

**FEDERAL RESERVE SYSTEM
12 CFR Part 208**

[Regulation H; Docket No. R-1066]

and

**DEPARTMENT OF THE TREASURY
Office of the Under Secretary for Domestic Finance
12 CFR Part 1501
BILLING CODE 4810-25
RIN 1505-AA77**

Financial Subsidiaries

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

ACTION: Final rule.

SUMMARY: Section 121 of the Gramm-Leach-Bliley Act (GLBA) permits a national bank or state member bank that is among the second 50 largest insured banks to own or control a financial subsidiary only if the bank meets either the eligible debt requirement set forth in section 121 of the Act or alternative criteria established jointly by the Board and Treasury. On March 14, 2000, the Board and Treasury adopted and requested public comment on an interim rule establishing this alternative criteria. (65 FR 15050). The interim rule provided that a national or state member bank meets the alternative criteria if the bank has a current long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization. After reviewing public comments, the Board and Treasury are adopting a final rule that is substantively identical to the interim rule.

DATES: The final rule is effective [INSERT DATE 30 DAYS AFTER PUBLICATION IN FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

Board of Governors: Kieran J. Fallon, Senior Counsel, Legal Division (202/452-5270); or Mark S. Carey, Senior Economist, Division of Research & Statistics (202/452-2784); Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Janice Simms (202/872-4984).

Department of the Treasury: Matthew Green, Senior Financial Analyst (202/622-2740); or Gary W. Sutton, Senior Banking Counsel (202/622-1976); U.S. Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 121 of the GLBA (Public Law 106-102, 113 Stat. 1338) authorizes national banks and state member banks to acquire control of, or hold an interest in, a new type of subsidiary called a “financial subsidiary.” A financial subsidiary may, with certain exceptions, engage in activities that have been determined to be financial in nature or incidental to financial activities in accordance with the GLBA, and in other activities that the parent bank is permitted to conduct directly.

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

Furthermore, if the bank is one of the 50 largest insured banks, as

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

The interim rule provided that a national bank or state member bank within the second 50 largest insured banks satisfies the alternative criteria if the bank has a current long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the rating organization. The interim rule defined a long-term issuer credit rating as a written opinion issued by a nationally recognized statistical ratings organization that assesses the bank's overall capacity and willingness to pay on a timely basis its unsecured, dollar-denominated financial obligations maturing in not less than one year.

The Board and Treasury received two comments from the public on the interim rule. One comment, which was filed by a trade association for banking institutions, supported the actions taken by the Board and Treasury and concurred that the long-term issuer credit rating requirement established by the interim rule is comparable to and consistent with the eligible debt requirement established by section 121 of the GLBA. The other comment, which was filed on behalf of a state member bank, suggested that the Board and Treasury rely on a bank's examination rating, rather than a rating assigned by an independent ratings agency, for determining whether a bank is eligible to own or control a financial subsidiary.

DESCRIPTION OF FINAL RULE

After reviewing public comments, the Board and Treasury have adopted a final rule that is substantially identical to the interim rule. A national or state member bank meets the requirements of the final rule if the bank has a current

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

long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization. An issuer credit rating is one that assesses the bank’s overall capacity and willingness to pay on a timely basis its unsecured financial obligations. Thus, an issuer credit rating differs from a debt rating in that it does not assess the bank’s ability and willingness to make payments on any individual class or issue of debt, nor does it reflect priority or preference in payment among financial obligations.

The issuer credit rating must be assigned to the national or state member bank that controls or holds an interest in the financial subsidiary. Issuer credit ratings that are assigned to a subsidiary or affiliate of the parent bank, such as a subsidiary engaged in derivatives activities, do not meet the rule’s requirements. Furthermore, ratings organizations may issue long-term or short-term issuer credit ratings for the same bank and separate ratings for dollar-denominated and foreign currency-denominated obligations. Only long-term issuer credit ratings for dollar-denominated obligations satisfy the requirements of the rule. An issuer credit rating is long-term if it reflects an assessment of the bank’s ability over a period of not less than one year to fulfill its financial obligations on a timely basis.

