(i) Acceptances outstanding that are not of the types described in section 13(7) of the FRA (12 U.S.C. 372);

(ii) Any liability of the lender to advance funds to or on behalf of a person pursuant to a guarantee, standby letter of credit, or similar agreements;

(iii) Investments in the securities of another organization, except where the organization is a subsidiary; and

(iv) Any underwriting commitments to an issuer of securities, where no binding commitments have been secured from subunderwriters or other purchasers.

(2) Limitations. Except as the Board may otherwise specify:

(i) The total loans and extensions of credit outstanding to any person by an Edge corporation engaged in banking, and its direct or indirect subsidiaries, may not exceed 15 percent of the Edge corporation's tier 1 capital;<sup>45/</sup> and

(ii) The total loans and extensions of credit to any person by a foreign bank or Edge corporation subsidiary of a member bank, and by majority-owned subsidiaries of a foreign bank or Edge corporation, when combined with the total loans and extensions of credit to the same person by the member bank and its majority-owned subsidiaries, may not exceed the member bank's limitation on loans and extensions of credit to one person.

(3) Exceptions. The limitations of paragraph (b)(2) of this section do not apply to:

<sup>44/</sup> In the case of a foreign government, these include loans and extensions of credit to the foreign government's departments or agencies deriving their current funds principally from general tax revenues. In the case of a partnership or firm, these include loans and extensions of credit to its members and, in the case of a corporation, these include loans and extensions of credit to the corporation's affiliates, where the affiliate incurs the liability for the benefit of the corporation.

<sup>45/</sup> For purposes of this paragraph (b), subsidiary includes subsidiaries controlled by the Edge corporation, but does not include companies otherwise controlled by affiliates of the Edge corporation.



(i) Deposits with banks and federal funds sold;

(ii) Bills or drafts drawn in good faith against actual goods and on which two or more unrelated parties are liable;

(iii) Any banker's acceptance, of the kind described in section 13(7) of the FRA (12 U.S.C. 372), that is issued and outstanding;

(iv) Obligations to the extent secured by cash collateral or by bonds, notes, certificates of indebtedness, or Treasury bills of the United States;

(v) Loans and extensions of credit that are covered by bona fide participation agreements; and

(vi) Obligations to the extent supported by the full faith and credit of the following:

(A) The United States or any of its departments, agencies, establishments, or wholly owned corporations (including obligations, to the extent insured against foreign political and credit risks by the Export-Import Bank of the United States or the Foreign Credit Insurance Association), the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank; or the European Bank for Reconstruction and Development;

(B) Any organization, if at least 25 percent of such an obligation or of the total credit is also supported by the full faith and credit of, or participated in by, any institution designated in paragraph (b)(3)(vi)(A) of this section in such manner that default to the lender would necessarily include default to that entity. The total loans and extensions of credit under this paragraph (b)(3)(vi)(B) to any person shall at no time exceed 100 percent of the tier 1 capital of the Edge corporation.

(c) Capitalization. (1) An Edge corporation shall at all times be capitalized in an amount that is adequate in relation to the scope and character of its activities.

(2) In the case of an Edge corporation engaged in banking, the minimum ratio of qualifying total capital to risk-weighted assets, as determined under the Capital Adequacy Guidelines, shall not be less than 10 percent, of which at least 50 percent shall consist of tier 1 capital; provided that for purposes of this paragraph (c), no limitation shall apply on the inclusion of

subordinated debt that qualifies as tier 2 capital under the Capital Adequacy Guidelines.

**? 211.11 Supervision and reporting.**

(a) Supervision. (1) Foreign branches and subsidiaries. U.S. banking organizations conducting international operations under this subpart shall supervise and administer their foreign branches and subsidiaries in such a manner as to ensure that their operations conform to high standards of banking and financial prudence.

(i) Effective systems of records, controls, and reports shall be maintained to keep management informed of their activities and condition.

(ii) Such systems shall provide, in particular, information on risk assets, exposure to market risk, liquidity management, operations, internal controls, legal and operational risk, and conformance to management policies.

(iii) Reports on risk assets shall be sufficient to permit an appraisal of credit quality and assessment of exposure to loss, and, for this purpose, provide full information on the condition of material borrowers.

(iv) Reports on operations and controls shall include internal and external audits of the branch or subsidiary.

(2) Joint ventures. Investors shall maintain sufficient information with respect to joint ventures to keep informed of their activities and condition. Such information shall include audits and other reports on financial performance, risk exposure, management policies, operations, and controls. Complete information shall be maintained on all transactions with the joint venture by the investor and its affiliates.

(3) Availability of reports and information to examiners. The reports specified in paragraphs (a)(1) and (2) of this section and any other information deemed necessary to determine compliance with U.S. banking law shall be made available to examiners of the appropriate bank supervisory agencies.

(b) Examinations. Examiners appointed by the Board shall examine each Edge corporation once a year. An Edge corporation shall make available to examiners information sufficient to assess its condition and operations and the condition and activities of any organization whose shares it holds.

(c) Reports. (1) Reports of condition. Each Edge

corporation shall make reports of condition to the Board at such times and in such form as the Board may prescribe. The Board may require that statements of condition or other reports be published or made available for public inspection.

(2) Foreign operations. Edge and agreement corporations, member banks, and bank holding companies shall file such reports on their foreign operations as the Board may require.

(3) Acquisition or disposition of shares. Member banks, Edge and agreement corporations, and bank holding companies shall report, in a manner prescribed by the Board, any acquisition or disposition of shares.

(d) Filing and processing procedures. (1) Unless otherwise directed by the Board, applications, notices, and reports required by this part shall be filed with the Federal Reserve Bank of the District in which the parent bank or bank holding company is located or, if none, the Reserve Bank of the District in which the applying or reporting institution is located. Instructions and forms for applications, notices, and reports are available from the Reserve Banks.

(2) The Board shall act on an application under this subpart within 60 calendar days after the Reserve Bank has received the application, unless the Board notifies the investor that the 60-day period is being extended and states the reasons for the extension.

#### **? 211.12 Reports of crimes and suspected crimes.**

An Edge or agreement corporation, or any branch or subsidiary thereof, shall file a suspicious-activity report in accordance with the provisions of ? 208.62 of Regulation H (12 CFR 208.62).

#### **? 211.13 Liquidation of Edge and agreement corporations.**

(a) Voluntary dissolution. (1) Prior notice. An Edge or agreement corporation desiring voluntarily to discontinue normal business and dissolve, shall provide the Board with 45 days' prior written notice of its intent to do so.

(2) Waiver of notice period. The Board may waive the 45-day period if it finds that immediate action is required by the circumstances presented.

(b) Involuntary dissolution. (1) Grounds for determining insolvency. The Board may appoint a receiver for an Edge corporation if the Board determines that:

(i) The corporation's assets are less than the corporation's obligations;

(ii) The corporation has been unable, or is likely to be unable, to pay the corporation's obligations as they fall due in the normal course of business;

(iii) The corporation has incurred, or is likely to incur, losses that will deplete all or substantially all of the corporation's capital, and there is no reasonable prospect for recapitalization; or

(iv) The corporation is otherwise insolvent.

(2) Powers of receiver. A receiver appointed by the Board for an Edge corporation shall have the same rights, privileges, powers, and authority with respect to the corporation and the corporation's assets as a receiver of a national bank may exercise with respect to a national bank and its assets, provided that the assets of the corporation subject to the laws of a foreign country shall be dealt with in accordance with the terms of such laws.

## **Subpart B - Foreign Banking Organizations**

### **? 211.20 Authority, purpose, and scope.**

(a) Authority. This subpart is issued by the Board of Governors of the Federal Reserve System (Board) under the authority of the Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. 1841 et seq.) and the International Banking Act of 1978 (IBA) (12 U.S.C. 3101 et seq.).

