



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

September 5, 1990

DALLAS, TEXAS 75222

Circular 90-65

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Request for Comment on Proposed Revisions to Regulation K

DETAILS

The Federal Reserve Board has requested public comment on proposed revisions to Regulation K (International Banking Operations). Comment is requested by September 30, 1990.

The proposed revisions would liberalize the authority of U.S. banking organizations to engage in underwriting and dealing in equity securities outside the United States. The current limits under which U.S. banking organizations may make investments abroad without prior notice to the Board would be increased. The proposals would also restructure authority to invest in any type of company outside the United States and would expand the list of permissible non-U.S. activities. The Board has requested comment on ways to expand the list of customers to which Edge corporations may provide full booking services in the United States. Finally, the revisions clarify the criteria for granting exemptions to certain foreign banking organizations.

The International Banking Act requires the Board to review its regulations with respect to Edge corporations at least every five years to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions and banking practices. Edge corporations are corporations chartered to engage in international or foreign banking or other international or foreign operations. In connection with this review, the Board has reviewed all of Regulation K governing international banking operations.

ATTACHMENT

The Board's notice as it appears on pages 32424-42, Vol. 55, No. 154, of the Federal Register dated Thursday, August 9, 1990, is attached.

MORE INFORMATION

For more information, please contact Linda Myers at (214) 744-7435. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

A handwritten signature in cursive script that reads "William H. Wallace".

For additional copies of any circular, please contact the Public Affairs Department at (214) 651-6289. Bankers and others are encouraged to use the following toll-free number in contacting the Federal Reserve Bank of Dallas: (800) 333-4460.

FEDERAL RESERVE SYSTEM**12 CFR Parts 211 and 265**

[Docket No. R-0703]

Regulation K—International Banking Operations; Rules Regarding Delegation of Authority**AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Proposed rule.

SUMMARY: The International Banking Act of 1978 (Pub. L. 95-369) (the "IBA") requires the Board to review and revise its regulation governing the operation of Edge corporations 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 purposes of the Edge Act include enabling U.S. banking organizations to compete effectively with foreign-owned institutions and stimulating competition in the provision of international banking and financing services throughout the United States. The IBA requires the Board to consider these goals consistent with supervisory standards relating to the safety and soundness of U.S. banking organizations. As a result of its review under this provision, the Board is proposing for comment a number of changes to Regulation K, 12 CFR part 211. Changes are proposed to the provisions governing permissible foreign activities of U.S. banking organizations, including securities activities; investments by U.S. banking organizations under the general consent procedures and portfolio investments; qualified business entities to whom Edge corporations may provide full banking services in the United States; and case-by-case exemptions from the standard for qualifying foreign banking organizations. In addition, there are proposed technical and clarifying amendments to Regulation K and certain amendments to the Board's Rules Regarding Delegation of Authority, 12 CFR part 265.

DATES: Written comments must be submitted to the Board on or before September 30, 1990.

ADDRESSES: All comments, which should refer to Docket No. R-0703, should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to room B-2233, 20th and Constitution Avenue, NW., Washington, DC, between the hours of 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Ricki Rhodarmer Tigert, Associate General Counsel (202/452-3428), Kathleen M. O'Day, Managing Senior Counsel (202/452-3786), Kimberly A. Lynch, Attorney (202/452-3584), Legal Division; or Michael G. Martinson, Assistant Director (202/452-3640), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The IBA requires the Board to review and revise its rules issued under section 25(a) 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 the light of prevailing economic conditions and banking practices. Edge corporations are international banking and financial vehicles through which U.S. banking organizations offer international banking services and through which they compete with similar foreign-owned institutions in the United States and abroad. The purposes of the Edge Act include enabling U.S. banking organizations to compete effectively with foreign-owned institutions and stimulating competition in the provision of international banking and financing services throughout the United States. The IBA requires the Board to consider these goals consistent with supervisory standards relating to the safety and soundness of U.S. banking organizations.

Regulation K was last fully reviewed and revised in 1985. The changes included authorizing Edge corporations to provide full banking services in the United States to certain qualified business entities; raising the lending limit for Edge corporations; implementing change on control procedures for Edge corporations; liberalizing the investment procedures; and expanding the list of permissible foreign activities. As a result of the current review, the Board has determined that certain of these areas

could be further revised. In addition, certain provisions that were not changed in 1985 warrant revision as well. The areas with respect to which the Board proposes revisions are: (1) The expansion of permissible foreign activities of U.S. banking organizations, including securities activities; (2) investments by U.S. banking organizations under the general consent procedures; (3) portfolio investments by U.S. banking organizations; (4) qualified business entities to which Edge corporations may provide full banking services in the United States; (5) case-by-case exemptions from the standard for qualifying foreign banking organizations; and (6) certain technical and clarifying amendments.

Permissible Foreign Activities

Under the Edge Act and the Bank Holding Company Act ("BHC Act"), the Board has authority to permit Edge corporations and bank holding companies to engage indirectly in a wider range of nonbanking activities outside the United States than is permitted domestically. Under the regulatory standard, the Board may authorize any activities that it finds to be "usual in connection with the transaction of banking or other financial operations abroad," provided the activity is consistent with maintaining the safety and soundness of U.S. banking organizations. Section 211.5(d) of Regulation K currently includes a list of activities that the Board has determined to meet this standard and therefore to be permissible for foreign subsidiaries of U.S. banking organizations. The list includes a number of activities not permitted domestically and also by its terms incorporates any activities that are permissible under Regulation Y, 12 CFR part 225. In addition to the list of permissible activities, the Board also considers applications on a case-by-case basis to engage in other activities abroad.

Securities Activities*Current Restrictions on Securities Activities*

Since 1979, Regulation K has explicitly authorized foreign subsidiaries of both U.S. banks and bank holding companies to underwrite and deal in equity securities outside the United States. The authority is provided currently by § 211.5(d)(13) of the regulation. Regulation K places no dollar limit on underwriting and dealing in debt

securities.¹ Regulation K currently places three restrictions on underwriting equity securities:

1. A subsidiary may underwrite not more than \$2 million of equity securities of one issuer in a given issue.
2. A banking organization using multiple foreign underwriting subsidiaries on a consolidated basis may not at any time have outstanding net commitments to underwrite more than \$15 million of equity securities of one issuer.
3. A banking organization also may not underwrite on a consolidated basis more than 20 percent of the voting shares or capital and surplus of any one issuer.

In addition, Regulation K restricts the ownership by U.S. banking organizations of shares of nonbank companies and applies these restrictions to securities held in dealing accounts as well as to securities held as investments. Three restrictions apply to the ownership of nonbank shares, whether held as investments or in dealing accounts:

1. A banking organization may not hold overnight on a consolidated basis more than \$15 million of the equity securities of any one issuer.
2. A banking organization may not hold on a consolidated basis more than 20 percent of the voting shares of any one issuer.
3. The total dollar amount of equity securities of companies engaged in impermissible activities may not exceed 100 percent of the capital and surplus of the investor, which may be a bank holding company, Edge corporation, or foreign bank subsidiary, depending upon which entity holds the securities company.

Proposed Revisions

Most of the restrictions on the equity securities activities of U.S. banks and bank holding companies result from the parallel that has developed historically between the limits applied under Regulation K's investment procedures and those applied to underwriting and dealing in equity securities abroad. For example, the \$15 million aggregate limit on underwriting and dealing in the equity securities of one issuer derived from the \$15 million limit on investments that may be made without prior notice to the Board under the general consent procedures. Similarly, the 20 percent limitation on underwriting or holding the equities of one issuer in a trading account is tied to the limitation on permissible "portfolio" investments of up to 20 percent of the shares of a company.

¹ With respect to debt securities activities conducted through a subsidiary of a bank, any underwriting commitments to a company, or securities of a company held in a trading account, when combined with all other loans to the same company, may not exceed the parent bank's single borrower lending limit.

These limits have imposed constraints on U.S. banking organizations in relation to their foreign competitors. The \$15 million limit has been a barrier to extensive foreign equity securities activities by U.S. banking organizations. In addition, the 20 percent limit on underwriting equity securities has effectively prevented U.S. banking organizations from participating in initial public offerings ("IPOs") of a company's shares, which are often not syndicated because of their relatively small size.

To alleviate these constraints the Board is seeking comment on whether it is appropriate to separate most of the limitations applicable to underwriting and dealing in equity securities abroad from the limitations applicable to the investment procedures. Accordingly, the Board proposes the following revisions to Regulation K's authority for equity securities activities.

Underwriting Limit

The Board proposes to raise the underwriting limit, on a consolidated basis, to the lesser of \$60 million or 25 percent of the investor's Tier 1 capital.² Moreover, the Board proposes to eliminate the per subsidiary limitation of \$2 million. The 25 percent limit proposed by the Board is analogous to the single borrower lending limit applicable to national banks for secured and unsecured lending to one borrower. In view of the absolute size of the proposed 25 percent limit for larger banking organizations, the Board proposes to cap the limit at \$60 million. These limits would not include any underwriting commitments made by a section 20 company, that is, a subsidiary of the bank holding company that is authorized to underwrite equity securities under section 4(c)(8) of the BHC Act.

