

FEDERAL RESERVE SYSTEM

Citigroup Inc.
New York, New York

Order Determining That Certain Pension Activities are Financial in Nature

Citigroup Inc. (“Citigroup”), a financial holding company (“FHC”) within the meaning of the Bank Holding Company Act (“BHC Act”),¹ has proposed to acquire, manage, and operate in the United Kingdom defined benefit pension plans established and maintained by unaffiliated third parties (“third-party U.K. pension plans”). These activities would be conducted by or through a nonbank subsidiary of Citigroup. Citigroup proposes to acquire third-party U.K. pension plans in stand-alone transactions and not as part of the acquisition of all or part of the ongoing business operations of the third parties.

Section 4 of the BHC Act generally prohibits a bank holding company, including an FHC, from directly or indirectly engaging in, or acquiring the shares of a company engaged in, any nonbanking activity unless the activity is otherwise permissible under the act. Section 4(k) of the BHC Act, as amended by the Gramm-Leach-Bliley Act (“GLB Act”), permits a bank holding company that qualifies to be an FHC to engage in, and acquire and retain shares of any company engaged in, a broad range of activities that are defined by statute to be financial in nature.² The BHC Act also permits an FHC to engage in, and acquire and retain shares of any company engaged in, any activity that the Board determines, by order or regulation and in consultation with the Secretary of the Treasury, to be financial

¹ 12 U.S.C. §§ 1841 et seq.

² See 12 U.S.C. § 1843(k)(4).

in nature or incidental to a financial activity.³ As the Board previously has noted, the “financial in nature or incidental” standard represents a significant expansion of the “closely related to banking” standard that the Board previously was required to apply in determining the permissibility of nonbanking activities for bank holding companies.⁴

The BHC Act directs the Board to consider a variety of factors in considering whether an activity is financial in nature or incidental to a financial activity, including: (1) the purposes of the BHC and GLB Acts; (2) the changes or reasonably expected changes in the marketplace in which FHCs compete; (3) the changes or reasonably expected changes in technology for delivering financial services; and (4) whether the proposed activity is necessary or appropriate to allow an FHC to compete effectively with companies seeking to provide financial services in the United States, efficiently deliver financial information and services through the use of technological means, and offer customers any available or emerging technological means for using financial services or for the document imaging of data.⁵ The Board also may consider other factors and information that it considers relevant to its determination.

As noted above, Citigroup proposes to acquire, manage, and operate third-party defined benefit pension plans in, and subject to the laws of, the United Kingdom. Citigroup initially proposes to acquire, through a nonbank

³ Id. at § 1843(k)(1)(A) and (2). In addition, the BHC Act permits an FHC to engage in any activity that the Board (in its sole discretion) determines, by regulation or order, is “complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.” Id. at § 1843(k)(1)(B).

⁴ See 66 Federal Register 307, 308 (Jan. 3, 2001).

⁵ 12 U.S.C. § 1843(k)(3).

subsidiary, a third-party pension plan in the United Kingdom with approximately \$400 million in gross liabilities to the plan's existing beneficiaries.

A defined benefit pension plan generally is a plan established by or on behalf of an employer (the plan "sponsor") that provides for the payment to employees, typically beginning on their retirement or other termination of service, of benefits in an amount that is specified in and determinable under the plan, typically through a formula that takes into account the employee's pay, years of employment, age at retirement, and other factors.⁶ The terms of the plan itself also typically specify the circumstances under which benefits will be paid under the plan to an employee, former employee, or related person (such as a spouse) (collectively a "beneficiary"), and the length of time such payments will be made to a beneficiary. The benefits payable under a plan typically take the form of a specified stream of payments that begin on retirement or, at the employee's option, a lump sum payable at retirement, and may include other ancillary benefits provided under plan rules, such as spousal or survivor benefits.⁷

The nonbank subsidiary of Citigroup that directly acquires a third-party U.K. pension plan would assume the responsibilities of the plan's sponsor under applicable U.K. law. In the United Kingdom, defined benefit pension plans are regulated by the U.K. Pensions Regulator under the Pensions Act of 1995, the Pensions Act of 2004, and the general law of trusts. These laws provide that

⁶ On the other hand, a defined contribution plan is a benefit plan under which an individual account is established for each participant and the benefits payable to each participant are based on the amount contributed to the participant's account, plus or minus income, gains, expenses, and losses allocated to that account.