(b) Purpose and scope. This subpart is in furtherance of the purposes of the BHC Act and the IBA. It applies to foreign banks and foreign banking organizations with respect to:

(1) The limitations on interstate banking under section 5 of the IBA (12 U.S.C. 3103);

(2) The exemptions from the nonbanking prohibitions of the BHC Act and the IBA afforded by sections 2(h) and 4(c)(9) of the BHC Act (12 U.S.C. 1841(h), 1843(c)(9));

(3) Board approval of the establishment of an office of a foreign bank in the United States under sections 7(d) and 10(a) of the IBA (12 U.S.C. 3105(d), 3107(a));

(4) The termination by the Board of a foreign bank's

representative office, state branch, state agency, or commercial lending company subsidiary under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(e), 3107(b)), and the transmission of a recommendation to the Comptroller to terminate a federal branch or federal agency under section 7(e)(5) of the IBA (12 U.S.C. 3105(e)(5));

(5) The examination of an office or affiliate of a foreign bank in the United States as provided in sections 7(c) and 10(c) of the IBA (12 U.S.C. 3105(c), 3107(c));

(6) The disclosure of supervisory information to a foreign supervisor under section 15 of the IBA (12 U.S.C. 3109);

(7) The limitations on loans to one borrower by state branches and state agencies of a foreign bank under section 7(h)(2) of the IBA (12 U.S.C. 3105(h)(2));

(8) The limitation of a state branch and a state agency to conducting only activities that are permissible for a federal branch under section (7)(h)(1) of the IBA (12 U.S.C. 3105(h)(1)); and

(9) The deposit insurance requirement for retail deposit taking by a foreign bank under section 6 of the IBA (12 U.S.C. 3104).

(c) Additional requirements. Compliance by a foreign bank with the requirements of this subpart and the laws administered and enforced by the Board does not relieve the foreign bank of responsibility to comply with the laws and regulations administered by the licensing authority.

#### ? 211.21 Definitions.

The definitions contained in ?? 211.1 and 211.2 of subpart A apply to this subpart, except as a term is otherwise defined in this section:

(a) Affiliate of a foreign bank or of a parent of a foreign bank means any company that controls, is controlled by, or is under common control with, the foreign bank or the parent of the foreign bank.

(b) Agency means any place of business of a foreign bank, located in any state, at which credit balances are maintained, checks are paid, money is lent, or, to the extent not prohibited by state or federal law, deposits are accepted from a person or entity that is not a citizen or resident of the United States. Obligations shall not be considered credit balances unless they

are:

(1) Incidental to, or arise out of the exercise of, other lawful banking powers;

(2) To serve a specific purpose;

(3) Not solicited from the general public;

(4) Not used to pay routine operating expenses in the United States such as salaries, rent, or taxes;

(5) Withdrawn within a reasonable period of time after the specific purpose for which they were placed has been accomplished; and

(6) Drawn upon in a manner reasonable in relation to the size and nature of the account.

(c)(1) Appropriate Federal Reserve Bank means, unless the Board designates a different Federal Reserve Bank:

(i) For a foreign banking organization, the Reserve Bank assigned to the foreign banking organization in ? 225.3(b)(2) of Regulation Y (12 CFR 225.3(b)(2));

(ii) For a foreign bank that is not a foreign banking organization and proposes to establish an office, an Edge corporation, or an agreement corporation, the Reserve Bank of the Federal Reserve District in which the foreign bank proposes to establish such office or corporation; and

(iii) In all other cases, the Reserve Bank designated by the Board.

(2) The appropriate Federal Reserve Bank need not be the Reserve Bank of the Federal Reserve District in which the foreign bank's home state is located.

(d) Banking subsidiary, with respect to a specified foreign bank, means a bank that is a subsidiary as the terms bank and subsidiary are defined in section 2 of the BHC Act (12 U.S.C. 1841).

(e) Branch means any place of business of a foreign bank, located in any state, at which deposits are received, and that is not an agency, as that term is defined in paragraph (b) of this section.

(f) Change the status of an office means to convert a

representative office into a branch or agency, or an agency or limited branch into a branch, but does not include renewal of the license of an existing office.

(g) Commercial lending company means any organization, other than a bank or an organization operating under section 25 of the Federal Reserve Act (FRA) (12 U.S.C. 601-604a), organized under the laws of any state, that maintains credit balances permissible for an agency, and engages in the business of making commercial loans. Commercial lending company includes any company chartered under article XII of the banking law of the State of New York.

(h) Comptroller means the Office of the Comptroller of the Currency.

(i) Control has the same meaning as in section 2(a) of the BHC Act (12 U.S.C. 1841(a)), and the terms controlled and controlling shall be construed consistently with the term control.

(j) Domestic branch means any place of business of a foreign bank, located in any state, that may accept domestic deposits and deposits that are incidental to or for the purpose of carrying out transactions in foreign countries.

(k) A foreign bank engages directly in the business of banking outside the United States if the foreign bank engages directly in banking activities usual in connection with the business of banking in the countries where it is organized or operating.

(l) To establish means:

(1) To open and conduct business through an office;

(2) To acquire directly, through merger, consolidation, or similar transaction with another foreign bank, the operations of an office that is open and conducting business;

(3) To acquire an office through the acquisition of a foreign bank subsidiary that will cease to operate in the same corporate form following the acquisition;

(4) To change the status of an office; or

(5) To relocate an office from one state to another.

(m) Federal agency, federal branch, state agency, and state branch have the same meanings as in section 1 of the IBA (12

U.S.C. 3101).

(n) Foreign bank means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States. The term foreign bank does not include a central bank of a foreign country that does not engage or seek to engage in a commercial banking business in the United States through an office.

(o) Foreign banking organization means a foreign bank, as defined in section 1(b)(7) of the IBA (12 U.S.C. 3101(7)), that:

(1) Operates a branch, agency, or commercial lending company subsidiary in the United States;

(2) Controls a bank in the United States;

(3) Controls an Edge corporation acquired after March 5, 1987; or

(4) Controls any company of which the foreign bank or its affiliate is a subsidiary.

(p) Home country, with respect to a foreign bank, means the country in which the foreign bank is chartered or incorporated.

(q) Home country supervisor, with respect to a foreign bank, means the governmental entity or entities in the foreign bank's home country with responsibility for the supervision and regulation of the foreign bank.

(r) Licensing authority means:

(1) The relevant state supervisor, with respect to an application to establish a state branch, state agency, commercial lending company, or representative office of a foreign bank; or

(2) The Comptroller, with respect to an application to establish a federal branch or federal agency.

(s) Limited branch means a branch of a foreign bank that enters into an agreement with the Board to limit its liabilities to those that would be permissible for an Edge corporation.

(t) Office or office of a foreign bank means any branch, agency, representative office, or commercial lending company subsidiary of a foreign bank in the United States.

(u) A parent of a foreign bank means a company of which the foreign bank is a subsidiary. An immediate parent of a foreign



bank is a company of which the foreign bank is a direct subsidiary. An ultimate parent of a foreign bank is a parent of the foreign bank that is not the subsidiary of any other company.

(v) Regional administrative office means a representative office that:

(1) Is established by a foreign bank that operates two or more branches, agencies, commercial lending companies, or banks in the United States;

(2) Is located in the same city as one or more of the foreign bank's branches, agencies, commercial lending companies, or banks in the United States;

(3) Manages, supervises, or coordinates the operations of the foreign bank or its affiliates, if any, in a particular geographic area that includes the United States or a region thereof, including by exercising credit approval authority in that area pursuant to written standards, credit policies, and procedures established by the foreign bank; and

(4) Does not solicit business from actual or potential customers of the foreign bank or its affiliates.

(w) Relevant state supervisor means the state entity that is authorized to supervise and regulate a state branch, state agency, commercial lending company, or representative office.

(x) Representative office means any place of business of a foreign bank, located in any state, that is not a branch, agency, or subsidiary of the foreign bank.

(y) State means any state of the United States or the District of Columbia.

(z) Subsidiary means any organization that:

(1) Has 25 percent or more of its voting shares directly or indirectly owned, controlled, or held with the power to vote by a company, including a foreign bank or foreign banking organization; and

(2) Is otherwise controlled, or capable of being controlled, by a foreign bank or foreign banking organization.

## **? 211.22 Interstate banking operations of foreign banking organizations.**

(a) Determination of home state. (1) A foreign bank that,

as of December 10, 1997, had declared a home state or had a home state determined pursuant to the law and regulations in effect prior to that date shall have that state as its home state.

(2) A foreign bank that has any branches, agencies, commercial lending company subsidiaries, or subsidiary banks in one state, and has no such offices or subsidiaries in any other states, shall have as its home state the state in which such offices or subsidiaries are located.

(b) Change of home state. (1) Prior notice. A foreign bank may change its home state once, if it files 30 days' prior notice of the proposed change with the Board.

(2)(i) Application to change home state. A foreign bank, in addition to changing its home state by filing prior notice under paragraph (b)(1) of this section, may apply to the Board to change its home state, upon showing that a national bank or state-chartered bank with the same home state as the foreign bank would be permitted to change its home state to the new home state proposed by the foreign bank.

(ii) A foreign bank may apply to the Board for such permission one or more times.