Underwriting commitments or securities acquired in the course of an underwriting would not be considered "investments" during the underwriting period and would not be subject to a prior notice requirement for amounts above the general consent limit or the 20 percent limitation of the portfolio investment authority. However, the Board proposes that 30 days after the close of the underwriting period any securities acquired as part of an underwriting would be subject to the dealing limits discussed below. Accordingly, a foreign subsidiary of a U.S. banking organization would be able

² As in the current regulation, the investor could be the bank holding company, an Edge corporation, or member bank, depending on which is the closest parent to the foreign company. See 12 CFR 211.2(j).

to underwrite up to 100 percent of an issuer's equity securities as part of an underwriting provided that the subsidiary divests any securities acquired as part of the underwriting to an otherwise permissible level under Regulation K within 30 days of the acquisition of the shares. Normally, the Board would expect a U.S. banking organization to have sufficient prior subunderwriting or purchase commitments to ensure that it was not required to acquire shares in excess of the dealing position limits. Moreover, underwriting commitments for equity securities of nonfinancial companies would be included in the aggregate limit on equity securities of companies.

The Board seeks comment on whether to permit banking organizations on a case-by-case basis to commit to underwrite equity securities in amounts greater than \$60 million, where the banking organization would remain strongly capitalized after the excess amount above the \$60 million underwriting limit is deducted from parent capital. In addition, where the underwriting subsidiary is a subsidiary of a bank, the Board requests comment on whether the parent bank holding company should be required to guarantee its subsidiary bank against any losses suffered by the subsidiary on underwriting commitments made in excess of the Regulation K limits.

Dealing Limits

The Board proposes that the limit relating to equity securities of any one issuer held in trading or dealing accounts be raised from \$15 million to the lesser of \$30 million or 10 percent of the investor's Tier 1 capital. The proposed dealing limits are lower than the proposed underwriting limits because underwritings are generally short term and because they rarely fail in their entirety. Equity of the same organization held in investment accounts would be included in determining compliance with the \$30 million limit.

The Board proposes to apply the \$30 million dealing limit on a net basis, that is, long positions in a security could be offset by contracts to sell the same security. The Board will also consider whether it would be appropriate to permit some allowance for hedging a position in a security through exchange-traded options and futures contracts for the purchase or sale of the same security. The Board, however, does not propose to allow a full offset for such instruments because of the risks associated with using derivative products to hedge a position.

Accordingly, the Board requests comment on the methods for allowing some offset in these circumstances and on the appropriate percentage of the value of a security that could be offset by futures or options contracts for the sale of the security.

The Board proposes to retain the other existing limitations applicable to dealing accounts. Under those limitations an investor may hold up to 20 percent of a single issuer's shares in a dealing account. In addition, the aggregate value of equity shares held in a dealing account, after giving any appropriate credit for hedging, will be aggregated with portfolio investments in nonfinancial companies held in the investment account and with any outstanding underwriting commitments for equity securities of nonfinancial companies, and the total value of such shares and commitments may not exceed 100 percent of the investor's capital. The Board believes that retention of the 20 percent restriction would promote appropriate diversification in the dealing account and prevent the banking organization from exercising control over a nonbank company. The 20 percent limit has been a significant constraint in underwriting IPOs but not more generally in conducting dealing activities.

The aggregate limit of 100 percent appears adequate to accommodate equity holdings in nonbank companies and would not appear to be imprudent in the case of investors that are Edge corporation and foreign bank subsidiaries of a bank, because the capital of these investors is already a fraction of the bank's capital. In the case of bank holding companies, however, the ceiling of 100 percent of capital that may be held in equity securities of nonbank companies appears excessive. The Board therefore proposes that the aggregate limit for bank holding companies be reduced to 25 percent of capital, which should be more than adequate to accommodate dealing positions. The Board requests comment on this proposal in particular from any banking organizations as to which an aggregate limit for bank holding companies of 25 percent of capital would significantly constrain current activities.

In addition, to address the concern that certain organizations may not have the expertise to underwrite and deal in equity securities at levels relative to their capital, the Board requests comment on its proposal to require any banking organizations not currently engaged in equity securities underwriting and dealing to file an

application with the Board the first time a subsidiary of the organization proposes to engage in the activity abroad. Such an approach would permit supervisory review of internal controls and limits on equity securities underwriting and dealing to ascertain whether they are consistent with the size and condition of the banking organization.

Life Insurance Underwriting

Currently, the § 211.5(d) includes authority for U.S. banking organizations to underwrite credit life, accident, and health insurance abroad. In addition, the Board has approved by order on a case-by-case basis a number of applications for U.S. banking organizations to engage in insurance underwriting activities in a number of countries.³ The Board has determined that the underwriting of actuarially predictable risks does not present undue risks to the banking organization where prudent investment and other management controls are employed.⁴ Thus, the Board proposes to add underwriting of life insurance and similar types of insurance for which the risks are actuarially predictable to the list of permissible activities in Regulation K.

The Board has, however, stated a strong preference that insurance underwriting activities, and other activities which are not traditional banking activities in the United States, be conducted in a separate subsidiary of the holding company in order to protect affiliated banks from adverse effects associated with the conduct of those activities.⁵ The Board has generally approved applications to engage in the underwriting of life and similar insurance risks only through subsidiaries of bank holding companies.

Thus, the Board proposes that the general authority to engage in life insurance underwriting be limited to subsidiaries of bank holding companies.

³ Specifically, the Board has approved: (1) Underwriting life insurance in the United Kingdom, Federal Republic of Germany and Australia; (2) underwriting credit insurance not directly related to extensions of credit by affiliates, savings completion insurance, and home loan life insurance and endowment life insurance related to mortgage lending activities of affiliates, in Belgium and Luxembourg; (3) underwriting pension fund-related insurance and disability insurance in connection with Chilean mandated worker pensions; (4) underwriting retirement-related life insurance in Argentina; and (5) underwriting health insurance in the United Kingdom.

⁴ The Board denied an application by a U.S. bank to engage in property and casualty insurance underwriting because the risks were not actuarially predictable. See Citibank Overseas Investment Corporation, 71 Federal Reserve Bulletin 808 (1985).

⁵ See Letter from Chairman Volcker, dated August 23, 1985.

Moreover, the Board proposes that bank holding companies should be required to deduct from their capital investments in and unsecured extensions of credit to such companies. A banking organization may apply to the Board for specific approval to conduct insurance activities through a subsidiary of the bank. In acting on such applications, the Board may require such conditions or restrictions as it considers necessary to prevent adverse effects and promote the safety and soundness of the parent bank.

Futures Commission Merchant Activities

Section 211.5(d)(15) of Regulation K, by incorporating Regulation Y, authorizes a banking organization to act as a futures commission merchant abroad with respect to certain financial instruments. In September 1982, however, the Board suspended the operation of the general consent procedures of Regulation K with respect to FCM activities conducted on exchanges outside of the United States. This action was taken so that the Board would have the opportunity to examine the rules of the exchanges on which U.S. banking organizations would be conducting FCM activities. The Board was concerned with the risk associated with exchanges on which members mutually guarantee each other's liabilities either directly or through mandatory assessments by a guaranty fund, and, in particular, with exchanges that require the parent corporation of the investor, as well as the investor itself, to provide a guarantee.

The Board has had the opportunity to examine the rules of various exchanges abroad since 1982 and has approved FCM activities on numerous exchanges.⁶ Accordingly, the Board proposes to lift the suspension of general consent authority for FCM activities on exchanges that the Board has previously approved.

FCM activities on exchanges that the Board has not examined will continue to be subject to specific approval procedures. In addition, potential risks to Edge corporation and foreign bank subsidiaries and their U.S. bank parents

⁶ The Board, under Regulation K, has approved FCM activities for certain bank holding companies on the London Gold Futures Market, the London International Financial Futures Exchange, the Singapore International Monetary Exchange, the Sydney Futures Exchange, the Tokyo Stock Exchange, the Marche a Terme d'Instruments Financiers, the Hong Kong Futures Exchange, the Bolsa Mercantile & de Futuras Exchange, the Bolsa de Mercadorias de Sao Paulo, the Bolsa Brasileira de Futuros, the Amsterdam Financial Futures Market, the Tokyo International Financial Futures Exchange, and the DTB Deutsche Terminborse.

presented by operations on mutual exchanges continue to be a source of concern, as do new untested nonfinancial instruments. Thus, the Board proposes to add FCM activities on exchanges that the Board has previously approved to the list of permissible activities in § 211.5(d), subject to the requirement that any activities by foreign subsidiaries of banks on mutual exchanges or any activities involving nonfinancial instruments or their derivatives continue to require the Board's prior approval.

Currency and Interest Rate Swaps

Banks in the United States may act as principals or agents in interest rate and foreign currency swap transactions and related swap derivative products. Although currency and interest rate swaps are not identified as a general banking power under the National Bank Act, the Comptroller of the Currency, under discretionary authority, has permitted such activities as incidental to banking powers. State member banks also engage in the activity as a power incidental to their state charter powers. Subsidiaries of U.S. banking organizations that are engaged in commercial or investment banking activities also engage in swap transactions as both principal and agent, again as incidental to their banking powers.

A significant number of foreign bank subsidiaries of U.S. banks have been engaging in swap transactions, acting as originator and principal, under incidental powers. The Board proposes to clarify the legal authority for a U.S. banking organization to engage in swap transactions through foreign subsidiaries by adding currency and interest rate swaps to the list of permissible activities in § 211.5(d) so that they may be conducted independently or any other banking activity.

