FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

November 25, 1994

Notice 94-120

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

SUBJECT

Final Amendments to Regulation K (International Banking Operations)

DETAILS

The Board of Governors of the Federal Reserve System has amended Part 211 of its regulations concerning the permissible activities of state-licensed branches and agencies of foreign banks. This amendment to Regulation K (International Banking Operations) sets forth the application procedures that state-licensed branches and agencies of foreign banks will be required to follow in order to request the Board's permission to engage in or continue to engage in an activity that is not permissible for a federal branch of a foreign bank and the requirements of divestiture and cessation plans.

Insured branches are also required to seek the approval of the Federal Deposit Insurance Corporation to engage in or to continue to engage in such an activity. The final rule also amends Part 211 to clarify that no application will be required in connection with the conversion by a foreign bank of its federally-licensed branch or agency into a state-licensed branch or agency.

ATTACHMENT

A copy of the Board's notice as it appears on pages 55026-29, Vol. 59, No. 212 of the Federal Register dated November 3, 1994, is attached.

MORE INFORMATION

For more information, please contact Ann Worthy at (214) 922-6156. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FINAL AMENDMENTS TO

REGULATION K

(INTERNATIONAL BANKING OPERATIONS

(DOCKET NO. R-0793)

FEDERAL RESERVE SYSTEM

12 CFR Part 211

[Regulation K; Docket No. R-0793]

International Banking Operations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System (Board or Federal Reserve) amends its Regulation K concerning the permissible activities of state-licensed branches and agencies of foreign banks. Section 202(a) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA or Act) provides that after December 19, 1992, a state-licensed branch or agency of a foreign bank may not engage in any activity that is not permissible for a federal branch of a foreign bank unless the Board has determined that the activity is consistent with sound banking practice, and in the case of an insured branch, the Federal Deposit Insurance Corporation (FDIC) has determined that the activity would pose no significant risk to the affected deposit insurance fund. This amendment to Regulation K sets forth the application procedures which state-licensed branches and agencies of foreign banks will be required to follow in order to request the Board's permission to engage in or continue to engage in an activity which is not permissible for a federal branch of a foreign bank and the requirements of divestiture and cessation plans. Insured branches are also required to seek the approval of the FDIC to engage in or to continue to engage in such an activity. The final rule also amends Regulation K to clarify that no application will be required in connection with the conversion by a foreign bank of its federally-licensed branch or agency into a state-licensed branch or agency.

EFFECTIVE DATE: This regulation is effective on January 1, 1995, except for § 211.21(e) which is effective December 5, 1994.

FOR FURTHER INFORMATION CONTACT: Kathleen M. O'Day, Associate General Counsel (202/452-3786), Ann E. Misback, Managing Senior Counsel (202/452-3788), John W. Rogers, Attorney (202/452-2798); 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], Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Section 202 of the Act amended section 7 of the International Banking Act (IBA) by adding several new subsections concerning the establishment and termination of foreign bank branches in the United States. New subsection 7(h) of the IBA provides that:

> (1) IN GENERAL.— After the end of the 1-year period beginning on the date of enactment of the [Act] a State branch or State agency may not engage in any type of activity that is not permissible for a Federal branch unless—
>
> (A) the [Federal Reserve] Board has determined that such activity is consistent with sound banking practice; and
>
> (B) in the case of an insured branch, the Federal Deposit Insurance Corporation has determined that the activity would pose no significant risk to the deposit insurance fund

12 U.S.C. 3105(h)(1).

In order to implement this provision, the Board issued a proposed rule on January 6, 1993, with a request for public comment. (58 FR 513). In taking this action, the Board stated that it would consider revisions to the proposed rule as appropriate and on the basis of the comments received. The comment period ended on March 5, 1993. The Board indicated that it would accept and process applications under the statute during the pendency of the rulemaking. No applications have been received.

The proposed rule required a foreign bank operating a state-licensed branch or agency in the United States, which desires to engage in or continue to engage in an activity that is not permissible for a federal branch, pursuant to statute, regulation or order or interpretation issued by the Office of the Comptroller of the Currency (OCC), to file an application in letter form to the Board for permission to conduct or to continue to conduct such activity. The proposed regulation set forth the required contents of the application and a procedure for divestiture or cessation of impermissible activities not approved by the Board.