(iii) In determining whether to grant the request of a foreign bank to change its home state, the Board shall consider whether the proposed change is consistent with competitive equity between foreign and domestic banks.

(3) Effect of change in home state. The home state of a foreign bank and any change in its home state by a foreign bank shall not affect which Federal Reserve Bank or Reserve Banks supervise the operations of the foreign bank, and shall not affect the obligation of the foreign bank to file required reports and applications with the appropriate Federal Reserve Bank.

(4) Conforming branches to new home state. Upon any change in home state by a foreign bank under paragraph (b)(1) or (b)(2) of this section, the domestic branches of the foreign bank established in reliance on any previous home state of the foreign bank shall be conformed to those which a foreign bank with the new home state could permissibly establish as of the date of such change.

(c) Prohibition against interstate deposit production offices. A covered interstate branch of a foreign bank may not be used as a deposit production office in accordance with the provisions in § 208.28 of Regulation H (12 CFR 208.28).

**? 211.23 Nonbanking activities of foreign banking organizations.**

(a) [Reserved]

(b) Qualifying foreign banking organizations. Unless specifically made eligible for the exemptions by the Board, a foreign banking organization shall qualify for the exemptions afforded by this section only if, disregarding its United States banking, more than half of its worldwide business is banking; and more than half of its banking business is outside the United States.<sup>46/</sup> In order to qualify, a foreign banking organization shall:

(1) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed total worldwide nonbanking assets;

(ii) Revenues derived from the business of banking outside the United States exceed total revenues derived from its worldwide nonbanking business; or

(iii) Net income derived from the business of banking outside the United States exceeds total net income derived from its worldwide nonbanking business; and

(2) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed banking assets held in the United States;

(ii) Revenues derived from the business of banking outside the United States exceed revenues derived from the business of banking in the United States; or

(iii) Net income derived from the business of banking outside the United States exceeds net income derived from the business of banking in the United States.

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<sup>46/</sup> None of the assets, revenues, or net income, whether held or derived directly or indirectly, of a subsidiary bank, branch, agency, commercial lending company, or other company engaged in the business of banking in the United States (including any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands) shall be considered held or derived from the business of banking "outside the United States".

(c) Determining assets, revenues, and net income. (1)(i) For purposes of paragraph (b) of this section, the total assets, revenues, and net income of an organization may be determined on a consolidated or combined basis.

(ii) The foreign banking organization shall include assets, revenues, and net income of companies in which it owns 50 percent or more of the voting shares when determining total assets, revenues, and net income.

(iii) The foreign banking organization may include assets, revenues, and net income of companies in which it owns 25 percent or more of the voting shares, if all such companies within the organization are included.

(2) Assets devoted to, or revenues or net income derived from, activities listed in ? 211.9(a) shall be considered banking assets, or revenues or net income derived from the banking business, when conducted within the foreign banking organization for purposes of paragraph (b)(1) of this section, and when conducted within the foreign banking organization by a foreign bank or its subsidiaries for purposes of paragraph (b)(2) of this section.

(d) Loss of eligibility for exemptions. (1) Failure to meet qualifying test. A foreign banking organization that qualified under paragraph (b) of this section shall cease to be eligible for the exemptions of this section if it fails to meet the requirements of paragraph (b) of this section for two consecutive years, as reflected in its annual reports (FR Y-7) filed with the Board.

(2)(i) Continuing activities and investments. A foreign banking organization that ceases to be eligible for the exemptions of this section may continue to engage in activities or retain investments commenced or acquired prior to the end of the first fiscal year for which its annual report reflects nonconformance with paragraph (b) of this section.

(ii) Termination or divestiture. Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second annual report, or at such time as the Board may determine upon request by the foreign banking organization to extend the period, unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section.

(3)(i) Request for specific determination of eligibility. A foreign banking organization that ceases to qualify under paragraph (b) of this section, or an affiliate of such foreign

banking organization, that requests a specific determination of eligibility under paragraph (e) of this section may, prior to the Board's determination on eligibility, continue to engage in activities and make investments under the provisions of paragraphs (f)(1), (2), (3), and (4) of this section.

(ii) The Board may grant consent for the foreign banking organization or its affiliate to make investments under paragraph (f)(5) of this section.

(e) Specific determination of eligibility for nonqualifying foreign banking organizations. (1) Application. (i) A foreign banking organization that does not qualify under paragraph (b) of this section for the exemptions afforded by this section, or that has lost its eligibility for the exemptions under paragraph (d) of this section, may apply to the Board for a specific determination of eligibility for the exemptions.

(ii) A foreign banking organization may apply for a specific determination prior to the time it ceases to be eligible for the exemptions afforded by this section.

(2) Factors considered by Board. In determining whether eligibility for the exemptions would be consistent with the purposes of the BHC Act and in the public interest, the Board shall consider:

(i) The history and the financial and managerial resources of the foreign banking organization;

(ii) The amount of its business in the United States;

(iii) The amount, type, and location of its nonbanking activities, including whether such activities may be conducted by U.S. banks or bank holding companies;

(iv) Whether eligibility of the foreign banking organization would result in undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices; and

(v) The extent to which the foreign banking organization is subject to comprehensive supervision or regulation on a consolidated basis.

(3) Conditions and limitations. The Board may impose any conditions and limitations on a determination of eligibility, including requirements to cease activities or dispose of

investments.

(4) Eligibility not granted. Determinations of eligibility generally would not be granted where:

(i) A majority of the business of the foreign banking organization derives from commercial or industrial activities; or

(ii) The U.S. banking business of the organization is larger than the non-U.S. banking business conducted directly by the foreign bank or banks of the organization.

(f) Permissible activities and investments. A foreign banking organization that qualifies under paragraph (b) of this section may:

(1) Engage in activities of any kind outside the United States;

(2) Engage directly in activities in the United States that are incidental to its activities outside the United States;

(3) Own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the United States, other than those that are incidental to the international or foreign business of such company;

(4) Own or control voting shares of any company in a fiduciary capacity under circumstances that would entitle such shareholding to an exemption under section 4(c)(4) of the BHC Act (12 U.S.C. 1843(c)(4)) if the shares were held or acquired by a bank;

(5) Own or control voting shares of a foreign company that is engaged directly or indirectly in business in the United States other than that which is incidental to its international or foreign business, subject to the following limitations:

(i) More than 50 percent of the foreign company's consolidated assets shall be located, and consolidated revenues derived from, outside the United States; provided that, if the foreign company fails to meet the requirements of this paragraph (f)(5)(i) for two consecutive years (as reflected in annual reports (FR Y-7) filed with the Board by the foreign banking organization), the foreign company shall be divested or its activities terminated within one year of the filing of the second consecutive annual report that reflects nonconformance with the requirements of this paragraph (f)(5)(i), unless the Board grants consent to retain the investment under paragraph (g) of this section.

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 10 percent of the voting shares of a company that underwrites, sells, or distributes securities in the United States, except to the extent permitted bank holding companies;

(iii) If the foreign company is a subsidiary of the foreign banking organization, the foreign company must be, or must control, an operating company, and its direct or indirect activities in the United States shall be subject to the following limitations:

(A) The foreign company's activities in the United States shall be the same kind of activities, or related to the activities, engaged in directly or indirectly by the foreign company abroad, as measured by the "establishment" categories of the Standard Industrial Classification (SIC). An activity in the United States shall be considered related to an activity outside the United States if it consists of supply, distribution, or sales in furtherance of the activity;

(B) The foreign company may engage in activities in the United States that consist of banking securities, insurance, or other financial operations, or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)), only under regulations of the Board or with the prior approval of the Board.

(1) Activities within Division H (Finance, Insurance, and Real Estate) of the SIC shall be considered banking or financial operations for this purpose, with the exception of acting as operators of nonresidential buildings (SIC 6512), operators of apartment buildings (SIC 6513), operators of dwellings other than apartment buildings (SIC 6514), and operators of residential mobile home sites (SIC 6515); and operating title abstract offices (SIC 6541); and

(2) The following activities shall be considered financial activities and may be engaged in only with the approval of the Board under paragraph (g) of this section: credit reporting services (SIC 7323); computer and data processing services (SIC 7371, 7372, 7373, 7374, 7375, 7376, 7377, 7378, and 7379); armored car services (SIC 7381); management consulting (SIC 8732, 8741, 8742, and 8748); certain rental and leasing activities (SIC 4741, 7352, 7353, 7359, 7513, 7514, 7515, and 7519); accounting, auditing, and bookkeeping services (SIC 8721); courier services (SIC 4215 and 4513); and arrangement of passenger transportation (SIC 4724, 4725, and 4729).