General Consent Authority of the Investment Procedures

Categories of Investments

Regulation K generally provides for three types of investments abroad:

(1) A controlling interest in a *subsidiary* company that engages almost exclusively in permissible financial activities;

(2) A *joint venture* investment in 20 to 50 percent of the voting shares of a company over which actual control is not exercised by the investor, which may derive up to 10 percent of its business from impermissible activities; and

(3) A passive non-controlling *portfolio investment* in up to 20 percent of the voting

shares in any company, regardless of the nature of its business.⁷

Investment Procedures

Under § 211.5(c) of Regulation K, U.S. banking organizations may make investment in these types of companies under three procedures:

(1) An investment that qualifies under the *general consent* procedures may be made without prior review or approval, although after-the-fact reports on all investments must be made to Reserve Banks. Currently, to qualify under the general consent authority an individual investment may not exceed the lesser of \$15 million or 5 percent of the capital and surplus of the immediate investor, which is, the closest parent company and may be a bank holding company, a bank, or an Edge corporation engaged in banking. As discussed below, an "investment" Edge corporation may invest in the lesser of \$15 million or 25 percent of its capital and surplus.

(2) An investment in a permissible activity listed in section 211.5(d) that exceeds the limits under the general consent authority may be made after giving 45 days *prior notification* to the Board. The Board may waive that period or determine that the investment requires action under specific consent procedures.

(3) Any other investment, such as an investment in a subsidiary company engaged in an activity that is not of the list of permissible activities in section 211.5(d), requires the *specific consent* of the Board.

The general consent procedures were liberalized in 1985 when the maximum dollar amount for investments without prior notice to the Board was increased from \$2 million to \$15 million. The current general consent procedures currently permit individual investments in an amount equal to the lesser of \$15 million or 5 percent of the investor's capital, except where the investor is an "investment" Edge corporation⁸ in which case the alternative limit is 25 percent, instead of 5 percent, of capital.⁹

⁷ Section 211.5(f) of Regulation K provides special rules for debt-for-equity investments in heavily indebted countries.

⁸ An Edge corporation that accepts deposits in the United States is considered to be engaged in banking (a "banking Edge corporation"). See 12 CFR 211.2(d). An Edge corporation not engaged in banking itself is generally a holding company for foreign investments (an "investment Edge corporation"). Because investment Edge corporations are not themselves U.S. deposit-taking institutions, the investment limit based on the investment Edge corporation's capital has traditionally been higher.

⁹ Section 211.5(c) also authorizes additional investments of up to 10 percent of the investor's capital and surplus per year. This authority may be carried forward and accumulated for up to five years. Again, the investor is considered to be either an Edge corporation, member bank, or bank holding company, whichever is the closest parent to the foreign company in the line of ownership.

The investment procedures in Regulation K do not appear to pose a significant regulatory burden on U.S. banking organizations. Moreover, there does not appear to have been any diminution in the profile of risks associated with the international business of large U.S. banks during the past five years that would warrant a significant modification of supervisory procedures. In order to provide some room for additional investments under the general consent procedures for U.S. banking organizations that are active internationally, the Board proposes to raise the dollar limits applicable to the general consent authority from \$15 million to \$25 million. The Board believes this increase can be justified on the basis of the increases in Tier 1 capital since the last revision to Regulation K and of projected comparable increases in Tier 1 capital over the next five years. The general consent procedures would, however, be available only to banking organizations that meet minimum capital adequacy guidelines.

The growth in capital of multinational U.S. banking organizations over the past five years was slightly less than one-third. With a projection for similar growth over the next five years, the dollar limit would be increased to \$25 million. Further, the Board proposes to amend the percentage limitation to reflect the investor's Tier 1 capital level rather than the current standard of capital and surplus.

Under the proposed standard, bank holding companies, banks, and Edge corporations engaged in banking would be able to invest the lesser of \$25 million or 5 percent of their Tier 1 capital in a proposed investment, while investment Edge corporations would be able to invest the lesser of \$25 million or 25 percent of their Tier 1 capital. The proposed standards would give greater scope for investments abroad without prior Board review for the largest U.S. banking organizations that are most active internationally. Some of these organizations have indicated that an increase in the dollar amount limitation for the general consent procedures might enhance their competitiveness abroad as compared with foreign institutions not subject to similar restrictions on investments. At the same time, the proposed standards would permit prior Board review of a significant portion of the foreign investments of U.S. banking organizations to ensure that expansion abroad for particular banking organizations is consistent with concerns for the safety and soundness of affiliated banks.

Portfolio Investments

Section 211.5(b) of Regulation K permits a U.S. banking organization to make a passive portfolio investment in a company abroad without regard to the nature of its non-U.S. activities.

Investments in less than 20 percent of the voting shares of a company are permitted under the portfolio investment provision of Regulation K so long as the investor does not control the company.

This authority to make portfolio investments was originally granted in large part to make U.S. banking organizations more competitive with foreign organizations in providing venture capital financing to foreign companies, although the authority has not been limited to those circumstances. The ability of a U.S. banking organization to hold up to 20 percent of the voting shares of any kind of company has provided scope for such investments. In the past few years, however, U.S. banking organizations have sought to avoid the limitation on portfolio investments by expanding the scope of their interests in nonbanking companies through non-voting equity investments in addition to voting equity investments explicitly permitted under Regulation K in 19.99 percent of the shares of such companies. Although nonvoting shares are nominally preferred shares, they often have the same financial characteristics as common shares. In addition, the level of an investor's involvement in a company can be expected to increase with the level of the organization's ownership interest, and corresponding profit participation, in a company. The risks associated with these larger investments, along with financing commitments to these companies, require clarification in Regulation K of the acceptable limits of such investments.

Large equity investments, whether voting or nonvoting, tend to increase the financial and managerial responsibility of an investor in a company. Moreover, the potential for large returns on an equity investment may induce an investor to lend to a company on a less than arm's-length basis. The Board has taken the position that a substantial equity interest in a company—even if in nonvoting form—raises the potential for a control relationship to arise.

In the domestic context under Regulation Y, the Board has adopted a Policy Statement on Nonvoting Equity Investments by Bank Holding Companies, 12 CFR 225.143, in response to the development and increasingly pervasive use of nonvoting equity instruments. The policy statement

imposes a limit for noncontrolling investments of 25 percent of a company's total equity. The 25 percent ceiling was implemented both to limit an investor's ability to control a company through nonvoting shares and to impose prudential constraints upon the acquisition of nonvoting instruments.

The lack of a similar constraint on larger nonvoting equity investments under Regulation K has presented some problems. U.S. banking organizations have acquired total equity ownership interests of close to 50 percent in nonfinancial companies abroad by combining nonvoting equity interests with ownership of 19.9 percent of the voting shares. Such acquisitions, in addition to being structured to avoid the limits of the portfolio investment provision, have the effect of increasing the exposure of U.S. banking organizations to nonfinancial risk, especially where large equity holdings are combined with extensive financing of the company or partnership in which the investment is made. Recently, U.S. banking organizations have used their portfolio investment authority to leverage the potential return from leveraged buy-outs and real estate lending, thereby resulting in greater risk-taking. In some cases, it is apparent that the credit would not have been extended without the prospect of a large return on the equity holdings, raising the issue of whether the ability to hold large equity interests may impair impartial credit judgments. To address these concerns, the Board proposes to define appropriate limits to the scope of the portfolio investment authority.

Venture Capital and Other Small Investments

The proposed revisions to Republican K attempt to recognize that the portfolio investment provisions of Regulation K were originally promulgated to facilitate financing for start-up ventures. Venture capital financing is generally for smaller companies where the total capital and debt needs of the company are not large in absolute terms. Because the company is usually in a start-up position, traditional sources of bank credit may not be available. To accommodate such situations, the Board proposes to permit banking organizations to make investments in up to 40 percent of the equity of a company, of which up to 20 percent may be voting shares, as long as the aggregate amount of equity investments in and loans to the company does not exceed \$25 million, which is the proposed general consent amount. This proposed revision would apply to both venture capital financing and any other type of small investment.

Because the total exposure, equity and credit, to the company is limited, this type of investment should not cause the banking organization to assume significant risks at the prospect of earning a large equity return. The Board also requests comments on what additional requirements may be necessary to assure that an investor does not exercise control over a company in which it holds an equity interest of 40 percent.

Larger Portfolio Investments

Where investments and loans exceed \$25 million, the Board proposes to limit the total amount of equity that may be held as a portfolio investment in a nonfinancial company to no more than 24.9 percent of the company's equity. This limit would both reduce the potential for a control relationship to exist and place prudential constraints upon large equity stakes in nonfinancial companies. The limit would also be consistent with the standards applicable domestically and would establish a standard that a U.S. banking organization may easily follow. Where the equity holding is limited to 24.9 percent, loans or other extensions of credit to a company—except subordinated debt—would not generally be restricted, other than by normal prudential considerations, or aggregated with the investment in the company for purposes of complying with the general consent amount limitations.

In some situations, however, banking organizations have provided financing to companies in which they hold equity interests in forms that appear to have an equity component. For example, credit may be provided where the lending banking organization also receives warrants or debt obligations convertible into stock of the company or where the lender receives a percentage of the profits of the company. In addition, subordinated debt has sometimes been provided to companies in which the banking organization also holds equity shares. In some circumstances, the subordinated debt served, and was intended to serve, as equity. These types of credit would appear to raise the same issues as the direct holding of equity. Consequently, the Board requests specific comment on its proposal to include such forms of financing in the definitions of "equity" and "investment," for purposes of determining compliance with the equity percentage limitation and the general consent investment amount under Regulation K, and on how such forms of financing should be defined. If by including such financing as an

investment an investor were to exceed the general consent dollar amount limitation, the investor would merely be required to file a notice with the Board. The Board would consider establishing a procedure to review subordinated debt or profit participation loans where the investor also holds equity shares of the company to determine whether in the circumstances of a particular case they serve as the equivalent of equity, and requests comment on the form of and standards for such a procedure.