The Board specifically requested comment on several items, including the contents of the application, whether prior notice rather than an application might be appropriate for certain classes of activities, and whether the conduct of activities permitted by the OCC pursuant to informal rather than formal interpretation, opinion or advice should require the filing of an application.

In addition, the Board requested comment on another provision of Regulation K which requires that a

foreign bank wishing to convert from a federal branch or agency license to a state branch or agency license file for approval to do so with the Board.

The Board received four public comments on the regulation. Comments were submitted by a state banking supervisor, an association of state banking supervisors, a trade association and a law firm. The commenters generally were supportive of the approach taken in the proposed rule. The comments focused on whether an activity-based approach rather than a bank-based approach would be preferable, whether the conduct of activities permitted by the OCC pursuant to informal rather than formal interpretation, opinion or advice should require an application and whether an application would be required to conduct an activity that the OCC permitted but only subject to quantitative restrictions. The commenters uniformly stated that no application should be required to convert from a federal branch or agency license to a state branch or agency license.

On March 2, 1993, the FDIC issued its own proposed regulation implementing section 7(h) of the IBA. See 58 FR 11992. The Board has consulted with the FDIC concerning the response to its proposed rule. Both the Board and the FDIC have attempted to make their final rules as consistent with one another as possible and thereby to reduce the burden that might be imposed on applicants. A description of the final rule and an analysis of the relevant comments follows.

Determining if an Activity is Permissible for a Federal Branch

The commenters generally stated that no application should be required from a state-licensed branch or agency for the conduct of an activity that is permitted for a federal branch pursuant to interpretation, opinion or advice issued in writing by the OCC or its staff, as well as by statute, regulation official bulletin, circular or order. The commenters argued that a stricter requirement would result in a competitive disadvantage to state licensed offices and thereby would be inconsistent with the intent of the statute. The Board agrees with that argument. Accordingly, the conduct of activities permitted for a federal branch pursuant to interpretation, opinion or advice issued in writing by the OCC or its staff would not require an application, so long as such interpretation, opinion or advice is still considered valid, *i.e.*, it has not been overruled by the OCC or found invalid by a court of competent jurisdiction. In addition, because national banks and federal branches may rely on a written opinion of counsel that an activity is permissible under the National Bank Act or other applicable statutes, in the Board's view, it would be appropriate to permit state-licensed branches and agencies also to rely on such opinions, provided the opinion of counsel is based on a reasoned analysis of applicable statutes, regulations, official bulletins, circular, orders, or interpretations, opinions or advice of the OCC or its staff. The Board plans to consult with the OCC when questions arise as to the permissibility of any particular activity. Insured branches of foreign banks also should consult with the FDIC as to the permissibility of particular activities.

Bank Approach Versus Activity Approach

The Board's proposed rule took a bank-based approach to implementing the statute; that is, an application was required from each bank wishing to conduct or continue to conduct an activity not permissible for a national bank. The comments suggested that the Board instead take an activity based approach, at least with respect to activities which the commenters believed presented minimal risk. One commenter suggested that the Board entertain applications from industry trade groups with respect to the conduct of such activities.

The Board has determined that a combination of the two approaches is the appropriate way to proceed and has modified the proposed rule accordingly. As described in further detail below, the final rule provides that certain categories of activities are consistent with sound banking practice and that no application should be required to conduct such activities. The fact that the Board's prior consent is not required does not preclude the Board from taking any appropriate action within its authority with respect to such activities if the facts and circumstances warrant such action.

Application Not Required in Certain Instances

The first category of activities exempted from the application requirement are certain activities already determined by the FDIC not to pose a significant risk to the Bank Insurance Fund pursuant to § 362.4(c)(3) of the FDIC's regulations (12 CFR part 362). The Board has determined not to require an application under this part for the conduct of any such activity that the FDIC would permit an insured state bank to conduct directly, provided the activity is permissible for the branch or agency under applicable state law and any other applicable federal law or regulation. The Board believes the conduct of these activities, with proper controls, is consistent with safe and sound banking. As set forth in 12 CFR 362.4(c)(3)(i)–(ii)(A), the exempted activities include guarantee activities and activities found by the Board by regulation or order to be closely related to banking. In addition, the Board has determined to exempt from the application requirement any activity conducted as agent rather than as principal, provided that the activity is one that could be conducted by a state-chartered bank headquartered in the same state as the branch or agency is licensed. Of course, all activities of the branches and agencies remain subject to examination. If any particular activity is found to be improperly conducted, the Board retains enforcement authority to require conformance to safety and soundness requirements.