(g) Exemptions under section 4(c)(9) of the BHC Act. A foreign banking organization that is of the opinion that other activities or investments may, in particular circumstances, meet the conditions for an exemption under section 4(c)(9) of the BHC Act (12 U.S.C. 1843(c)(9)) may apply to the Board for such a determination by submitting to the appropriate Federal Reserve Bank a letter setting forth the basis for that opinion.

(h) Reports. (1) The foreign banking organization shall inform the Board through the organization's appropriate Federal Reserve Bank, within 30 days after the close of each calendar year, of all shares of companies engaged, directly or indirectly, in activities in the United States that were acquired during the calendar year under the authority of this section.

(2) The foreign banking organization also shall report any direct activities in the United States commenced during each calendar quarter by a foreign subsidiary of the foreign banking organization. This information shall (unless previously furnished) include a brief description of the nature and scope of each company's business in the United States, including the 4-digit SIC numbers of the activities in which the company engages. Such information shall also include the 4-digit SIC numbers of the immediate parent of any U.S. company acquired, together with a statement of total assets and revenues of the immediate parent.

(i) Availability of information. If any information required under this section is unknown and not reasonably available to the foreign banking organization (either because obtaining it would involve unreasonable effort or expense, or because it rests exclusively within the knowledge of a company that is not controlled by the organization) the organization shall:

(A) Give such information on the subject as it possesses or can reasonably acquire, together with the sources thereof; and

(B) Include a statement showing that unreasonable effort or expense would be involved, or indicating that the company whose shares were acquired is not controlled by the organization, and stating the result of a request for information.

**? 211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.**

(a) Board approval of offices of foreign banks. (1) Prior Board approval of branches, agencies, commercial lending



companies, or representative offices of foreign banks. (i) Except as otherwise provided in paragraphs (a)(2) and (a)(3) of this section, a foreign bank shall obtain the approval of the Board before it:

(A) Establishes a branch, agency, commercial lending company subsidiary, or representative office in the United States; or

(B) Acquires ownership or control of a commercial lending company subsidiary.

(2) Prior notice for certain offices. (i) After providing 45 days? prior written notice to the Board, a foreign bank may establish:

(A) An additional office (other than a domestic branch) outside the home state of the foreign bank, provided that the Board has previously determined the foreign bank to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor (comprehensive consolidated supervision or CCS); or

(B) A representative office, if:

(1) The Board has not yet determined the foreign bank to be subject to CCS, but the foreign bank is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a));

(2) The Board previously has approved, by order, an application by the foreign bank to establish a representative office.

(ii) The Board may waive the 45-day notice period if it finds that immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is received by the appropriate Federal Reserve Bank. The Board may suspend the period or require Board approval prior to the establishment of such office if the notification raises significant policy or supervisory concerns.

(3) General consent for certain representative offices.

(i) The Board grants its general consent for a foreign bank that is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a)), to establish:

(A) A representative office, but only if the Board has previously determined that the foreign bank proposing to establish a representative office is subject to CCS;

(B) A regional administrative office; or

(C) An office that solely engages in limited administrative functions (such as separately maintaining back-office support systems) that:

(1) Are clearly defined;

(2) Are performed in connection with the U.S. banking activities of the foreign bank; and

(3) Do not involve contact or liaison with customers or potential customers, beyond incidental contact with existing customers relating to administrative matters (such as verification or correction of account information).

(ii) A foreign bank must notify the Board in writing within 30 days of establishing an office under the general-consent provisions in this paragraph (a)(3).

(4) Suspension of general-consent or prior-notice procedures. The Board may, at any time, upon notice, modify or suspend the prior-notice and general-consent procedures in paragraphs (a)(2) and (3) of this section for any foreign bank with respect to the establishment by such foreign bank of any U.S. office of such foreign bank.

(5) Temporary offices. The Board may, in its discretion, determine that a foreign bank that is well managed as defined in ? 225.2(s) of Regulation Y (12 CFR 225.2(s)) has not established an office if the foreign bank temporarily operates, for a period not to exceed 12 months, a second location in the same city of an existing branch or agency due to an expansion of the permissible activities of such existing office or an increase in personnel of such office that cannot be accommodated in the physical space of the existing office. The foreign bank must provide reasonable advance notice of its intent temporarily to utilize a second location and commit, in writing, to operate only a single location for the office at the end of the 12-month period.

(6) After-the-fact Board approval. Where a foreign bank proposes to establish an office in the United States through the acquisition of, or merger or consolidation with, another foreign bank with an office in the United States, the Board may, in its discretion, allow the acquisition, merger, or consolidation to proceed before an application to establish the office has been filed or acted upon under this section if:

(i) The foreign bank or banks resulting from the

acquisition, merger, or consolidation, will not directly or indirectly own or control more than 5 percent of any class of the voting securities of, or control, a U.S. bank;

(ii) The Board is given reasonable advance notice of the proposed acquisition, merger, or consolidation; and

(iii) Prior to consummation of the acquisition, merger, or consolidation, each foreign bank, as appropriate, commits in writing either:

(A) To comply with the procedures for an application under this section within a reasonable period of time; to engage in no new business, or otherwise to expand its U.S. activities until the disposition of the application; and to abide by the Board's decision on the application, including, if necessary, a decision to terminate the activities of any such U.S. office, as the Board or the Comptroller may require; or

(B) Promptly to wind-down and close the office, the establishment of which would have required an application under this section; and to engage in no new business or otherwise to expand its U.S. activities prior to the closure of such office.

(7) Notice of change in ownership or control or conversion of existing office or establishment of representative office under general-consent authority. A foreign bank with a U.S. office shall notify the Board in writing within 10 days of the occurrence of any of the following events:

(i) A change in the foreign bank's ownership or control, where the foreign bank is acquired or controlled by another foreign bank or company and the acquired foreign bank with a U.S. office continues to operate in the same corporate form as prior to the change in ownership or control;

(ii) The conversion of a branch to an agency or representative office; an agency to a representative office; or a branch or agency from a federal to a state license, or a state to a federal license; or

(iii) The establishment of a representative office under general-consent authority.

(8) Transactions subject to approval under Regulation Y. Subpart B of Regulation Y (12 CFR 225.11-225.17) governs the acquisition by a foreign banking organization of direct or indirect ownership or control of any voting securities of a bank or bank holding company in the United States if the acquisition results in the foreign banking organization's ownership or

control of more than 5 percent of any class of voting securities of a U.S. bank or bank holding company, including through acquisition of a foreign bank or foreign banking organization that owns or controls more than 5 percent of any class of the voting securities of a U.S. bank or bank holding company.

(b) Procedures for application. (1) Filing application. An application for the Board's approval pursuant to this section shall be filed in the manner prescribed by the Board.

(2) Publication requirement. (i) Newspaper notice. Except with respect to a proposed transaction where more extensive notice is required by statute or as otherwise provided in paragraphs (b)(2)(ii) and (iii) of this section, an applicant or notificant under this section shall publish a notice in a newspaper of general circulation in the community in which the applicant or notificant proposes to engage in business.

(ii) Contents of notice. The newspaper notice shall:

(A) State that an application or notice is being filed as of the date of the newspaper notice; and

(B) Provide the name of the applicant or notificant, the subject matter of the application or notice, the place where comments should be sent, and the date by which comments are due, pursuant to paragraph (b)(3) of this section.

(C) Copy of notice with application. The applicant or notificant shall furnish with its application or notice to the Board a copy of the newspaper notice, the date of its publication, and the name and address of the newspaper in which it was published.

(iii) Exception. The Board may modify the publication requirement of paragraphs (b)(2)(i) and (ii) of this section in appropriate circumstances.

(iv) Federal branch or federal agency. In the case of an application or notice to establish a federal branch or federal agency, compliance with the publication procedures of the Comptroller shall satisfy the publication requirement of this section. Comments regarding the application or notice should be sent to the Board and the Comptroller.

(3) Written comments. (i) Within 30 days after publication, as required in paragraph (b)(2) of this section, any person may submit to the Board written comments and data on an application or notice.

(ii) The Board may extend the 30-day comment period if the Board determines that additional relevant information is likely to be provided by interested persons, or if other extenuating circumstances exist.

(4) Board action on application. (i) Time limits. (A) The Board shall act on an application from a foreign bank to establish a branch, agency, or commercial lending company subsidiary within 180 calendar days after the receipt of the application.