Aggregate Portfolio Investments Limits

Section 211.5(b) of Regulation K currently imposes an aggregate limit on portfolio investments. A bank holding company, bank, or Edge corporation investor may not invest more than the equivalent of 100 percent of its capital and surplus in equity securities of nonbanking companies. This limit includes equity securities held in dealing accounts. As discussed in the context of securities activities, the Board requests comment on its proposal to lower the aggregate limit on portfolio and certain other equity holdings to 25 percent of the investor's capital and surplus where the investor is a bank holding company. This lower limit appears appropriate because of the adverse effect that fluctuation in the value of a relatively large equity portfolio could have on the capital of the bank holding company. A comparable reduction is not proposed for other investors because their total capital is already a fraction of the parent organization's consolidated capital.

Qualified Business Entities for Which Edge Corporations May Provide Full Banking Services in the United States

The Edge Act limits lending and deposit-taking by Edge corporations in the United States to transactions related to international or foreign business. The Board has viewed this mandate as requiring that all banking transactions, and particularly those with U.S. residents, have an international character or purpose. Thus, Edge corporations are generally required to verify that every deposit or credit transaction it conducts is related to an international transaction.

As part of the 1985 revision of Regulation K, the Board adopted an exception to this general rule if the company with which the transaction is done is a so-called qualified business entity ("QBE"), a company that by charter or license is engaged exclusively in activities of an international character, such as a foreign sales corporation or an export trading corporation. Because QBEs are restricted

to conducting predominately international activities, Edge corporations may provide full banking services to such entities and are relieved of the administrative burden of documenting the international character of each transaction with a QBE. As part of this five-year review, the Board seeks public comment on whether there are other organizations that could be added to the current list of QBEs for which Edge corporations could appropriately act as full service banks in the United States.

Qualifying Foreign Banking Organizations

Background

The BHC Act contains exemptions from its nonbanking prohibitions for certain activities of foreign banks. These exemptions—sections 2(h)(2) and 4(c)(9) of the BHC Act—were intended to recognize that foreign banks are generally permitted by the laws of their home countries to engage in a wider range of nonbanking activities than U.S. banks and that many foreign banks are linked through stock ownership to foreign nonbanking companies that have operations in the United States. The exemptions help to avoid extraterritorial application of U.S. prohibitions against the combination of banking and nonbanking activities under a bank holding company. At the same time, the exemptions were not intended to permit foreign commercial and industrial firms to conduct a commercial banking business in the United States.

Section 211.23 of Regulation K implements these statutory provisions by making the exemptions available only to qualifying foreign banking organizations ("QFBOs"). In order to be deemed a QFBO, the foreign banking organization generally must derive more than half of its non-U.S. business from banking outside of the United States and conduct more than half of its banking business outside the United States.¹⁰

¹⁰ More specifically, the test requires that the foreign banking organization meet at least two of the following requirements:

1. Foreign banking assets exceed total worldwide nonbanking assets.
 2. Revenues from foreign banking business exceed revenues from worldwide nonbanking business, or
 3. Net income from foreign banking business exceeds net income from worldwide nonbanking business; and at least two of the following requirements:
 1. Foreign banking assets exceed U.S. banking assets.
 2. Revenues from foreign banking business exceed revenues from U.S. banking business, or
 3. Net income from foreign banking business exceeds net income from U.S. banking business.
- See 12 CFR 211.23(b).

Banking business is defined to include any activity listed as permissible in Regulation K, if such activities are conducted by the foreign bank of a subsidiary of the foreign bank.

Nonqualifying Organizations

The overwhelming majority of foreign banks have always met and continue to meet the QFBO test. There have been, however, an increasing number of acquisitions and mergers occurring outside the United States among foreign companies engaged in financial services, which have resulted in affiliations between banks and nonbank financial companies, particularly life insurance companies. Such corporate combinations may lead to situations where a previously qualifying foreign bank could now be part of a larger financial services company that may not satisfy the QFBO standard. A nonqualifying foreign banking organization is faced with the option of either conforming its worldwide activities to those permitted for a U.S. bank holding company or terminating its U.S. banking business, unless the Board grants a specific exemption.

As was discussed above, the proposed revision to § 211.5(d) would add underwriting life and related insurance to the list of activities that are permissible for a U.S. banking organization abroad. Under § 211.23(c), any activity on the list of permissible activities for U.S. banks abroad automatically becomes a banking activity for purposes of the QFBO standard as long as the activity is conducted in the bank ownership chain. Adding life insurance to the list of activities generally will aid foreign banks that acquire foreign insurance companies in continuing to meet the QFBO standard.

This change, however, would not assist those foreign banks that, because they have been acquired by larger foreign insurance companies, no longer meet the QFBO standard. Because the life insurance activities are not conducted through the bank ownership chain, but by the parent company, adding life insurance to the list of permissible activities would not assist these organizations in maintaining compliance with the QFBO standard.

Section 211.23(g) of Regulation K provides that an organization that does not meet the standard may apply for a specific determination of eligibility. The Board has in the past generally granted exemptions only in limited circumstances, chiefly because of concerns for safety and soundness and

competitive equality with U.S. banking organizations.

There may, however, be undue hardship in applying that standard strictly to foreign financial services companies that are engaged mostly in activities permissible to U.S. bank holding companies abroad. Thus, the Board requests comment on a proposal to exercise its discretion under § 211.23(g) on a case-by-case basis to prevent hardship to foreign companies in these circumstances. In considering whether a special exemption should be granted, the Board would give due consideration to whether the non-qualifying owner of a foreign bank engages predominately in activities permissible to U.S. bank holding companies abroad. This standard would be one factor the Board would consider in reviewing requests for specific determinations of eligibility by foreign companies. A specific determination of eligibility for a life insurance company that owns a foreign bank with U.S. operations would not, absent other factors, appear to be substantially at variance with the purposes of the BHC Act, as long as the life insurance company does no or only *de minimis* insurance business in the United States. Consequently, the Board could grant determinations of eligibility to foreign insurance companies, if such companies engage substantially in activities that U.S. banking organizations may conduct outside the United States, without creating substantial inconsistencies with the purposes of the BHC Act.

There are certain situations, however, in which granting qualifying status would be at variance with the purposes of the BHC Act. The Board proposes to add language to § 211.23(e) of Regulation K stating that specific determinations of eligibility would generally not be granted to a foreign industrial or commercial company that owns a foreign bank or to a company that derives less of its commercial banking business from outside the United States than it derives from inside the United States. In either case, eligibility would provide potential competitive advantages to those companies as compared with U.S. banking organizations and could have adverse consequences for the safety and soundness of the U.S. banking operations. The proposed language is intended to clarify that in this context a commercial banking business means a banking business conducted through a regulated foreign bank.

Interim Authority Until a Specific Determination Is Made

Another problem arises when a foreign bank is acquired by a foreign company. When an organization does not qualify for QFBO status, its worldwide activities and investments must conform to those of a U.S. bank holding company. In the time period prior to any action that the Board might take on a request by a foreign organization for a specific determination of eligibility under § 211.23(g), the foreign organization must apply to the Board for permission to make even purely foreign acquisitions. To address this situation, the Board requests comment on a proposal to modify the regulation to permit a nonqualifying company to continue to conduct activities and make acquisitions abroad without prior Board review until such time as the Board acts on a request for exemption from the QFBO test. The proposed language makes it clear that the organization must abide by the Board's final determination regarding the organization's status, including any requirements to cease activities or divest investments. The Board believes that this proposed interim measure strikes an appropriate balance between the Board's interest in compliance by foreign banks with applicable statutory and regulatory standards and the Board's desire to avoid unnecessary impact on the non-U.S. operations of foreign banking organizations.

Technical and Clarifying Amendments

Technical Modifications to Provisions Governing Debt-for-Equity Conversions

Section 211.5(f) of Regulation K permits debt-for-equity investments to be made under special consent procedures that require no prior notice to the Board unless the size of the investment exceeds the greater of \$15 million or one percent of the bank holding company's equity capital. Consistent with the new risk-based standards, the Board proposes to replace the equity capital standard with the Tier 1 capital standard.

In addition, the provisions of § 211.5(f) related to debt-for-equity conversions were enacted at a time when debt-for-equity swap programs were commonly administered by heavily indebted foreign governments. Such swaps are now more frequently conducted outside the scope of formal programs. In light of this change in the market, the Board proposes two technical amendments to § 211.5(f) with respect to the following: (1) Modifying the reference to the procedures for swap transactions to make clear that such procedures need

not be pursuant to a formal government program; and (2) adjusting the divestiture requirement—that investments be divested within two years after full repatriation of the investment is permitted by the debtor country—to take account of the fact that in the absence of a formal program there may not be any restrictions on repatriation, in which case divestiture would be required within ten years of acquisition, subject to an extension of time at the discretion of the Board for an additional five years.

Establishing Closer Supervision Over Edge Corporations

As a result of recent enforcement problems involving certain Edge corporations, the Board proposes to amend § 211.4 of Regulation K to clarify that the Board's broad supervisory authority over Edge corporations includes the authority to call an emergency meeting of the shareholders of an Edge corporation to address pressing problems of the Edge corporation. This proposed measure provides the Board with an alternative supervisory tool to a more time-consuming enforcement proceeding.