Finally, like the proposed rule, the final rule provides that an application under this section normally shall not be required where an activity is permissible to a federal branch but the OCC imposes a quantitative restriction on the conduct of such activity by the federal branch. The commenters were supportive of this exemption. The Board believes appropriate quantitative restrictions can be addressed on a case-by-case basis as part of the ongoing supervisory process.

Contents of Application

Section 211.29(b) of the proposed regulation provided that the application shall be in letter form and shall contain certain information, including among other things, a description of the activity in which the branch or agency desires to engage or in which it is already engaged, the foreign bank's financial condition, the assets and liabilities of the branch or agency, the projected effect of the proposed activity on the financial condition of the foreign bank and the branch or agency, and in the case of an application by a state-licensed insured branch, a statement of why the proposed activity will pose no significant risk to the deposit insurance fund.

The commenters suggested that applicants not be required to provide information already available to the Federal Reserve through its general examination and supervisory process. Accordingly, the Board has deleted from the final rule the requirement to provide certain financial information. The Board may request such information in individual cases if the information in its

possession is either out of date or otherwise deemed insufficient.

The Board and the FDIC have consulted concerning the type of information which each agency will need in order to make an informed judgment and have agreed on a common list of information in order that applicants will need to prepare only one application which, in the case of insured branches, may be submitted to both agencies. It is contemplated that the Board and the FDIC will review such applications simultaneously.

Standards To Be Examined

Section 211.29(d) of the final rule sets forth the standards that the Board will examine in order to determine whether a particular activity is consistent with sound banking practice. These factors are:

- What types of risks, if any, the activity poses to the U.S. operations of the foreign banking organization;
- If the activity poses any such risks, the magnitude of each risk; and
- If a risk is not *de minimis*, the actual or proposed procedures to control and minimize such risk.

Each of these factors shall be evaluated in light of the ability of the foreign bank to provide financial and managerial support to the branch or agency, the performance record of the foreign bank in general and the branch or agency in particular, and the volume of the proposed activity. The Board may also determine that a particular activity, after consideration of the above factors and subject to any conditions or limits imposed by the Board, may be conducted by any other state-licensed branch or agency without further application to the Board.

This section remains unchanged from the proposed rule.

Cessation or Divestiture

In the event that a state branch or agency is required to cease conducting an activity pursuant to the final regulation, § 211.29(f) sets forth the guidelines that must be followed to divest or cease the impermissible activity. Generally, this section provides that the state branch or agency shall submit a written plan of divestiture or cessation within 60 days of (1) being notified by the Board or the FDIC that an application to continue to conduct the activity has been denied, (2) the effective date of the regulation in the event that the foreign bank elects not to apply for permission to continue to conduct the activity, and (3) any change in statute, regulation, order or OCC interpretation that renders the activity impermissible. Divestiture or cessation shall be completed within one year, or sooner if the Board so directs. The Board requested comment on whether or not this period of time should be longer or shorter.

No comments were received on this portion of the proposed rule. Accordingly, no substantive changes were made.

Conversion From Federal to State License

As suggested by the commenters, the Board has determined not to require an application under the Foreign Bank Supervision Enhancement Act in connection with the conversion of: (1) a federally-licensed branch to a state licensed-branch; or (2) a federally licensed-agency to a state-licensed agency. Applications are not considered necessary in light of the fact that state-licensed branches and agencies must restrict their activities to those permissible for a federal branch or receive the Board's approval to engage in the activity. Section 24 of Regulation K will be amended accordingly.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), it is certified that this final rule will not have a significant impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 211

Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and record-keeping requirements.

For the reasons set forth in the preamble, the Board amends 12 CFR part 211 as set forth below:

PART 211—INTERNATIONAL BANKING OPERATIONS (REGULATION K)

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

Authority: 12 U.S.C. 221 *et seq.*, 1818, 1841 *et seq.*, 1843 *et seq.*, 3101 *et seq.*, 3901 *et seq.*

2. In § 211.21, paragraph (e) is revised to read as follows:

§ 211.21 Definitions.

* * * * *

(e) *Change the status* of an office means convert a representative office into a branch or agency, or an agency into a branch, but does not include renewal of the license of an existing office.