(B) The Board may extend for an additional 180 calendar days the period within which to take final action, after providing notice of and reasons for the extension to the applicant and the licensing authority.

(C) The time periods set forth in this paragraph (b)(4)(i) may be waived by the applicant.

(ii) Additional information. The Board may request any information in addition to that supplied in the application when the Board believes that the information is necessary for its decision, and may deny an application if it does not receive the information requested from the applicant or its home country supervisor in sufficient time to permit adequate evaluation of the information within the time periods set forth in paragraph (b)(4)(i) of this section.

(5) Coordination with other regulators. Upon receipt of an application by a foreign bank under this section, the Board shall promptly notify, consult with, and consider the views of the licensing authority.

(c) Standards for approval of U.S. offices of foreign banks. (1) Mandatory standards. (i) General. As specified in section 7(d) of the IBA (12 U.S.C. 3105(d)), the Board may not approve an application to establish a branch or an agency, or to establish or acquire ownership or control of a commercial lending company, unless it determines that:

(A) Each of the foreign bank and any parent foreign bank engages directly in the business of banking outside the United States and, except as provided in paragraph (c)(1)(iii) of this section, is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor; and

(B) The foreign bank has furnished to the Board the information that the Board requires in order to assess the application adequately.

(ii) Basis for determining comprehensive consolidated supervision. In determining whether a foreign bank and any parent foreign bank is subject to CCS, the Board shall determine whether the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. In making such a determination, the Board shall assess, among other factors, the extent to which the home country supervisor:

(A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;

(B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;

(C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;

(D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;

(E) Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

(iii) Determination of comprehensive consolidated supervision not required in certain circumstances. (A) If the Board is unable to find, under paragraph (c)(1)(i) of this section, that a foreign bank is subject to comprehensive consolidated supervision, the Board may, nevertheless, approve an application by the foreign bank if:

(1) The home country supervisor is actively working to establish arrangements for the consolidated supervision of such bank; and

(2) All other factors are consistent with approval.

(B) In deciding whether to use its discretion under this paragraph (c)(1)(iii), the Board also shall consider whether the foreign bank has adopted and implemented procedures to combat money laundering. The Board also may take into account whether the home country supervisor is developing a legal regime to

address money laundering or is participating in multilateral efforts to combat money laundering. In approving an application under this paragraph (c)(1)(iii), the Board, after requesting and taking into consideration the views of the licensing authority, may impose any conditions or restrictions relating to the activities or business operations of the proposed branch, agency, or commercial lending company subsidiary, including restrictions on sources of funding. The Board shall coordinate with the licensing authority in the implementation of such conditions or restrictions.

(2) Additional mandatory standards for certain interstate applications. As specified in section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3)), the Board may not approve an application by a foreign bank to establish a branch, other than a limited branch, outside the home state of the foreign bank under section 5(a)(1) or (2) of the IBA (12 U.S.C. 3103(a)(1), (2)) unless the Board:

(i) Determines that the foreign bank's financial resources, including the capital level of the bank, are equivalent to those required for a domestic bank to be approved for branching under section 5155 of the Revised Statutes (12 U.S.C. 36) and section 44 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. 1831u);

(ii) Consults with the Department of the Treasury regarding capital equivalency;

(iii) Applies the standards specified in section 7(d) of the IBA (12 U.S.C. 3105(d)) and this paragraph (c);

(iv) Applies the same requirements and conditions to which an application by a domestic bank for an interstate merger is subject under section 44(b)(1), (3), and (4) of the FDIA (12 U.S.C. 1831u(b)(1), (3), (4)); and

(v) In the case of an application to establish a branch through a change in status of an agency or limited branch, the establishment and operation of the branch would be permitted:

(A) In the case of a federal branch, under section 5155 of the Revised Statutes (12 U.S.C. 36(g)) (relating to de novo branching), if the foreign bank were a national bank whose home state (as defined in section 5155 of the Revised Statutes (12 U.S.C. 36(g))) is the same state as the home state of the foreign bank; or

(B) In the case of a state branch, under section 18(d)(4) of the FDIA (12 U.S.C. 1828(d)(4)) (relating to de novo branching), if the foreign bank were a state-chartered bank whose home state (as defined in section 18(d)(4) of the FDIA (12 U.S.C.

1828(d)(4))) is the same state as the home state of the foreign bank.

(3) Discretionary standards. In acting on any application under this subpart, the Board may take into account:

(i) Consent of home country supervisor. Whether the home country supervisor of the foreign bank has consented to the proposed establishment of the branch, agency, or commercial lending company subsidiary;

(ii) Financial resources. The financial resources of the foreign bank (including the foreign bank's capital position, projected capital position, profitability, level of indebtedness, and future prospects) and the condition of any U.S. office of the foreign bank;

(iii) Managerial resources. The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors; the integrity of its principal shareholders; management's experience and capacity to engage in international banking; and the record of the foreign bank and its management of complying with laws and regulations, and of fulfilling any commitments to, and any conditions imposed by, the Board in connection with any prior application;

(iv) Sharing information with supervisors. Whether the foreign bank's home country supervisor and the home country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(v) Assurances to Board. (A) Whether the foreign bank has provided the Board with adequate assurances that information will be made available to the Board on the operations or activities of the foreign bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the BHC Act, and other applicable federal banking statutes.

(B) These assurances shall include a statement from the foreign bank describing the laws that would restrict the foreign bank or any of its parents from providing information to the Board;

(vi) Measures for prevention of money laundering. Whether the foreign bank has adopted and implemented procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; and



(vii) Compliance with U.S. law. Whether the foreign bank and its U.S. affiliates are in compliance with applicable U.S. law, and whether the applicant has established adequate controls and procedures in each of its offices to ensure continuing compliance with U.S. law, including controls directed to detection of money laundering and other unsafe or unsound banking practices.

(4) Additional discretionary factors. The Board may consider the needs of the community and the history of operation of the foreign bank and its relative size in its home country, provided that the size of the foreign bank is not the sole factor in determining whether an office of a foreign bank should be approved.

(5) Board conditions on approval. The Board may impose any conditions on its approval as it deems necessary, including a condition which may permit future termination by the Board of any activities or, in the case of a federal branch or a federal agency, by the Comptroller, based on the inability of the foreign bank to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

(d) Representative offices. (1) Permissible activities.  
A representative office may engage in:

(i) Representational and administrative functions.  
Representational and administrative functions in connection with the banking activities of the foreign bank, which may include soliciting new business for the foreign bank; conducting research; acting as liaison between the foreign bank's head office and customers in the United States; performing any of the activities described in 12 CFR 250.141; or performing back-office functions; but shall not include contracting for any deposit or deposit-like liability, lending money, or engaging in any other banking activity for the foreign bank; and

(ii) Other functions. Other functions for or on behalf of the foreign bank or its affiliates, such as operating as a regional administrative office of the foreign bank, but only to the extent that these other functions are not banking activities and are not prohibited by applicable federal or state law, or by ruling or order of the Board.

(2) Standards for approval of representative offices. As specified in section 10(a)(2) of the IBA (12 U.S.C. 3107(a)(2)), in acting on the application of a foreign bank to establish a representative office, the Board shall take into account, to the

extent it deems appropriate, the standards for approval set out in paragraph (c) of this section. The standard regarding supervision by the foreign bank's home country supervisor (as set out in paragraph (c)(1)(i)(A) of this section) will be met, in the case of a representative office application, if the Board makes a finding that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities and the operating record of the applicant.

(3) Special-purpose foreign government-owned banks. A foreign government-owned organization engaged in banking activities in its home country that are not commercial in nature may apply to the Board for a determination that the organization is not a foreign bank for purposes of this section. A written request setting forth the basis for such a determination may be submitted to the Reserve Bank of the District in which the foreign organization's representative office is located in the United States, or to the Board, in the case of a proposed establishment of a representative office. The Board shall review and act upon each request on a case-by-case basis.

(4) Additional requirements. The Board may impose any additional requirements that it determines to be necessary to carry out the purposes of the IBA.

(e) Preservation of existing authority. Nothing in this subpart shall be construed to relieve any foreign bank or foreign banking organization from any otherwise applicable requirement of federal or state law, including any applicable licensing requirement.

(f) Reports of crimes and suspected crimes. Except for a federal branch or a federal agency or a state branch that is insured by the Federal Deposit Insurance Corporation (FDIC), a branch, agency, or representative office of a foreign bank operating in the United States shall file a suspicious activity report in accordance with the provisions of ? 208.20 of Regulation H (12 CFR 208.20).