⁷ For purposes of this order, the term "defined benefit pension plan" does not include a plan that provides health insurance to employees or that guarantees or indemnifies employees for health care costs.

pension plans must be managed and administered by a trustee that is independent of the plan sponsor. Plan sponsors also must provide sufficient assets to a pension plan to pay all benefits under the plan,⁸ consult with the trustees for the pension plan concerning the investment strategy of the plan, and agree with the plan trustees on a statement of funding principles that sets out the plan's funding target, methods, and assumptions. In addition, trustees and plan sponsors must agree on amendments to any part of the plan.

Citigroup proposes to acquire a third-party U.K. pension plan only if no additional beneficiaries may be added to the plan and existing beneficiaries may not accrue additional benefits under the plan (a "hard-frozen" plan). In addition, Citigroup proposes that it would acquire a third-party U.K. pension plan only if the plan at the time of acquisition is fully funded by the selling sponsor based on the plan's assets and projected liabilities (using appropriate actuarial assumptions).⁹ Citigroup has indicated that, as part of its due diligence process for each transaction, Citigroup will employ qualified actuaries to review and analyze the present value of benefits owed to plan beneficiaries to ensure that all pension plans acquired are fully funded by the selling sponsor.

The activity of acquiring, operating, and managing third-party pension plans has not been determined to be financial in nature or incidental to a financial

⁸ On the other hand, the sponsor may recover assets contributed to or held on behalf of a plan after all of the plan's obligations to beneficiaries have been satisfied and the plan is closed out.

⁹ For purposes of this order, the term "fully funded" means that, at the time of acquisition, the current value of the plan's assets is at least equal to the present value of the plan's projected liabilities. The selling sponsor may issue debt to the plan or Citigroup to fully fund the plan at acquisition. In some situations, the requirement of this order that a plan be fully funded may require funding in excess of the statutory funding requirements of the relevant jurisdiction.

activity for purposes of the BHC Act. The proposed activity is broader than the pension plan activities that FHCs currently are permitted to conduct for third parties. For example, as discussed above, a nonbank subsidiary of Citigroup would assume the rights and obligations of the sponsor of an acquired third-party U.K. pension plan and would do so in transactions that do not represent the acquisition of a going concern or ongoing business operations by Citigroup. In addition, the assets and liabilities of an acquired third-party U.K. pension plan (unlike assets held by an FHC as trustee for third parties or assets held by the pension plans maintained for Citigroup's own employees) would be fully consolidated with the assets and liabilities of Citigroup on its balance sheet.¹⁰

The Board concludes for the reasons set forth below, however, that there is a reasonable basis for determining that the acquisition, management, and operation by Citigroup of hard-frozen, fully funded third-party U.K. pension plans is an activity that is financial in nature within the meaning of the BHC Act. The activity involves, at its core, the types of investment advisory and investment management skills that are routinely exercised by banking organizations and the types of operational and investment risks that banking organizations routinely incur and manage.

¹⁰ Because Citigroup would acquire each third-party U.K. pension plan in a stand-alone transaction, and not as part of a business combination involving Citigroup and the selling sponsor, Citigroup has stated that it will fully reflect the assets and liabilities of an acquired plan as assets and liabilities of Citigroup on its balance sheet. This treatment differs from the manner in which the assets and liabilities of an internal pension plan of an employer typically are accounted for on the balance sheet of the employer under U.S. generally accepted accounting principles. See FAS 158, Accounting for Defined Benefit Pension and Other Post Retirement Plans.

FHCs currently are permitted by the BHC Act to engage in activities that are related or operationally and functionally similar to the proposed activity and that involve similar risks. For example, an FHC already is permitted to provide a wide variety of services to third-party pension plans, including acting as trustee, custodian, or investment adviser (with or without investment discretion) for a third-party benefit plan, as well as designing, assisting in the implementation of, providing administrative services to, and developing employee communication programs for third-party benefit plans.¹¹ FHCs engaged in these activities have gained substantial expertise with the laws, regulations, and fiduciary obligations associated with providing fiduciary, custodial, and administrative services to pension plans. Moreover, FHCs engaged in these plan-related activities have developed risk-management systems and internal controls to monitor, manage, and address the legal, operational, and reputational risks associated with managing the investments of and administering third-party pension plans.