Conforming the Capital Requirements for Edge Corporations to the Risk-Based Guidelines

Currently § 211.6(c) requires Edge corporations engaged in banking to be capitalized at an amount not less than seven percent of the Edge corporation's risk assets. Risk assets are defined as total assets less cash, amounts due from domestic banking organizations, U.S. government securities, and federal funds sold. The Board proposes to amend the capital requirements to conform to the Board's new risk-based capital guidelines. However, because of the international character and limited diversification of the portfolios of Edge corporations, the Board proposes to require a ten percent minimum ratio for 1992 under the guidelines, rather than the eight percent target applied to state member banks and bank holding companies.

Conforming the Exemptions for Qualifying Foreign Banking Organizations ("QFBOs") to the Current SIC Standards

Under § 211.23(f)(5)(iii) of Regulation K, QFBOs are allowed to engage in certain nonfinancial activities in the United States provided that, among other things, the U.S. activities are in the same line of business as the activities of the foreign company abroad. Regulation K looks to the Standard Industrial

Classification (the "SIC") to determine whether activities are in the same line of business. The SIC was revised in 1987. The Board proposes to revise the references to the SIC in § 211.23(f)(5)(iii) to reflect the new SIC categories. Other technical modifications are made to reflect revisions to section 2(h) of the BHC Act (12 U.S.C. 1841(h)) in 1987.

Clarifying the Definition of "Subsidiary"

Regulation K is currently silent as to the significance of partnership interests. Although § 211.2(i) defines "investment" to include partnership interests, it does not define what type of investment—a subsidiary, joint venture, or portfolio investment—a partnership interest constitutes.

Under Regulation Y, "company" is defined to include general and limited partnerships. 12 CFR 225.2(d)(1). The result is that when a bank holding company or its subsidiary is a general partner in a partnership, the partnership is considered a subsidiary of the bank holding company because it is deemed to control the partnership. Thus, the activities of the partnership must be limited to those that are permissible for a bank holding company. The rationale behind this policy is typically that under applicable law general partners have full management powers and full personal liability for partnership debt and commitments.

Similarly, the Board has interpreted a general partnership interest to be equivalent to a subsidiary for purposes of Regulation K. Thus, the partnership's activities are confined to those permissible for a U.S. banking organization under Regulation K. Accordingly, the Board proposes to clarify the regulation by specifying that any company of which an investor or its affiliate is a general partner will be considered a subsidiary of the investor.

The definition of subsidiary would also be amended to clarify that an investor will be deemed to control an organization if the investor and its affiliates own or control more than half of the equity of the organization.

These clarifications of the definition of subsidiary are not exhaustive. Other facts and circumstances may also give rise to the conclusion that an investor controls an organization, thereby causing the organization to be deemed a subsidiary.

Clarifying the Meaning of "Governmental Entity" with Respect to Foreign Branch Investment Powers

A foreign branch of a U.S. bank may, under § 211.3 of Regulation K, (1) invest in the securities of "governmental entities" and (2) underwrite, distribute,

buy, and sell obligations of "an agency or instrumentality of the national government", subject to certain amount limitations. The issue of what constitutes the security of a governmental entity or the obligation of an instrumentality of a national government has been raised in connection with several proposed investments abroad. In order to avoid such questions in the future the Board proposes to amend § 211.3(b) to clarify that governmental ownership alone does not make an entity a governmental entity or an instrumentality of the national government; rather, the test is whether there is a government guarantee or whether the taxing authority of full faith and credit of the government is available to support the obligations of the entity.

Conforming the Regulations Governing Export Trading Companies to the New Standards Mandated by Congress

Under the Export Trading Company Act Amendments of 1988, enacted as part of the Omnibus Trade and Competitiveness Act of 1988 (Pub. L. 100-148) ("Trade Act"), certain changes in the Board's regulation of bank affiliated export trading companies ("ETC's") are required. ETCs are companies in which bank holding companies may invest for the purpose of promoting U.S. exports. Specifically, consistent with the purposes of the Trade Act, the Board proposes to:

- (1) Amend the revenues test, which demonstrates that the business of the ETC is largely export-oriented, to neutralize the effect of third party transactions;
- (2) Provide companies with a longer start-up period before they must satisfy the revenues test; and
- (3) Clarify the misconception that certain delegation rules regarding leverage and inventory standards constitute maximum limits.

These standards have been applied administratively since the Trade Act was adopted. As part of the current revision, the Board proposes to incorporate these standards into subpart C of Regulation K and to amend the Board's delegation rules at 12 CFR 265.2 to eliminate the references to leverage and inventory limits.

The Board welcomes comment on all of these proposals including any changes not noted above but that are set forth in the attached draft regulation.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that this notice of

proposed rulemaking, if adopted as a final rule, will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation.

List of Subjects

12 CFR Part 211

Accounting for fees on international loans, Allocated transfer risk reserve, Export trading companies, Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements, Reporting and disclosure of international assets.

12 CFR Part 265

Authority delegations (Government agencies), Federal Reserve System.

For the reasons set forth above, the Board proposes to amend 12 CFR parts 211 and 265 as follows:

PART 211—INTERNATIONAL BANKING OPERATIONS

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

Authority: Federal Reserve Act (12 U.S.C. 221 *et seq.*); Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*); the International Banking Act of 1978 (Pub. L. 95-369; 92 Stat. 607; 12 U.S.C. 3101 *et seq.*); the Bank Export Services Act (Title II, Pub. L. 97-290, 98 Stat. 1235); the International Lending Supervision Act (Title IX, Pub. L. 98-181, 97 Stat. 1153, 12 U.S.C. 3901 *et seq.*); and the Export Trading Company Act Amendments of 1988 (Title III, Pub. L. 100-418, 102 Stat. 1384 (1988)).

2. Subpart A of part 211 is revised to read as follows:

Subpart A—International Operations of United States Banking Organizations

Sec.

- 211.1 Authority, purpose, and scope.
- 211.2 Definitions.
- 211.3 Foreign branches of U.S. banking organizations.
- 211.4 Edge and agreement corporations.
- 211.5 Investments and activities abroad.
- 211.6 Lending limits and capital requirements.
- 211.7 Supervision and reporting.

Subpart A—International Operations of United States 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 Banking Holding Company Act of 1956 ("BHC Act") (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978

("IBA") (92 Stat. 607; 12 U.S.C. 3101 *et seq.*). Requirements for the collection of information contained in this regulation have been approved by the Office of Management and Budget under the provision of 44 U.S.C. 3501 *et seq.* and have been assigned OMB Nos. 7100-0107; 7100-0109; 7100-0110; 7100-0069; 7100-0086; and 7100-0073.

(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 corporations to engage in international banking and for investments in foreign organizations.

(c) *Scope.* This subpart applies to corporations organized under section 25(a) of the FRA (12 U.S.C. 611-631), "Edge corporations"; to corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601-604a), "Agreement corporations"; to 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);¹ and to bank holding companies with respect to the exemption from the nonbanking prohibitions of the BHC Act afforded by section 4(c)(13) of the BHC 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 and surplus* means paid-in and unimpaired capital and surplus, and includes undivided profits but does not include the proceeds of capital notes or debentures.

(c) *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 organization.

(d) 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.

(e) *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.

(f) *Equity* means an ownership interest in an organization, whether through voting or nonvoting shares, general or limited partnership interests, or 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, and loans that provide rights to participate in the profits of an organization and subordinated debt of an organization that is held by an investor or its affiliates when shares of the organization are also held by the investor or its affiliates, unless the investor receives a determination that such loans or subordinated debt should not be considered equity in the circumstances of the particular investment.

(g) *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.

(h) *Foreign bank* means an organization that is organized under the laws of a foreign country; engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of its business; and has the power to accept demand deposits.

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

(j) *Investment* means the ownership or control of shares (including partnership interests and other interests evidencing ownership), binding commitments to acquire shares, contributions to the capital and surplus of an organization, and the holding of an organization's subordinated debt or of other loans that provide rights to participate in the profits of the organization when shares or other interests in the organization are also held by the investor or the investor's affiliate.

(k) *Investor* means an Edge corporation, Agreement corporation, bank holding company, or member bank.

(l) *Joint venture* means an organization that has 20 percent or more of its voting share held directly or indirectly by the investor or by an affiliate of the investor, but which is not a subsidiary of the investor.

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

(n) *Person* means an individual or an organization.

(o) *Portfolio investment* means an investment in an organization:

(1) Other than a subsidiary or joint venture; and

(2) In the case of investments in companies that do not meet the requirements for eligible investments in a subsidiary or a joint venture, the investor and its affiliates hold less than 25 percent of the total equity of the organization.

(p) *Representative office* means an office that engages solely in representational and administrative functions such as solicitation of new business for or liaison between the organization's head office and customers in the United States, and does not have authority to make business decisions for the account of the organization represented.

(q) *Subsidiary* means an organization more than 50 percent of the voting shares of which is held directly or indirectly by the investors, or which is otherwise controlled or capable of being controlled by the investor or an affiliate of the investor. Among other circumstances, an investor is considered to control an organization if the investor or an affiliate is a general partner of the organization or if the investor and its affiliates directly or indirectly own or control more than 50 percent of the entity of the organization.

(r) *Tier 1 capital* means common stockholders equity and such other instruments as qualify as Tier 1 capital under guidelines adopted by the Board from time to time for risk-based capital (12 CFR part 225, appendixes A and B).

§ 211.3 Foreign branches of U.S. banking organizations.

