



FEDERAL RESERVE BANK
OF DALLAS

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

March 15, 1996

DALLAS, TEXAS
75265-5906

Notice 96-24

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 announced a final rule setting out the criteria for evaluating continued operation of a foreign bank in the United States. The rule applies in cases where the foreign bank is not subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor.

The Board will take these criteria into account in reaching a view regarding whether a foreign bank that the Board has determined is not subject to comprehensive, consolidated, home country supervision should be permitted to continue its U.S. operations with or without supervisory constraints, or whether such U.S. operations should be terminated. The final rule, which amends Regulation K (International Banking Operations), becomes effective March 25, 1996.

ATTACHMENT

A copy of the Board's notice as it appears on pages 6918-21, Vol. 61, No. 37 of the *Federal Register* dated February 23, 1996, is attached.

MORE INFORMATION

For more information, please contact Howard Edmonds at (214) 922-6278. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Part 211

[Regulation K; Docket No. R-0862]

International Banking Operations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: Section 202(e)(7) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA or Act) provides that the Board, in consultation with the Treasury, develop and publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive supervision or

regulation on a consolidated basis. This final rule amends Regulation K on international banking operations to set out such criteria pursuant to section 202(e)(7) of FDICIA.

EFFECTIVE DATE: March 25, 1996.

FOR FURTHER INFORMATION CONTACT:

Kathleen M. O'Day, Associate General Counsel (202/452-3786), Sandra L. Richardson, Managing Senior Counsel (202/452-6406), John W. Rogers, Attorney (202/452-2798); Michael G. Martinson, Assistant Director (202/452-3640), Elizabeth H. Roberts, Manager (202/452-3846), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For users of Telecommunication Device for the Deaf (TDD), please contact Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System (Board or Federal Reserve), 20th and C Streets, N.W., Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Section 7(e)(7) of the International Banking Act (IBA) was added by the Foreign Bank Supervision Enhancement Act (FBSEA) and requires the Board, in consultation with the Treasury Department, to publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive, consolidated supervision by its home country supervisor. A determination by the Board that a foreign bank is not subject to comprehensive, consolidated supervision is a sufficient ground, in and of itself, for the Board to require, or with respect to federal branches or agencies to recommend, termination of the foreign bank's U.S. branches, agencies, or commercial lending company subsidiaries. However, termination of its U.S. operations is not mandatory in these circumstances. Instead, in enacting section 7(e)(7) of the IBA, Congress recognized that there may be factors in particular cases that militate against termination of a foreign bank's U.S. operations.

On December 13, 1994, the Board published for comment a proposed amendment to Regulation K (the Proposed Rule), 59 FR 64171, setting forth criteria to be used in evaluating whether a foreign bank's U.S. operations, in the absence of comprehensive, consolidated supervision, should be terminated or permitted to continue and, if the latter, whether any supervisory constraints should be placed upon the bank in connection with those operations.

The Proposed Rule further provided that any foreign bank found not to be subject to comprehensive, consolidated supervision may be required to enter into and comply with an agreement to conduct its U.S. operations in accordance with restrictions the Board may determine to be appropriate in order to assure the safety and soundness of such operations. Prior to imposing any such restrictions, whether through written agreement or otherwise, the Board would consult with the Office of Comptroller of the Currency (OCC) or the relevant state banking authorities. In appropriate circumstances, the OCC or the relevant state banking authorities may join in any such agreement. If any requirements imposed in such an agreement were not adhered to, the U.S. banking operations of the foreign bank would be subject to further enforcement action, including potentially the issuance of an order terminating the activities of its U.S. offices or transmittal of a recommendation to the OCC for such termination.

The Board received six public comments with regard to the Proposed Rule. Comments were submitted by two Members of Congress, an association of state banking supervisors, three trade associations, and one domestic bank. The comments focused on the following general topics: maintaining flexibility in the evaluation process, as well as in the supervisory responses to a determination that a foreign bank is not subject to comprehensive, consolidated supervision; taking into account a country's progress towards a system of comprehensive, consolidated supervision; excluding representative offices from evaluation under the criteria; providing notice to a foreign bank prior to making a comprehensive, consolidated supervision determination; clarifying relevant state banking regulators for purposes of consultation under the rule; and evaluating a foreign bank's overall financial condition. The comments are discussed further below.