The proposed activity also bears a strong functional resemblance to issuance of a group annuity contract. The BHC Act, as amended by the GLB Act, expressly states that providing and issuing annuities is an activity that is financial in nature.¹² A company that issues a fixed annuity becomes obligated to make periodic payments to the annuitant during his or her lifetime and to pay any death or survivor benefits in accordance with the terms of the annuity contract. The company that issues a fixed annuity assumes responsibility for investing and managing the funds received from the annuitant and bears the risk that such funds and the returns earned on the funds will not be sufficient to pay out the full amount

¹¹ See 12 CFR 225.28(b)(5), (6), and (9)(ii).

¹² See 12 U.S.C. § 1843(k)(4)(B).

of benefits promised under the annuity contract. The company also assumes responsibility for administering the annuity contract both before and during its payout period.

In connection with these activities, the issuer of fixed annuities is exposed to certain types of risks, which are part of the activity determined to be financial in the GLB Act. These risks include the risk that (1) the life expectancy of annuitants, on average, will exceed the actuarial estimates used in establishing the terms of and funding for the annuities; (2) the inflation rate and other assumptions used to determine the expected obligations under the annuity contracts underestimate these obligations; and (3) payments from the annuitant and the return obtained through the investment of such payments will fall short of estimates.

Citigroup would perform essentially the same financial functions and assume essentially the same financial obligations and risks through the acquisition of a third-party U.K. pension plan as an insurance company performs and assumes in connection with the issuance of fixed annuities. The functional similarity between a plan sponsor's obligations under a defined benefit pension plan and an insurance company's obligations under an annuity contract is especially close where, as proposed, the pension plan is both fully funded and hard-frozen. In situations where a pension plan's obligations to plan beneficiaries are hard-frozen and the plan is fully funded, one method commonly used by a plan sponsor to close out a plan is to purchase a terminal funding group annuity contract from an insurance company. Through such an annuity contract, the provider of the annuity becomes obligated to satisfy the responsibility to pay the benefits promised under the plan to the plan's beneficiaries. Accordingly, Citigroup's proposed activities would be specifically permitted under the BHC Act if provided through an annuity

contract or other form of insurance. By permitting Citigroup to provide these services in an alternative way, the proposed activities should help Citigroup respond to changes or reasonably expected changes in the marketplace for financial products and services.

In evaluating this proposal, the Board considered that, under U.K. law, the nonbank subsidiary established by Citigroup to acquire a third-party U.K. pension plan generally will bear sole responsibility for making additional contributions to the plan if the plan assets are not sufficient to meet the plan's expected or actual liabilities. However, U.K. law also permits the U.K. Pensions Regulator in certain circumstances to commence proceedings to hold an affiliate of a plan sponsor (including a depository institution affiliate) responsible for the sponsor's obligations to the plan.¹³

The Board generally has taken the position that, when a depository institution is secondarily liable for a financial obligation of an affiliate, even if the depository institution's liability is created by statute or regulatory action, the institution has issued a guarantee on behalf of an affiliate for purposes of section 23A of the Federal Reserve Act and the Board's Regulation W.¹⁴ Section 23A and Regulation W impose quantitative and qualitative limits on covered transactions between a depository institution and its affiliates. Covered

¹³ See U.K. Pensions Act of 2004, § 38 (contribution notices) and § 43 (financial support directives). The U.K. Pensions Regulator may issue a contribution notice or financial support directive to an affiliate of a sponsor only if, among other things, the Pensions Regulator determines that it is reasonable to impose the proposed financial obligations on the affiliate.

¹⁴ See 12 U.S.C. § 371c(b)(7)(E); 12 CFR 223.3(h)(5); Board Letter dated October 25, 2005, to Carl V. Howard, Esq. (Citigroup).

transactions include, among other things, an extension of credit by a depository institution to an affiliate and the issuance of a guarantee by a depository institution on behalf of an affiliate.¹⁵ The limitations in section 23A and Regulation W provide important protections against a depository institution suffering losses due to covered transactions with its affiliates, and also limit the ability of a depository institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net.

To address the potential section 23A and Regulation W issues presented by its initial proposed transaction, and in accordance with U.K. law,¹⁶ Citigroup has obtained written assurances from the U.K. Pensions Regulator that it will not seek to hold any of Citigroup's depository institution subsidiaries that are subject to section 23A responsible for any shortfalls that may occur in the pension plan proposed to be acquired by Citigroup in this initial transaction. As a condition of this order, Citigroup must obtain similar written assurances from the U.K. Pensions Regulator before acquiring any additional third-party U.K. pension plan.¹⁷

¹⁵ See 12 U.S.C. § 371c(b)(7); 12 CFR 223.3(h).