#### **? 211.25 Termination of offices of foreign banks.**

(a) Grounds for termination. (1) General. Under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(d), 3107(b)), the Board may order a foreign bank to terminate the activities of its representative office, state branch, state agency, or commercial lending company subsidiary if the Board finds that:

(i) The foreign bank is not subject to comprehensive

consolidated supervision in accordance with ? 211.24(c)(1), and the home country supervisor is not making demonstrable progress in establishing arrangements for the consolidated supervision of the foreign bank; or

(ii) Both of the following criteria are met:

(A) There is reasonable cause to believe that the foreign bank, or any of its affiliates, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States; and

(B) As a result of such violation or practice, the continued operation of the foreign bank's representative office, state branch, state agency, or commercial lending company subsidiary would not be consistent with the public interest, or with the purposes of the IBA, the BHC Act, or the FDIA.

(2) Additional ground. The Board also may enforce any condition imposed in connection with an order issued under ? 211.24.

(b) Factor. In making its findings under this section, the Board may take into account the needs of the community, the history of operation of the foreign bank, and its relative size in its home country, provided that the size of the foreign bank shall not be the sole determining factor in a decision to terminate an office.

(c) Consultation with relevant state supervisor. Except in the case of termination pursuant to the expedited procedure in paragraph (d)(3) of this section, the Board shall request and consider the views of the relevant state supervisor before issuing an order terminating the activities of a state branch, state agency, representative office, or commercial lending company subsidiary under this section.

(d) Termination procedures. (1) Notice and hearing. Except as otherwise provided in paragraph (d)(3) of this section, an order issued under paragraph (a)(1) of this section shall be issued only after notice to the relevant state supervisor and the foreign bank and after an opportunity for a hearing.

(2) Procedures for hearing. Hearings under this section shall be conducted pursuant to the Board's Rules of Practice for Hearings (12 CFR part 263).

(3) Expedited procedure. The Board may act without providing an opportunity for a hearing, if it determines that expeditious action is necessary in order to protect the public

interest. When the Board finds that it is necessary to act without providing an opportunity for a hearing, the Board, solely in its discretion, may:

(i) Provide the foreign bank that is the subject of the termination order with notice of the intended termination order;

(ii) Grant the foreign bank an opportunity to present a written submission opposing issuance of the order; or

(iii) Take any other action designed to provide the foreign bank with notice and an opportunity to present its views concerning the order.

(e) Termination of federal branch or federal agency. The Board may transmit to the Comptroller a recommendation that the license of a federal branch or federal agency be terminated if the Board has reasonable cause to believe that the foreign bank or any affiliate of the foreign bank has engaged in conduct for which the activities of a state branch or state agency may be terminated pursuant to this section.

(f) Voluntary termination. A foreign bank shall notify the Board at least 30 days prior to terminating the activities of any office. Notice pursuant to this paragraph (f) is in addition to, and does not satisfy, any other federal or state requirements relating to the termination of an office or the requirement for prior notice of the closing of a branch, pursuant to section 39 of the FDIA (12 U.S.C. 1831p).

**? 211.26 Examination of offices and affiliates of foreign banks.**

(a) Conduct of examinations. (1) Examination of branches, agencies, commercial lending companies, and affiliates. The Board may examine:

(i) Any branch or agency of a foreign bank;

(ii) Any commercial lending company or bank controlled by one or more foreign banks, or one or more foreign companies that control a foreign bank; and

(iii) Any other office or affiliate of a foreign bank conducting business in any state.

(2) Examination of representative offices. The Board may examine any representative office in the manner and with the frequency it deems appropriate.

(b) Coordination of examinations. To the extent possible,

the Board shall coordinate its examinations of the U.S. offices and U.S. affiliates of a foreign bank with the licensing authority and, in the case of an insured branch, the FDIC, including through simultaneous examinations of the U.S. offices and U.S. affiliates of a foreign bank.

(c) Annual on-site examinations. Unless otherwise specified, each branch, agency, or commercial lending company subsidiary of a foreign bank shall be examined on-site at least once during each 12-month period (beginning on the date the most recent examination of the office ended) by:

(1) The Board;

(2) The FDIC, if the branch of the foreign bank accepts or maintains insured deposits;

(3) The Comptroller, in the case of a federal branch or federal agency; or

(4) The relevant state supervisor, in the case of a state branch or state agency.

**? 211.27 Disclosure of supervisory information to foreign supervisors.**

(a) Disclosure by Board. The Board may disclose information obtained in the course of exercising its supervisory or examination authority to a foreign bank regulatory or supervisory authority, if the Board determines that disclosure is appropriate for bank supervisory or regulatory purposes and will not prejudice the interests of the United States.

(b) Confidentiality. Before making any disclosure of information pursuant to paragraph (a) of this section, the Board shall obtain, to the extent necessary, the agreement of the foreign bank regulatory or supervisory authority to maintain the confidentiality of such information to the extent possible under applicable law.

**? 211.28 Provisions applicable to branches and agencies:  
limitation on loans to one borrower.**

(a) Limitation on loans to one borrower. Except as provided in paragraph (b) of this section, the total loans and extensions of credit by all the state branches and state agencies of a foreign bank outstanding to a single borrower at one time shall be aggregated with the total loans and extensions of credit by all federal branches and federal agencies of the same foreign bank outstanding to such borrower at the time; and shall be subject to the limitations and other provisions of section 5200 of the Revised Statutes (12 U.S.C. 84), and the regulations promulgated thereunder, in the same manner that extensions of credit by a federal branch or federal agency are subject to section 4(b) of the IBA (12 U.S.C. 3102(b)) as if such state branches and state agencies were federal branches and federal agencies.

(b) Preexisting loans and extensions of credit. Any loans or extensions of credit to a single borrower that were originated prior to December 19, 1991, by a state branch or state agency of the same foreign bank and that, when aggregated with loans and extensions of credit by all other branches and agencies of the foreign bank, exceed the limits set forth in paragraph (a) of this section, may be brought into compliance with such limitations through routine repayment, provided that any new loans or extensions of credit (including renewals of existing unfunded credit lines, or extensions of the maturities of existing loans) to the same borrower shall comply with the limits set forth in paragraph (a) of this section.

**? 211.29 Applications by state branches and state agencies to  
conduct activities not permissible for federal branches.**

(a) Scope. A state branch or state agency shall file with the Board a prior written application for permission to engage in or continue to engage in any type of activity that:

(1) Is not permissible for a federal branch, pursuant to statute, regulation, official bulletin or circular, or order or interpretation issued in writing by the Comptroller; or

(2) Is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction.

(b) Exceptions. No application shall be required by a

state branch or state agency to conduct any activity that is otherwise permissible under applicable state and federal law or regulation and that:

(1) Has been determined by the FDIC, pursuant to 12 CFR 362.4(c)(i)-(ii)(A), not to present a significant risk to the affected deposit insurance fund;

(2) Is permissible for a federal branch, but the Comptroller imposes a quantitative limitation on the conduct of such activity by the federal branch;

(3) Is conducted as agent rather than as principal, provided that the activity is one that could be conducted by a state-chartered bank headquartered in the same state in which the branch or agency is licensed; or

(4) Any other activity that the Board has determined may be conducted by any state branch or state agency of a foreign bank without further application to the Board.

(c) Contents of application. An application submitted pursuant to paragraph (a) of this section shall be in letter form and shall contain the following information:

(1) A brief description of the activity, including the manner in which it will be conducted, and an estimate of the expected dollar volume associated with the activity;

(2) An analysis of the impact of the proposed activity on the condition of the U.S. operations of the foreign bank in general, and of the branch or agency in particular, including a copy, if available, of any feasibility study, management plan, financial projections, business plan, or similar document concerning the conduct of the activity;

(3) A resolution by the applicant's board of directors or, if a resolution is not required pursuant to the applicant's organizational documents, evidence of approval by senior management, authorizing the conduct of such activity and the filing of this application;

(4) If the activity is to be conducted by a state branch insured by the FDIC, statements by the applicant:

(i) Of whether or not it is in compliance with 12 CFR 346.19 (Pledge of Assets) and 346.20 (Asset Maintenance);

(ii) That it has complied with all requirements of the FDIC concerning an application to conduct the activity and the status

of the application, including a copy of the FDIC's disposition of such application, if available; and

(iii) Explaining why the activity will pose no significant risk to the deposit insurance fund; and

(5) Any other information that the Reserve Bank deems appropriate.