The Board and Treasury have reviewed the ratings and rating categories used by nationally recognized statistical rating organizations in the United States. The Board and Treasury believe that the following ratings assigned by the indicated rating agencies currently meet the requirements of the rule, provided that they assess the parent bank’s ability and willingness to meet its financial obligations denominated in U.S. dollars.

Rating Organization	Type of Rating	Rating
Standard & Poor’s	Issuer Credit Rating (including a Counterparty Credit Rating)	AAA, AA or A
Moody’s	Issuer Credit Rating	Aaa, Aa or A
Fitch	International Credit Rating	AAA, AA or A

Standard & Poor’s and Fitch may modify their AA or A ratings with the addition of a plus (+) or minus (-) sign to show relative standing within these rating

categories. Any rating from A minus to AAA would satisfy the long-term issuer credit rating requirement; an A minus would constitute the lowest acceptable rating in the case of Standard & Poor's and Fitch. Moody's top three investment grade categories for long-term issuer credit ratings are Aaa, Aa, or A, with Aaa denoting the highest rating. Moody's applies numerical modifiers of 1, 2 and 3 in the Aa and A rating categories, with 3 denoting the lowest end of the letter-rating modifiers. Any rating from A-3 to Aaa would satisfy the long-term issuer credit rating requirement; a rating of A-3 would be the lowest acceptable rating in the case of Moody's.

The long-term issuer credit rating assigned large banks generally is identical to the rating given the bank's senior long-term unsecured debt, where such rated debt exists. Furthermore, representatives of rating organizations have indicated that the rating given to a specific long-term unsecured financial obligation of an issuer is anchored to the issuer's long-term issuer credit rating because the latter rating exemplifies the issuer's fundamental creditworthiness over the long-term. For these reasons, the Board and Treasury believe that long-term issuer credit ratings that meet the requirements of the rule are comparable to, and consistent with, the debt rating requirement of section 121.

The Board and Treasury intend to monitor the criteria used by Standard & Poor's, Moody's and Fitch in assigning ratings to ensure that the ratings and rating categories listed above remain comparable to, and consistent with, the debt rating requirement of section 121. In addition, the Board and Treasury will monitor developments in the ratings industry to see whether additional types of ratings assigned by the rating organizations listed above or by other rating organizations may in the future be determined to be comparable to, and consistent with, the debt rating requirement of section 121. The Board and Treasury may modify the listing of ratings that meet the requirements of the rule as appropriate.

Regulatory Flexibility Act Analysis

The rule applies only to national banks and state member banks that are within the second 50 largest insured banks. Accordingly, the final rule is not expected to have a significant economic impact on a substantial number of small entities, as defined in the Regulatory Flexibility Act (5 U.S.C. §§ 601 et. seq.).

Executive Order 12866 Determination

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

List of Subjects

12 CFR Part 208

Administrative practice and procedure, Federal Reserve System, Banks.

12 CFR Part 1501

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements.

Federal Reserve System

12 CFR Chapter II

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

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

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

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

2. Section 208.71(c) is amended to read as follows:

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

* * * * *

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

3. Section 208.77(e) is amended to read as follows:

§ 208.77 Definitions.

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

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By order of the Board of Governors of the Federal Reserve System,
January 19, 2000.

(Signed) Jennifer J. Johnson

Jennifer J. Johnson,
Secretary of the Board.

Department of the Treasury

12 CFR Chapter XV

Authority and Issuance

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

PART 1501 – FINANCIAL SUBSIDIARIES

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

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

2. Section 1501.3 is amended to read as follows:

SECTION 1501.3 - Comparable ratings requirement for national banks among the second 50 largest insured banks

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

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

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

Dated: January 19, 2001

(Signed) Gregory A. Baer

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