¹⁶ The Pensions Act of 2004 expressly authorizes the U.K. Pensions Regulator, on application by a plan or other person, to issue a "clearance statement" that determines that it would be unreasonable to issue a contribution notice or financial support directive to the plan or person under the circumstances described in the application. See Pensions Act of 2004, §§ 42 and 46. Citigroup has received such a clearance statement with respect to its initial proposed acquisition of a third-party pension plan in the United Kingdom.

¹⁷ Citigroup has indicated that the written assurances provided by the U.K. Pensions Regulator are subject to review and renewal by the regulator no later than five years after issuance. Before the expiration of any written assurances provided by the U.K. Pensions Regulator in connection with the acquisition by Citigroup of a third-party U.K. pension plan, Citigroup must either ensure that its activities conform with those permitted under section 23A and Regulation W or obtain an exemption from the Board from the limitations of section 23A and Regulation W with respect to the plan. The Board has not

Based on the foregoing and other facts of record, the Board concludes that the acquisition, management, and operation by Citigroup of hard-frozen, fully funded third-party U.K. pension plans, when conducted in accordance with the conditions and limitations set forth in this order, is an activity that is financial in nature within the meaning of section 4(k) of the BHC Act. Any investment made by a third-party U.K. pension plan acquired by Citigroup must otherwise be permissible for an FHC under the BHC Act and the Board's Regulation Y.¹⁸ The statutory and regulatory framework governing the establishment, operation, and management of pension plans varies considerably across jurisdictions and, accordingly, the nature and scope of risks associated with such activities may differ materially depending on the jurisdiction involved.¹⁹ To provide for the

determined that section 23A applies to the contingent liabilities that may arise under applicable pension law from the establishment or operation by an affiliate of a depository institution of employee benefit plans in the ordinary course of its other business to provide benefits to the employees or former employees of the affiliate.

¹⁸ See, e.g., 12 U.S.C. § 1843(c)(5), (c)(6), and (k)(4)(H).

¹⁹ In the United States, for example, the establishment and operation of defined benefit pension plans are subject to extensive regulation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). See 29 U.S.C. §§ 1400 et seq. ERISA provides that all entities under common control with the sponsor of a defined benefit plan are jointly and severally liable for the obligations of the plan at termination. For ERISA purposes, companies under common control with a plan sponsor include any company that directly or indirectly owns 80 percent or more of the voting stock of the plan sponsor (the "parent company") and any company in which the parent company directly or indirectly owns 80 percent or more of the voting stock. See 29 U.S.C. §§ 1301(a)(14)(A) and (B), (b)(1), and 1362(a); 26 CFR 1.414(c)-2.

consideration of any special issues that may be associated with the acquisition of third-party pension plans in jurisdictions other than the United Kingdom, the authorization and determination granted by this order are limited to the acquisition, management, and operation by Citigroup of third-party pension plans in the United Kingdom.²⁰

Under the BHC Act, the Board may not determine, by regulation or order, that an activity is financial in nature or incidental to a financial activity if the Secretary of the Treasury (“Secretary”) notifies the Board in writing that the Secretary believes the activity is not financial in nature, incidental to a financial activity, or otherwise permissible under section 4 of the BHC Act.²¹ The Board has provided the Secretary notice of Citigroup’s proposal in accordance with the BHC Act, and the Secretary has informed the Board in writing that the Secretary does not intend to prevent the Board from authorizing Citigroup to engage in the proposed U.K. pension activities, subject to the conditions and limitations set forth in this order.

The Board’s determination and approval is subject to all the conditions set forth in Regulation Y, including those in section 225.7,²² and to the Board’s authority to require modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions and purposes

²⁰ Other FHCs may seek approval to engage in similar activities by requesting a determination with respect to their own proposed activities under section 4(k)(2)(A) of the BHC Act and section 225.88 of the Board’s Regulation Y (12 CFR 225.88).

²¹ See 12 U.S.C. § 1843(k)(2)(A).

²² 12 CFR 225.7.

of the BHC Act and the Board's regulations and orders issued thereunder. The Board's decision is specifically conditioned on compliance with all the commitments made to the Board in connection with the request, including the commitments and conditions discussed in this order. The commitments and conditions relied on in reaching this decision shall be deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors,²³ effective October 12, 2007.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

²³ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.