(a) *Establishment of foreign branches*—(1) *Right to establish branches.* 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, or a subsidiary held pursuant to this subpart. Unless otherwise provided in this section, the establishment of a foreign branch requires the specific prior approval of the Board.

(2) *Branching within a foreign country.* Unless the organization has been notified otherwise, no prior Board approval is required for an organization to establish additional branches in any

¹ Section 25 of the FRA, 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).

foreign country where it operates one or more branches.²

(3) *Branching into additional foreign countries.* After giving the Board 45 days' prior written notice, an organization that operates branches in two or more foreign countries may establish a branch in an additional foreign country, unless notified otherwise by the Board.³

(4) *Expiration of branching authority.* Authority to establish branches through prior approval or prior notice shall expire one year from the earliest date on which the authority could have been exercised, unless the Board extends the period.

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

(b) *Further powers 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:

(1) *Guarantees.* Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events,⁴ if the guarantee or agreement specifies a maximum monetary liability; it may not have liabilities 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 paragraph (a)(1) of section 5200 of the Revised Statutes (12 U.S.C. 84) for loans and extensions of credit;

(2) *Investments.* Invest in:

(i) The securities of the central bank, clearing houses, governmental entities,⁵

² For the purpose of this paragraph, a subsidiary other than a bank or an Edge or Agreement corporation is considered to be operating a branch in a foreign country if it has an affiliate that operates an office (other than a representative office) in that country.

³ For the purpose of this paragraph, a subsidiary other than a bank or an Edge or Agreement corporation is considered to be operating a branch in a foreign country if it has an affiliate that operates an office (other than a representative office) in that country.

⁴ "Readily ascertainable events" include, but are not limited to, events such as nonpayment of taxes, rentals, customs duties, or costs of transport and loss of nonconformance of shipping documents.

⁵ For this purpose, securities or obligations of a governmental entity or agency or instrumentality are those securities or obligations supported by the taxing authority, guarantee or the full faith and credit of the national government.

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 requirement; and

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

However, the total investments of the bank's branches in that country under this paragraph (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 one 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);

(3) *Government obligations.* Underwrite, distribute, buy, and sell obligations of:

(i) The national government of the country in which the branch is located;

(ii) An agency or instrumentality⁶ of the national government; and

(iii) A municipality or other local or regional governmental entity of the country.

However, no member bank may hold, or be under commitment with respect to, such obligations for its own account in an aggregate amount exceeding 10 percent of its capital and surplus;

(4) *Credit extensions to bank's officers.* Extend credit to an officer of the bank residing in the country in which the foreign branch is located to finance the acquisition or construction of living quarters to be used as the officer's residence abroad, provided the credit extension is reported promptly to the branch's home office and any extension of credit exceeding \$100,000 (or the equivalent in local currency) is reported also to the bank's board of directors;

(5) *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;

(6) *Insurance.* Act as insurance agent or broker;

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

⁶ For this purpose, securities or obligations of a governmental entity or agency or instrumentality are those securities or obligations supported by the taxing authority, guarantee or the full faith and credit of the national government.

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

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

(9) *Investment in subsidiaries.* With the Board's prior approval, establish or invest in a wholly-owned subsidiary to engage solely in activities in which the member bank is permitted to engage or activities that are incidental to the activities of the foreign branch; and

(10) *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.

(c) *Reserves of foreign branches of member banks.* Reserves shall be maintained against foreign branch deposits when required by part 204 of this chapter (Regulation D).

§ 211.4 Edge and Agreement corporations

(a) *Organization—(1) 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.

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

(3) *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.

(4) *Factors considered by the 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.

(5) *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 United States 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. Unexercised authority to commence business as an Edge corporation shall expire one year after issuance of the permit, unless the Board extends the period.

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

(7) *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 to attend may result in removal or barring of such shareholders from further participation in the management of the Edge corporation.

(b) *Nature and ownership of shares—*

(1) *Shares.* Shares of stock in the Edge corporation may not include no-par value shares and shall be issued and transferred only on its books and in compliance with section 25(a) of the FRA and this subpart. 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) Limitations upon the rights of ownership and transfer of shares imposed by section 25(a) of the FRA; and

(B) Rules that the Edge corporation prescribes in its by-laws to ensure compliance with this paragraph. Any change in status of a shareholder that causes a violation of section 25(a) of the FRA shall be reported to the Board as soon as possible, and the Edge corporation shall take such action as the Board may direct.

(2) *Ownership or Edge corporations by foreign institutions—*(i) *Prior Board approval.* One or more foreign or foreign-controlled domestic institutions referred to in paragraph 13 of section 25(a) 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.

(ii) *Conditions and requirements.* Such an institution shall:

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

(B) Ensure that any transaction by an Edge corporation with an affiliate⁷ 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;

(C) 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;

(D) In the case of a foreign institution not subject to section 4 of the BHC Act:

(1) 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

(2) Give the Board 45 days' prior written notice, in a form to be prescribed by the Board, 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; in connection with such notice, the Board may impose conditions necessary to prevent adverse effects that may result from such activity or investment; and

(E) Invest in Edge corporations no more than 10 percent of the institution's capital and surplus.

(3) *Change in control—*(i) *Prior notice.* Any person shall give the Board 60 days' prior written notice, in a form to be prescribed by the Board, before acquiring, directly or indirectly, 25 percent or more of the voting shares, or otherwise acquiring control, of an Edge corporation. The Board may extend the 60-day period for an additional 30 days by notifying the acquiring party. A notice under this paragraph 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).

⁷ For purposes of this paragraph, "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.

(ii) *Board review.* In reviewing a notice filed under this paragraph, the Board shall consider the factors set forth in paragraph (a)(4) 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.

(c) *Domestic branches—*(1) *Prior notice.* An Edge corporation may establish branches in the United States 45 days after the Edge corporation has given notice to its Reserve Bank, unless the Edge corporation is notified to the contrary within that time. 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 and may appear no earlier than 90 calendar days prior to submission of notice of the proposal to the Reserve Bank. The newspaper notice must 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.* The factors considered in acting upon a proposal to establish a branch are enumerated in paragraph (a)(4) of this section.

(3) *Expiration of authority.* Authority to open 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.

(d) *Reserve requirements and interest rate limitations.* The deposits of an Edge or Agreement corporation are subject to parts 204 and 217 of this chapter (Regulations D and Q) in the same manner and to the same extent as if the Edge or Agreement corporation were a member bank.

(e) *Permissible activities in the United States.* An Edge corporation may engage directly or indirectly in activities in the United States that are permitted by the sixth paragraph of section 25(a) of the FRA 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) *Deposit activities—*(i) *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; offices or establishments located, and individuals residing, outside the United States. Temporary overdrafts in an account may not be frequent and should be restored within a short period of time.

(ii) *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:

(A) Are to be transmitted abroad;

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

(C) 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;

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

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

(F) Are received from Edge or Agreement corporations, foreign banks and other depository institutions (as described in part 204 of this chapter (Regulation D));

(G) 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 (26 U.S.C. 921); 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 that are exclusively engaged in activities related to international trade.

(2) *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 part 204 of this chapter (Regulation D), and other Edge and Agreement corporations; or

(iii) Money market instruments (including repurchase agreements with respect to such instruments) such as bankers' acceptances, obligations of or

fully guaranteed by federal, state, and local governments and their instrumentalities, federal funds sold, and commercial paper.

(3) *Borrowings.* An Edge corporation may:

(i) Borrow from offices of other Edge and Agreement corporations, foreign banks, and depository institutions (as described in part 204 of this chapter, Regulation D) or issue obligations to the United States or any of its agencies or instrumentalities;

(ii) 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;

(iii) Issue long-term subordinated debt that does not qualify as a "deposit" under part 204 of this chapter (Regulation D).

(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 acquisitions of obligations of foreign governments;

(iv) Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events,⁹ if the guarantee or agreement specifies the maximum monetary liability thereunder and is related to a type of transaction described in paragraphs (e)(4) (i) and (ii) of this section; and

(v) Provide Credit and other banking services for domestic and foreign purposes to organizations of the type described in § 211.4(e)(1)(ii)(G) of this subpart.

⁹ For purposes of this paragraph, "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.

(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 shall be 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,⁹ and by providing advice on mergers and acquisitions, provided such services for U.S. persons shall be 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 part 215 of this

⁹ For purposes of this section, management of an investment portfolio does not include operational management of real property, or industrial or commercial assets.

chapter (Regulation Q) 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.

(f) *Agreement corporations.* 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.

§ 211.5 Investments and activities abroad.

(a) *General policy.* Activities abroad, whether conducted directly or indirectly, shall be confined to those of a banking or financial nature and those that are necessary to carry on such activities. In doing so, investors shall at all times 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) *Investment requirements.—(1) Eligible investments.* (i) An investor may directly or indirectly:

(A) Invest in a subsidiary that engages solely in activities listed in paragraph (d) of this section or in such other activities as the Board has determined in the circumstances of a particular case are permissible except 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 five percent of either the consolidated assets or revenues of the acquired organization;

(B) 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 shall be attributable to activities not listed in paragraph (d) of this section;

(C) Make portfolio investments in an organization if the total direct and indirect portfolio investments in organizations engaged in activities that are not permissible for joint ventures, when combined with all securities held in trading or dealing accounts and all equity held pursuant to paragraph (b)(1)(i)(D) of this section, do not at any time exceed 25 percent of the investor's Tier 1 capital where the investor is a bank holding company or 100 percent of

Tier 1 capital for any other investor;¹⁰ and

(D) Subject to the aggregate limit established in paragraph (b)(1)(i)(C) of this section, make other equity investments in up to 40 percent of the equity of an organization where the amount invested in the organization, combined with all direct or indirect loans or other extensions of credit to the organization, by the investor does not exceed the general consent limits of § 211.5(c)(1). The authority of this paragraph (D) may not be combined with the authority of paragraphs (b)(1)(i)(B) or (C) of this section.