(d) Factors considered in determination. (1) The Board shall consider the following factors in determining whether a proposed activity is consistent with sound banking practice:

(i) The types of risks, if any, the activity poses to the U.S. operations of the foreign banking organization in general, and the branch or agency in particular;

(ii) If the activity poses any such risks, the magnitude of each risk; and

(iii) If a risk is not de minimis, the actual or proposed procedures to control and minimize the risk.

(2) Each of the factors set forth in paragraph (d)(1) of this section shall be evaluated in light of the financial condition of the foreign bank in general and the branch or agency in particular and the volume of the activity.

(e) Application procedures. Applications pursuant to this section shall be filed with the appropriate Federal Reserve Bank. An application shall not be deemed complete until it contains all the information requested by the Reserve Bank and has been accepted. Approval of such an application may be conditioned on the applicant's agreement to conduct the activity subject to specific conditions or limitations.

(f) Divestiture or cessation. (1) If an application for permission to continue to conduct an activity is not approved by the Board or, if applicable, the FDIC, the applicant shall submit a detailed written plan of divestiture or cessation of the activity to the appropriate Federal Reserve Bank within 60 days of the disapproval.

(i) The divestiture or cessation plan shall describe in detail the manner in which the applicant will divest itself of or cease the activity, and shall include a projected timetable describing how long the divestiture or cessation is expected to take.

(ii) Divestiture or cessation shall be complete within one



year from the date of the disapproval, or within such shorter period of time as the Board shall direct.

(2) If a foreign bank operating a state branch or state agency chooses not to apply to the Board for permission to continue to conduct an activity that is not permissible for a federal branch, or which is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction, the foreign bank shall submit a written plan of divestiture or cessation, in conformance with paragraph (f)(1) of this section within 60 days of the effective date of this part or of such change or decision.

**? 211.30 Criteria for evaluating U.S. operations of foreign banks not subject to consolidated supervision.**

(a) Development and publication of criteria. Pursuant to the Foreign Bank Supervision Enhancement Act, Pub. L. 102-242, 105 Stat. 2286 (1991), the Board shall develop and publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive consolidated supervision.

(b) Criteria considered by Board. Following a determination by the Board that, having taken into account the standards set forth in ? 211.24(c)(1), a foreign bank is not subject to CCS, the Board shall consider the following criteria in determining whether the foreign bank's U.S. operations should be permitted to continue and, if so, whether any supervisory constraints should be placed upon the bank in connection with those operations:

(1) The proportion of the foreign bank's total assets and total liabilities that are located or booked in its home country, as well as the distribution and location of its assets and liabilities that are located or booked elsewhere;

(2) The extent to which the operations and assets of the foreign bank and any affiliates are subject to supervision by its home country supervisor;

(3) Whether the home country supervisor of such foreign bank is actively working to establish arrangements for comprehensive consolidated supervision of the bank, and whether demonstrable progress is being made;

(4) Whether the foreign bank has effective and reliable systems of internal controls and management information and reporting, which enable its management properly to oversee its

worldwide operations;

(5) Whether the foreign bank's home country supervisor has any objection to the bank continuing to operate in the United States;

(6) Whether the foreign bank's home country supervisor and the home country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(7) The relationship of the U.S. operations to the other operations of the foreign bank, including whether the foreign bank maintains funds in its U.S. offices that are in excess of amounts due to its U.S. offices from the foreign bank's non-U.S. offices;

(8) The soundness of the foreign bank's overall financial condition;

(9) The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors, and the integrity of its principal shareholders;

(10) The scope and frequency of external audits of the foreign bank;

(11) The operating record of the foreign bank generally and its role in the banking system in its home country;

(12) The foreign bank's record of compliance with relevant laws, as well as the adequacy of its anti-money-laundering controls and procedures, in respect of its worldwide operations;

(13) The operating record of the U.S. offices of the foreign bank;

(14) The views and recommendations of the Comptroller or the relevant state supervisors in those states in which the foreign bank has operations, as appropriate;

(15) Whether the foreign bank, if requested, has provided the Board with adequate assurances that such information will be made available on the operations or activities of the foreign bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the IBA, the BHC Act, and other U.S. banking statutes; and

(16) Any other information relevant to the safety and soundness of the U.S. operations of the foreign bank.

(c) Restrictions on U.S. operations. (1) Terms of agreement. Any foreign bank that the Board determines is not subject to CCS may be required to enter into an agreement to conduct its U.S. operations subject to such restrictions as the Board, having considered the criteria set forth in paragraph (b) of this section, determines to be appropriate in order to ensure the safety and soundness of its U.S. operations.

(2) Failure to enter into or comply with agreement. A foreign bank that is required by the Board to enter into an agreement pursuant to paragraph (c)(1) of this section and either fails to do so, or fails to comply with the terms of such agreement, may be subject to:

(i) Enforcement action, in order to ensure safe and sound banking operations, under 12 U.S.C. 1818; or

(ii) Termination or a recommendation for termination of its U.S. operations, under ? 211.25(a) and (e) and section (7)(e) of the IBA (12 U.S.C. 3105(e)).

### **Subpart C - Export Trading Companies**

#### **? 211.31 Authority, purpose, and scope.**

(a) Authority. This subpart is issued by the Board of Governors of the Federal Reserve System (Board) under the authority of the Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. 1841 *et seq.*), the Bank Export Services Act (title II, Pub. L. 97-290, 96 Stat. 1235 (1982)) (BESA), and the Export Trading Company Act Amendments of 1988 (title III, Pub. L. 100-418, 102 Stat. 1384 (1988)) (ETC Act Amendments).

(b) Purpose and scope. This subpart is in furtherance of the purposes of the BHC Act, the BESA, and the ETC Act Amendments, the latter two statutes being designed to increase U.S. exports by encouraging investments and participation in export trading companies by bank holding companies and the specified investors. The provisions of this subpart apply to eligible investors as defined in this subpart.

#### **? 211.32 Definitions.**

The definitions in ?? 211.1 and 211.2 of subpart A apply to this subpart, subject to the following:

(a) Appropriate Federal Reserve Bank has the same meaning as in ? 211.21(c).

(b) Bank has the same meaning as in section 2(c) of the BHC Act (12 U.S.C. 1841(c)).

(c) Company has the same meaning as in section 2(b) of the BHC Act (12 U.S.C. 1841(b)).

(d) Eligible investors means:

(1) Bank holding companies, as defined in section 2(a) of the BHC Act (12 U.S.C. 1841(a));

(2) Edge and agreement corporations that are subsidiaries of bank holding companies but are not subsidiaries of banks;

(3) Banker's banks, as described in section 4(c)(14)(F)(iii) of the BHC Act (12 U.S.C. 1843(c)(14)(F)(iii)); and

(4) Foreign banking organizations, as defined in ? 211.21(o).

(e) Export trading company means a company that is exclusively engaged in activities related to international trade and, by engaging in one or more export trade services, derives:

(1) At least one-third of its revenues in each consecutive four-year period from the export of, or from facilitating the export of, goods and services produced in the United States by persons other than the export trading company or its subsidiaries; and

(2) More revenues in each four-year period from export activities as described in paragraph (e)(1) of this section than it derives from the import, or facilitating the import, into the United States of goods or services produced outside the United States. The four-year period within which to calculate revenues derived from its activities under this section shall be deemed to have commenced with the first fiscal year after the respective export trading company has been in operation for two years.

(f) Revenues shall include net sales revenues from exporting, importing, or third-party trade in goods by the export trading company for its own account and gross revenues derived from all other activities of the export trading company.

(g) Subsidiary has the same meaning as in section 2(d) of the BHC Act (12 U.S.C. 1841(d)).

(h) Well capitalized has the same meaning as in ? 225.2(r) of Regulation Y (12 CFR 225.2(r)).

(i) Well managed has the same meaning as in ? 225.2(s) of Regulation Y (12 CFR 225.2(s)).

**? 211.33 Investments and extensions of credit.**

(a) Amount of investments. In accordance with the procedures of ? 211.34, an eligible investor may invest no more than 5 percent of its consolidated capital and surplus in one or more export trading companies, except that an Edge or agreement corporation not engaged in banking may invest as much as 25 percent of its consolidated capital and surplus but no more than 5 percent of the consolidated capital and surplus of its parent bank holding company.

(b) Extensions of credit. (1) Amount. An eligible investor in an export trading company or companies may extend credit directly or indirectly to the export trading company or companies in a total amount that at no time exceeds 10 percent of the investor's consolidated capital and surplus.