Flexibility

The commenters generally endorsed the flexibility indicated by the Board in proposing to take into account a wide variety of criteria in evaluating whether a foreign bank's U.S. operations should be terminated or permitted to continue when that foreign bank is not subject to comprehensive, consolidated supervision.

Several commenters urged the Board to apply the criteria and develop any subsequent supervisory response on a case-by-case basis, taking into account the unique circumstances of the foreign bank concerned, rather than developing

a "standardized" response based upon a foreign bank's country of origin. The commenters further urged the Board explicitly to endorse the case-by-case approach to such determinations, either in the final rule or in commentary to the final rule.

As the Board indicated in the preamble to the Proposed Rule, determinations with regard to whether a foreign bank is subject to comprehensive, consolidated supervision will be made in the context of the supervision and regulation of the foreign bank's existing U.S. operations. A case-by-case approach to such determinations was contemplated in the Proposed Rule and the Board continues to believe that this is the appropriate basis on which such determinations should be made. That said, an adverse determination with regard to whether a particular bank is subject to comprehensive, consolidated supervision will suggest that further inquiry may be appropriate with regard to the nature and scope of supervision of other banks with the same home country supervisor.

Progress Towards Comprehensive, Consolidated Supervision

The commenters also noted that many foreign supervisors have reacted to passage of the FBSEA by undertaking initiatives to institute systems of comprehensive, consolidated supervision. The commenters urged the Board to take into account as an additional criterion whether the foreign bank's home country supervisor was making progress towards comprehensive, consolidated supervision as outlined in the minimum standards for the supervision of international banking groups and their cross-border establishments published by the Basle Committee on Banking Supervision. The Board considers this to be an appropriate suggestion and the final rule has been amended to include such a criterion.

Supervisory Response

Several commenters were concerned that imposing a requirement that a foreign bank conduct its U.S. banking operations on the basis of such operations being in a net-due-to position vis-a-vis the parent should not be the standard supervisory response stemming from a determination that a foreign bank is not subject to comprehensive, consolidated supervision. The commenters noted generally that such a requirement could be extremely damaging to the business of a foreign bank. These commenters also noted that the Board, in the

preamble to the Proposed Rule, indicated that it was appropriate, in developing the proposed criteria, to take into account the panoply of tools available to the Board and other banking regulators to regulate the operations of foreign banks not yet subject to comprehensive, consolidated supervision. One commenter recommended that the Board clarify that it only would use specific supervisory agreements in cases where it has safety and soundness concerns regarding the U.S. operations of a foreign bank, not solely on the basis that the foreign bank's home country supervisor does not exercise comprehensive, consolidated supervision.

The Proposed Rule provided that any foreign bank that the Board determines is not subject to comprehensive, consolidated supervision may be required to conduct its U.S. operations subject to such restrictions as the Board, having taken into account the criteria, determines to be appropriate in order to assure the safety and soundness of the bank's U.S. operations. 59 FR 64173. The Board stated in the preamble to the Proposed Rule that requiring a foreign bank to conduct its U.S. banking operations in a net-due-to position vis-a-vis the rest of the organization would be one means of assuring the safe and sound operation of the bank's U.S. offices. The Board also noted that other operational requirements also could be imposed, such as collateralization of affiliate transactions, asset maintenance requirements, increased asset pledges, and liquidity requirements. Which of these operational requirements, if any, would be imposed upon a foreign bank's offices in the United States following a determination that the bank is not subject to comprehensive, consolidated supervision would be determined in light of the circumstances of each case.

Representative Offices

Two commenters asked the Board to consider the implications of the Proposed Rule as regards representative offices, arguing that the criteria should not apply to foreign banks that operate only representative offices in the United States. The Board notes that the FBSEA permits the approval of applications to establish representative offices even in the absence of comprehensive, consolidated supervision. The absence of comprehensive, consolidated supervision would not mean necessarily that any action would be taken under the criteria in relation to a bank with only representative offices in the United States. If, however, supervisory concerns should arise in relation to such a bank, the criteria would apply.