* * * * *

3. In § 211.29, the text is added to read as follows:

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

(a) *Scope.* A state-licensed branch or agency shall file with the Board a prior written application for permission to engage in or continue to engage in any type of activity that:

(1) Is not permissible for a federal branch, pursuant to statute, regulation, official bulletin or circular, or order or interpretation issued in writing by the Office of the Comptroller of the Currency; or

(2) Is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction.

(b) *Exceptions.* No application shall be required by a state-licensed branch or agency to conduct any activity that is otherwise permissible under applicable state and federal law or regulation and that:

(1) Has been determined by the FDIC pursuant to 12 CFR 362.4(c)(3)(i)–(c)(3)(ii)(A) not to present a significant risk to the affected deposit insurance fund;

(2) Is permissible for a federally-licensed branch but the OCC imposes a quantitative limitation on the conduct of such activity by the federal branch;

(3) Is conducted as agent rather than as principal, provided that the activity is one that could be conducted by a state-chartered bank headquartered in the same state in which the branch or agency is licensed; or

(4) Any other activity that the Board has determined may be conducted by any state-licensed branch or agency of a foreign bank without further application to the Board.

(c) *Contents of application.* An application submitted pursuant to paragraph (a) of this section shall be in letter form and shall contain the following information:

(1) A brief description of the activity, including the manner in which it will be conducted and an estimate of the expected dollar volume associated with the activity;

(2) An analysis of the impact of the proposed activity on the condition of the U.S. operations of the foreign bank in general and of the branch or agency in particular, including a copy, if available, of any feasibility study, management plan, financial projections, business plan, or similar document concerning the conduct of the activity;

(3) A resolution by the applicant's board of directors or, if a resolution is not required pursuant to the applicant's organizational documents, evidence of

approval by senior management, authorizing the conduct of such activity and the filing of this application;

(4) If the activity is to be conducted by a state-licensed insured branch, a statement by the applicant of whether or not it is in compliance with 12 CFR 346.19 and 346.20, Pledge of Assets and Asset Maintenance, respectively;

(5) If the activity is to be conducted by a state-licensed insured branch, statements by the applicant:

(i) That it has complied with all requirements of the Federal Deposit Insurance Corporation concerning an application to conduct the activity and the status of the application, including a copy of the FDIC's disposition of such application, if available; and

(ii) Explaining why the activity will pose no significant risk to the deposit insurance fund; and

(6) Any other information that the Reserve Bank deems appropriate.

(d) *Factors considered in determination.* (1) The Board shall consider the following factors in determining whether a proposed activity is consistent with sound banking practice:

(i) The types of risks, if any, the activity poses to the U.S. operations of the foreign banking organization in general and the branch or agency in particular;

(ii) If the activity poses any such risks, the magnitude of each risk; and

(iii) If a risk is not de minimis, the actual or proposed procedures to control and minimize the risk.

(2) Each of the factors set forth in paragraph (d)(1) of this section, shall be evaluated in light of the financial condition of the foreign bank in general and the branch or agency in particular and the volume of the activity.

(e) *Application procedures.* Applications pursuant to this section shall be filed with the responsible Reserve Bank for the foreign bank. An application shall not be deemed complete until it contains all the information requested by the Reserve Bank and has been accepted. Approval of such an application may be conditioned on the applicant's agreement to conduct the activity subject to specific conditions or limitations.

(f) *Divestiture or cessation.* (1) In the event that an applicant's application for permission to continue to conduct an activity is not approved by the Board or, if applicable, the FDIC, the applicant shall submit a detailed written plan of divestiture or cessation of the activity to the responsible Reserve Bank within 60 days of the disapproval. The divestiture or cessation plan shall describe in detail the manner in which the applicant will divest itself of or cease the activity and shall include a projected timetable describing how long the divestiture or cessation is expected to take. Divestitures or cessation shall be complete within one year from the date of the disapproval, or within such shorter period of time as the Board shall direct.

(2) In the event that a foreign bank operating a state branch or agency chooses not to apply to the Board for permission to continue to conduct an activity that is not permissible for a federal branch or which is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction, the foreign bank shall submit a written plan of divestiture or cessation, in conformance with paragraph (f)(1), of this section within 60 days of January 1, 1995 or of such change or decision.

By order of the Board of Governors of the Federal Reserve System, October 27, 1994.

William W. Wiles,

Secretary of the Board.

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