(2) Terms. (i) An eligible investor in an export trading company may not extend credit directly or indirectly to the export trading company or any of its customers or to any other investor holding 10 percent or more of the shares of the export trading company on terms more favorable than those afforded similar borrowers in similar circumstances, and such extensions of credit shall not involve more than the normal risk of repayment or present other unfavorable features.

(ii) For the purposes of this section, an investor in an export trading company includes any affiliate of the investor.

(3) Collateral requirements. Covered transactions between a bank and an affiliated export trading company in which a bank holding company has invested pursuant to this subpart are subject to the collateral requirements of section 23A of the Federal Reserve Act (12 U.S.C. 371c), except where a bank issues a letter of credit or advances funds to an affiliated export trading company solely to finance the purchase of goods for which:

(i) The export trading company has a bona fide contract for the subsequent sale of the goods; and

(ii) The bank has a security interest in the goods or in the proceeds from their sale at least equal in value to the letter of credit or the advance.

**? 211.34 Procedures for filing and processing notices.**

(a) General policy. Direct and indirect investments by eligible investors in export trading companies shall be made in accordance with the general consent or prior notice procedures contained in this section. The Board may at any time, upon notice, modify or suspend the general-consent procedures with respect to any eligible investor.

(b) General consent. (1) Eligibility for general consent. Subject to the other limitations of this subpart, the Board grants its general consent for any investment an export trading company:

(i) If the eligible investor is well capitalized and well managed;

(ii) In an amount equal to cash dividends received from that export trading company during the preceding 12 calendar months; or

(iii) That is acquired from an affiliate at net asset value or through a contribution of shares.

(2) Post-investment notice. By the end of the month following the month in which the investment is made, the investor shall provide the Board with the following information:

(i) The amount of the investment and the source of the funds with which the investment was made; and

(ii) In the case of an initial investment, a description of the activities in which the export trading company proposes to engage and projections for the export trading company for the first year following the investment.

(c) Filing notice. (1) Prior notice. An eligible investor shall give the Board 60 days? prior written notice of any investment in an export trading company that does not qualify under the general consent procedure.

(2) Notice of change of activities. (i) An eligible investor shall give the Board 60 days? prior written notice of changes in the activities of an export trading company that is a subsidiary of the investor if the export trading company expands its activities beyond those described in the initial notice to include:

(A) Taking title to goods where the export trading company does not have a firm order for the sale of those goods;

(B) Product research and design;

(C) Product modification; or

(D) Activities not specifically covered by the list of activities contained in section 4(c)(14)(F)(ii) of the BHC Act (12 U.S.C. 1843(c)(14)(F)(ii)).

(ii) Such an expansion of activities shall be regarded as a proposed investment under this subpart.

(d) Time period for Board action. (1) A proposed investment that has not been disapproved by the Board may be made 60 days after the appropriate Federal Reserve Bank accepts the notice for processing. A proposed investment may be made before the expiration of the 60-day period if the Board notifies the investor in writing of its intention not to disapprove the investment.

(2) The Board may extend the 60-day period for an additional 30 days if the Board determines that the investor has not furnished all necessary information or that any material information furnished is substantially inaccurate. The Board may disapprove an investment if the necessary information is provided within a time insufficient to allow the Board reasonably to consider the information received.

(3) Within three days of a decision to disapprove an investment, the Board shall notify the investor in writing and state the reasons for the disapproval.

(e) Time period for investment. An investment in an export trading company that has not been disapproved shall be made within one year from the date of the notice not to disapprove, unless the time period is extended by the Board or by the appropriate Federal Reserve Bank.

\* \* \* \* \*

#### **PART 265 - RULES REGARDING DELEGATION OF AUTHORITY**

1. The authority citation for part 265 would continue to read as follows:

**Authority:** 12 U.S.C. 248(i) and (k).

2. Paragraph (f) of ? 265.6 would be revised as follows:

**? 265.6 Functions delegated to General Counsel.**

\* \* \* \* \*

(f) International banking. (1) After-the-fact applications. With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request by a foreign bank to establish a branch, agency, commercial lending company, or representative office through certain acquisitions, mergers, consolidations, or similar transactions, in conjunction with which:

(i) The foreign bank would be required to file an after-the-fact application for the Board's approval under ? 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)); or

(ii) The General Counsel may waive the requirement for an after-the-fact application if:

(A) The surviving foreign bank commits to wind down the U.S. operations of the acquired foreign bank; and

(B) The merger or consolidation raises no significant policy or supervisory issues.

(2) To modify the requirement that a foreign bank that has submitted an application or notice to establish a branch, agency, commercial lending company, or representative office pursuant to ? 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)) shall publish notice of the application or notice in a newspaper of general circulation in the community in which the applicant or notificant proposes to engage in business, as provided in ? 211.24(b)(2) of Regulation K (12 CFR 211.24(b)(2)).

(3) With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request for an exemption under section 4(c)(9) of the Bank Holding Company Act (12 U.S.C. 1843(c)(9)), provided that the request raises no significant policy or supervisory issues that the Board has not already considered.

\* \* \* \* \*

3. Section 265.7 would be amended as follows:

a. Paragraph (d)(4) would be revised; and

b. New paragraphs (d)(9), (d)(10), and (d)(11) would be added.

The revision and additions would read as follows:



**? 265.7 Functions delegated to Director of Division of Banking Supervision and Regulation.**

\* \* \* \* \*

(d)(4) Authority under general-consent and prior-notice procedures. (i) With regard to a prior notice to establish a branch in a foreign country under ? 211.3 of Regulation K (12 CFR 211.3):

(A) To waive the notice period;

(B) To suspend the notice period;

(C) To determine not to object to the notice; or

(D) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice to make an investment under ? 211.8(g) of Regulation K (12 CFR 211.8(g)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under ? 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iv) To suspend the ability:

(A) Of a foreign banking organization to establish an office under the prior-notice procedures in ? 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)) or the general-consent procedures in ? 211.24(a)(3) of Regulation K (12 CFR 211.24(a)(3));

(B) Of a U.S. banking organization to establish a foreign branch under the prior-notice or general-consent procedures in

? 211.3(b) of Regulation K (12 CFR 211.3(b));

(C) Of an investor to make investments under the general-consent or prior-notice procedures in ? 211.8 of Regulation K (12 CFR 211.8); and

(D) Of an eligible investor to make an investment in an export trading company under the general-consent procedures in ? 211.34(b) of Regulation K (12 CFR 211.34(b)).

\* \* \* \* \*

(d)(9) Allowing use of general-consent procedures. To allow an investor that is not well capitalized and well managed to make investments under the general-consent procedures in ? 211.8 or 211.34(b) of Regulation K (12 CFR 211.8, 211.34(b)), provided that:

(i) The investor has implemented measures to become well capitalized and well managed;

(ii) Granting such authority raises no significant policy or supervisory concerns; and

(iii) Authority granted by the Director under this paragraph (d)(9) expires after one year, but may be renewed.

(d)(10) Exceeding general-consent investment limits. To allow an investor to exceed the general-consent investment limits under ? 211.8 of Regulation K (12 CFR 211.8), provided that:

(i) The investor demonstrates adequate financial and managerial strength;

(ii) The investor's investment strategy is not unsafe or unsound;

(iii) Granting such authority raises no significant policy or supervisory concerns; and

(iv) Authority granted by the Director under this paragraph (d)(10) expires after one year, but may be renewed.

(d)(11) Approval of temporary U.S. offices. To allow a foreign bank to operate a temporary office in the United States, pursuant to ? 211.24 of Regulation K (12 CFR 211.24), provided that:

(i) There is no direct public access to such office, with respect to any branch or agency function; and

(ii) The proposal raises no significant policy or supervisory issues.

\* \* \* \* \*

4. Section 265.11 would be amended as follows:

- a. Paragraph (d)(8) would be revised; and
- b. Paragraph (d)(11) would be removed.

The revision would read as follows:

**? 265.11 Functions delegated to Federal Reserve Banks.**

\* \* \* \* \*

(d)(8) Authority under prior-notice procedures. (i) With regard to a prior notice to make an investment under ? 211.8(g) of Regulation K (12 CFR 211.8(g)):

(A) To suspend the notice period; or

(B) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under ? 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To suspend the notice period; or

(B) To require that the foreign bank file an application for the Board's specific consent.

\* \* \* \* \*

By order of the Board of Governors of the Federal Reserve System, December 17, 1997.

(signed) William W. Wiles

William W. Wiles,  
Secretary of the Board.