(ii) A member bank's direct investments under section 25 of the FRA shall be limited to foreign banks and to foreign organizations formed for the sole purpose of either holding shares of a foreign bank or performing nominee, fiduciary, or other banking services incidental to the activities of a foreign branch or foreign bank affiliate of the member bank.

(2) *Investment limit.* In computing the amount that may be invested in any organization under this section, there shall be included any unpaid amount for which the investor is liable and any investments by affiliates.

(3) *Divestiture.* An investor shall dispose of an investment promptly (unless the Board authorizes retention) if:

(i) The organization invested in—
(A) Underwrites, distributes or deals in securities in the United States, or engages in the general business of buying or selling goods, wares, merchandise, or commodities in the United States;

(B) Engages directly or indirectly in other business in the United States that is not permitted to an Edge corporation in the United States except that an investor may hold up to five 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
(C) Engages in impermissible activities to an extent not permitted under paragraph (b)(1) of this section; or

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

(c) *Investment procedures.*¹¹ Direct and indirect investments shall be made

¹⁰ For this purpose, a direct subsidiary of a member bank is deemed to be an investor.

¹¹ When necessary, the general consent and prior notice provisions of this section constitute the Board's approval under the eighth paragraph of section 25(a) of the FRA for investments in excess

in accordance with the general consent, prior notice, or specific consent procedures contained in this paragraph. In order for an investor to make investments under the general consent procedure, the investor and any other investor of which it is a subsidiary shall be in compliance with minimum capital adequacy guidelines. The Board may at any time, upon notice, modify or suspend the general consent and prior notice procedures with respect to any investor or with respect to the acquisition of shares of organizations engaged in particular kinds of activities. An investor shall apply for and receive the prior specific consent of the Board for its initial investment in its first subsidiary or joint venture unless an affiliate has made such an investment, and for authority to commence underwriting or dealing in equity securities where the investor is not currently engaged in such activities. Authority to make investments under prior notice or specific consent shall expire one year from the earliest date on which the authority could have been exercised, unless the Board extends the period.

(1) *General consent.* Subject to the other limitations of this section, the Board grants its general consent for the following:¹²

(i) Any investment in a joint venture or subsidiary, and any portfolio or other equity investment described in § 211.5(b)(1) of this subpart, if the total amount invested (in one transaction or in a series of transactions) does not exceed the lesser of:

(A) \$25 million; or
(B) 5 percent of the Investor's Tier 1 capital in the case of a member bank, bank holding company, or Edge corporation engaged in banking, or 25 percent of the investor's Tier 1 capital in the case of an Edge corporation not engaged in banking;

(ii) Any additional investment in an organization in any calendar year so long as:

(A) The total amount invested in that calendar year does not exceed 10 percent of the investor's Tier 1 capital; and

(B) The total amount invested under § 211.5 of this subpart (including investments made pursuant to specific

of the limitations therein based on capital and surplus.

¹² In determining compliance with these limits, an investor shall combine the value of all securities of an organization held in trading or dealing accounts with other investments in the same organization. Securities held in trading or dealing accounts are also subject to the limits in § 211.5(d)(15) of this subpart.

consent or prior notice) in that calendar year does not exceed cash dividends reinvested under paragraph (c)(1)(iii) of this section plus 10 percent of the investor's direct and indirect historical cost¹³ in the organization, which investment authority, to the extent unexercised, may be carried forward and accumulated for up to five consecutive years;

(iii) Any additional investment in an organization in an amount equal to cash dividends received from that organization during the preceding 12 calendar months; or

(iv) Any investment that is acquired from an affiliate at net asset value.

(2) *Prior notice.* An investment that does not qualify under the general consent procedure may be made after the investor has given 45 days' prior written notice to the Board. The Board may waive the 45-day period if it finds immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is accepted. The Board may suspend the period or act on the investment under the Board's specific consent procedures.

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

(d) *Permissible activities.* 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;

¹³ This "historical cost" of an investment consists of the actual amounts paid for shares or otherwise contributed to the capital accounts, as measured in dollars at the exchange rate in effect at the time each investment was made. It does not include subordinated debt or unpaid commitments to invest even though these may be considered investments for other purposes of this part. For investments acquired indirectly as a result of acquiring a subsidiary, the historical cost to the investor is measured as of the date of acquisition of the subsidiary at the net asset value of the equity interest in the case of subsidiaries and joint ventures, and in the case of portfolio investments, at the book carrying value.

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

(6) Performing services for other direct or indirect operations of a United States 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;

(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) Managing a mutual fund if the fund's shares are not sold or distributed in the United States or to United States residents and the fund does not exercise managerial control over the firms in which it invests;

(12) Performing management consulting services provided that such services when rendered with respect to the United States 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 where:

(i) Any underwriting commitments by an investor and its affiliates (other than an affiliate authorized to underwrite equity securities under section 4(c)(8) of the BHC Act) for the shares of an issuer do not in the aggregate exceed the lesser of \$60 million or 25 percent of the investor's Tier I capital, unless the investor or its affiliates have secured binding commitments from subunderwriters or other purchasers, or the investor receives prior approval from the Board to exceed these limits under paragraph (d)(14)(iii) of this section; and

(ii) Any shares of an issuer held by the investor and its affiliates at the end of 30 days after the acquisition of shares in connection with the underwriting otherwise conform to the permissible limits for holding equity shares under paragraphs (b) and (d)(15)(i) of this action;¹⁴ or

¹⁴ Underwriting commitments for equity securities and any equity securities retained 30 days after their acquisition in connection with an

(iii) With the prior approval of the Board, underwriting commitments for equity securities exceed the limits of paragraph (d)(14)(i) of this section if:

(A) The amounts approved in excess of the limits of paragraph (d)(14)(i) of this section are fully deducted from the capital of the investor;

(B) In the Board's judgment, the investor is strongly capitalized and would remain so after the deduction required in paragraph (d)(14)(iii)(A) of this section; and

(C) In the case of an underwriting commitment made by a subsidiary of an insured U.S. bank, the parent bank holding company guarantees any losses that the bank may incur in connection with the underwriting.

(15) Dealing in equity securities of foreign issuers outside the United States where:

(i) The amount of equity securities of any one issuer held in dealing accounts of the investor and its affiliates does not exceed the lesser of \$30 million or 10 percent of the investor's Tier I capital; and

(ii) All equity securities of an issuer held in all trading or dealing accounts, when combined with all other equity interests in the issuer held by the investor and its affiliates, otherwise conform to the permissible limits for investment in an organization under paragraph (b) of this section;

(16) Operating a travel agency provided that the travel agency is operated in connection with financial services offered abroad by the investor or others;

(17) Underwriting life, accident and health insurance or other similar insurance, including certain types of pension-related insurance, where the associated risks have been previously determined by the Board to be actuarially predictable provided that:

(i) If the activity is conducted or investment is made by a subsidiary of a U.S. insured bank, prior approval of the Board is obtained; and

(ii) The investor's investments in and unsecured credit to the company by the investor or its affiliates shall be deducted from the capital of the investor; for purposes of this paragraph, credit is considered unsecured if it is not fully secured in accordance with the requirements of section 23A of the Federal Reserve Act (12 U.S.C. 371c) or with such other standards as the Board may require;

underwriting commitment shall be included in the aggregate portfolio investment limit under § 211.5(b)(1)(i)(C).

(18) Acting as a futures commission merchant in accordance with the standards set forth in § 225.25(b)(18) of the Board's Regulation Y (12 CFR 225.25(b)(18)) with respect to such products as the Board has previously approved, except that where such activities are to be conducted by a subsidiary of a U.S. insured bank on an exchange that requires members to guarantee or otherwise contract to cover losses suffered by other members, the prior approval of the Board is obtained;

(19) Acting as principal or agent in swap transactions relating to currency or interest rate obligations and swap transactions in their derivative products;

(20) Engaging in activities that the Board has determined in Regulation Y (12 CFR 225.25(b)) are closely related to banking under section 4(c)(8) of the BHC Act; and

(21) With the Board's specific approval, engaging 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.

(e) *Debts previously contracted.* Shares or other ownership interests acquired to prevent a loss upon a debt previously contracted in good faith shall not be subject to the limitations or procedures of this section; however, they shall be disposed of promptly but in not event later than two years after their acquisition, unless the Board authorizes retention for a longer period.

(f) *Investments made through debt-for-equity conversions—(T)* Definitions. For purposes of this paragraph:

(i) *Eligible country* means a country that, since 1990, has restructured its sovereign debt held by foreign creditors, and any other country the Board deems to be eligible;

(ii) *Investment* has the meaning set forth in § 211.2(j) of this subpart and, for purposes of the investment procedures of this paragraph, shall include loans or other extensions of credit by the bank holding company or its affiliates to a company acquired pursuant to this paragraph; and

(iii) *Loans and extensions of credits* 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.

(2) *Permissible investments.* In addition to investments that may be made under other provisions of this section, a bank holding company may make the following 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 are used to purchase the investment:

(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 control 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 extension 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.

(3) *Investments by bank subsidiary of bank holding company.* Upon application, the Board may permit an investment to be made pursuant to this paragraph through an insured bank subsidiary of the bank holding company where the bank holding company demonstrates that such ownership is necessary due to special circumstances such as the requirements of local law. 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.

(4) *Divestiture* (i) *Time limits for divestiture.* The bank holding company shall divest the shares of or other ownership interests in any company acquired pursuant to this paragraph (unless the retention of the shares or other ownership interest is otherwise permissible at the time required for divestiture) within the longer of ten years from the date of acquisition of the investment except that the Board may extend such period if, in the Board's judgement, such an extension would not be detrimental to the public interest or two years from the date on which the

bank holding company is permitted to repatriate in full the investment in the foreign company, but in either case within 15 years of the date of acquisition.

(ii) *Report to Board.* The bank holding company shall report to the Board on its plans for divesting an investment made under this paragraph no later than 10 years after the date the investment is made if the investment may be held for longer than 10 years and shall report to the Board again 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 shall be subject to paragraphs (b)(3)(i) (A) and (B) 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.

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

(ii) All other investments shall be made in accordance with the procedures of paragraph (c) of this section requiring prior notice or specific consent.

(6) *Conditions—(i) Name.* Any company acquired pursuant to this paragraph 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 any confidential business information or other information concerning customers that are engaged in the same or related lines of business as the company.

§ 211.6 Lending limits and capital requirements.

(a) *Acceptances of Edge corporations—(1) Limitations.* An Edge corporation shall be and remain fully secured for:

(i) All acceptance outstanding in excess of 200 percent of its capital and surplus; and

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

These limitations apply only to acceptances of the types described in paragraph 7 of section 13 of the FRA (12 U.S.C. 372).

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

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

(ii) Is covered by participation agreements from other banks, as such agreements are described in § 250.165 of this chapter.

(b) *Loans and extensions of credit to one person—(1) 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;¹⁵ 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.

(2) *Loans and extensions of credit* means all direct or indirect advances of funds to a person¹⁶ made on the basis of any obligation of that person to repay the funds. These shall include acceptances outstanding not of the types described in paragraph 7 of section 13 of the FRA (12 U.S.C. 372); 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 agreement; investments in the securities of another organization except where the organization is a subsidiary; and any underwriting commitments to an issuer of securities where no binding commitments have been secured from subunderwriters or other purchasers.

(3) *Exceptions.* The limitations of paragraph (b)(1) of this section do not apply to:

(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 bankers' acceptance of the kind described in paragraph 7 of section 13 of the FRA 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; or

(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, or the Asian Development Bank;

(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 will necessarily include default to that entity. The total loans and extensions of credit under this subparagraph to any person shall at no time exceed 100 percent of the capital and surplus of the Edge corporation.

(c) *Capitalization.* 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. In the case of an Edge corporation engaged in banking, its minimum ratio of qualifying total capital to weighted-risk assets shall be not less than 10 percent, of which at least half shall be in the form of Tier 1 capital. Capital and weighted-risk assets should be determined in accordance with the definitions and procedures of the Board's guidelines on risk-based capital for state member banks (12 CFR part 225, appendixes A and B).

§ 211.7 Supervision and reporting.

(a) *Supervision—(1) Foreign branches and subsidiaries.* Organizations conducting international banking 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.

Effective systems of records, controls, and reports shall be maintained to keep management informed of their activities and condition. Such systems should provide, in particular, information on risk assets, liquidity management, and operations of controls and conformance to management policies. Reports on risk assets should 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. Reports on the operations of controls should 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, and operations of controls. Complete information shall be maintained on all transactions with the joint venture by the investor and its affiliates.

(3) *Availability of reports to examiners.* The reports and information specified in paragraphs (a) (1) and (2) of this section 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 sufficient information 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 of disposition of shares.* A member bank, Edge or Agreement corporation or a bank holding company 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, notifications, and reports required by this part shall be

¹⁵ For purposes of this subsection, "subsidiary" includes subsidiaries controlled by the Edge corporation but does not include companies otherwise controlled by affiliates of the Edge corporation.

¹⁶ 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.

filed with the Federal Reserve Bank of the district in which the parent bank or bank holding company is located or, if none, the Federal Reserve Bank of the district in which the applying or reporting institution is located. Instructions and forms for applications, notifications and reports are available from the Federal Reserve Banks.

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

Subpart B—Foreign Banking Organizations

3. In § 211.23, paragraphs (d), (e) and (f)(5) are revised and the introductory text of paragraph (f) is republished to read as follows:

* * * * *

(d) *Loss of eligibility for exemptions.* A foreign banking organization that qualified under paragraph (b) of this section or an organization that qualified as a "foreign bank holding company" under § 225.4(g) of Regulation Y (12 CFR 225.4(g))¹⁷ 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 (F.R. Y-7) filed with the Board. A foreign banking organization that ceases to be eligible for the exemptions 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. Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second Annual Report unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section. A 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) and (4) of this section.

(e) *Specific determination of eligibility for nonqualifying foreign*

banking organizations. 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. 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. In determining whether eligibility for the exemptions would be consistent with the purposes of the BHCA and in the public interest, the Board shall consider the history and the financial and managerial resources of the organization; the amount of its business in the United States; the amount, type and location of its nonbanking activities, including whether such activities may be conducted by U.S. banks or bank holding companies; and whether eligibility of the foreign banking organization would result in undue concentration of resources, decreased or unfair competition, conflicts or interests, or unsound banking practices. Such determination shall be subject to any conditions and limitations imposed by the Board including any requirements to cease activities or dispose of investments. Determinations of eligibility would generally not be granted where a majority of the business of the foreign banking organization derives from commercial or industrial activities or where 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 (as defined in § 211.2(h) of this chapter) of the organization.

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

* * * * *

(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;

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 5 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 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 BHCA, only under regulations of the Board or with the prior approval of the Board. 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). In addition, 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).

* * * * *

4. Subpart C of part 211 is revised to read as follows:

Subpart C—Export Trading Companies

211.31 Authority, purpose, and scope.

211.32 Definitions.

211.33 Investments and extensions of credit.

¹⁷ "[F]oreign bank holding company" means a bank holding company organized under the laws of a foreign country, more than half of whose consolidated assets are located or consolidated revenues derived, outside the United States." (12 CFR 225.4(g)(iii)).

211.34 Procedures for filing and processing notices.

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, as amended (12 U.S.C. 1841 et seq.) ("BHC Act") and 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:

(1) Bank holding companies as defined in section 2 of the BHC Act (12 U.S.C. 1841(a));

(2) Edge and Agreement corporations, as described in § 211.1(b) of this part, that are subsidiaries of bank holding companies but are not subsidiaries of banks;

(3) Bankers' 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 § 211.23(a)(2) of this part. These entities are hereinafter referred to as "eligible investors."

§ 211.32 Definitions.

The definitions of § 211.2 in subpart A apply to this subpart subject to the following:

(a) *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 (a)(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.

For purposes of paragraph (a) of this section, 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.

(b) The terms *bank*, *company* and *subsidiary* have the same meanings as those contained in section 2 of the BHC Act (12 U.S.C. 1841).

§ 211.33 Investments and extensions of credit.

(a) *Amount of investments.* In accordance with the procedures of § 211.34 of this subpart, an eligible investor may invest no more than five 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 five 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.* 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. For the purposes of this provision, 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) *Filing notice.*—(1) *Prior notice of investment.* An eligible investor shall give the Board 60 days' prior written notice of any investment in an export trading company.

(2) *Subsequent notice.* 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:

(i) Taking title to goods where the export trading company does not have a firm order for the sale of those goods;

(ii) Product research and design;

(iii) Product modification; or

(iv) Activities not specifically covered by the list of activities contained in section 4(c)(14)(F)(ii) of the BHC Act. Such an expansion of activities shall be regarded as a proposed investment under this subpart.

(b) *Time period for Board action.* (1) A proposed investment that has not been disapproved by the Board may be made 60 days after the 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.

(c) *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.

(d) *Time period for calculating revenues.* For any export trading company that had commenced operations two years or more prior to August 23, 1988, the four-year period within which to calculate revenues derived from its activities under § 211.32(a) of this subpart shall be deemed to have commenced with the

beginning of the 1988 fiscal year for that export trading company. For all other export trading companies, the four-year period shall commence with the first fiscal year after the respective export trading company has been in operation for two years.

PART 265—RULES REGARDING DELEGATION OF AUTHORITY

1. The authority citation for part 265 continues to read as follows:

Authority: Sec. 11(k), 38 Stat. 261 and 80 Stat. 1314 (12 U.S.C. 248(k)).

2. In § 265.2, paragraphs (f)(46)(iii) and (46)(v) are removed; paragraphs (f)(46)(iv) and (46)(vi) are redesignated as (f)(46)(iii) and (46)(iv) respectively; and paragraph (f)(46)(ii) is revised to read as follows:

§ 265.2 Specific functions delegated to Board employees and to Federal Reserve Banks.

* * * * *

(f) *Each Federal Reserve Bank.* * * *

* * * * *

(46) * * *

(ii) A bank holding company investor and its lead bank meet the minimum capital adequacy guidelines of the Board, the Comptroller of the Currency or the Federal Deposit Insurance Corporation or have enacted capital enhancement plans that have been determined by the appropriate supervisory authority to be acceptable;

* * * * *

Board of Governors of the Federal Reserve System, August 1, 1990.

William W. Wiles,
Secretary of the Board.

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