Notice to Foreign Bank

One commenter noted that language in the preamble to the Proposed Rule could imply that a Board determination as to comprehensive, consolidated supervision may be made without notice to the foreign bank other than when expeditious action is necessary or in connection with an application requiring such determination. The commenter further stated that the strength of support assessment to be made in connection with the Supervisory Program for the U.S. Operations of Foreign Banking Organizations presents an opportunity for a comprehensive, consolidated supervision determination to be made unbeknownst to the foreign bank. This commenter recommended that the final rule confirm that a foreign bank will always receive notice and an opportunity to provide its views and relevant information when a comprehensive, consolidated supervision determination is being made and expeditious action in the public interest is not necessary.

As the Board indicated in the Proposed Rule, all determinations with regard to whether a foreign bank is subject to comprehensive, consolidated supervision will be made in the context of the supervision of the foreign bank's U.S. operations or, of course, in connection with an application. Just as is the case with other such determinations, a foreign bank generally will have an opportunity to provide its views and any information it considers relevant during the course of the application, supervision, or examination process. Information gained in the course of the supervisory process will be available to the Board when making the determination of whether a foreign bank is subject to comprehensive, consolidated supervision. Any action that might result from a determination, such as a decision to terminate or to begin enforcement proceedings, would provide the foreign bank with an opportunity to provide further information to the Board.

State Banking Regulators

One commenter noted that the criteria do not specify which state banking regulator would be the "relevant" banking regulator in those cases where a foreign bank has operations in more than one state. This commenter, therefore, recommended that the Board clarify that the "relevant" state regulator includes all state bank regulators where the foreign bank in question has offices. This amendment is consistent with the intention underlying the subject

provision of the Proposed Rule and the final rule has been amended accordingly.

Evaluation of Financial Condition

One commenter indicated that due regard should be accorded different accounting systems used by the foreign bank when evaluating the soundness of the foreign bank's financial condition, particularly if the accounting treatments differ from U.S. generally accepted accounting principles. The Board considers that no amendment to the Proposed Rule is necessary to address this point. The Board notes that it approaches the evaluation of a foreign bank's financial condition with sufficient flexibility to accommodate such accounting differences, yet with sufficient rigor to reach a view regarding whether the foreign bank's overall financial strength is equivalent to that required of U.S. banks seeking to engage in similar activities.

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the rule under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the rule.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*), it is certified that the final rule would not have a significant impact on a substantial number of small entities that are subject to its regulation.

List of Subjects in 12 CFR Part 211

Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements.

For the reasons outlined above, the Board is amending 12 CFR Part 211 as set forth below:

PART 211—INTERNATIONAL BANKING OPERATIONS (REGULATION K)

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

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

2. A new § 211.30 is added to Subpart B to read as follows:

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

(a) *General.* Pursuant to the Foreign Bank Supervision Enhancement Act, Pub.L. 102-242, 105 Stat. 2286 (1991), the Board shall develop and publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive supervision or regulation on a consolidated basis.

(b) *Criteria.* Following a determination by the Board that, having taken into account the standards set forth in § 211.24(c)(1) of this subpart, a foreign bank is not subject to comprehensive, consolidated supervision by its home country supervisor, the Board shall consider the following criteria in determining whether the foreign bank's U.S. operations should be permitted to continue and, if so, whether any supervisory constraints should be placed upon the bank in connection with those operations:

(1) The proportion of the foreign bank's total assets and total liabilities that are located or booked in its home country, as well as the distribution and location of its assets and liabilities that are located or booked elsewhere;

(2) The extent to which the operations and assets of the foreign bank and any affiliates are subject to supervision by its home country supervisor;

(3) Whether the appropriate authorities in the home country of such foreign bank are actively working to establish arrangements for the comprehensive, consolidated supervision of such bank and whether demonstrable progress is being made;

(4) Whether the foreign bank has effective and reliable systems of internal controls and management information and reporting, which enable its management properly to oversee its worldwide operations;

(5) Whether the foreign bank's home country supervisor has any objection to the bank continuing to operate in the United States;

(6) Whether the foreign bank's home country supervisor and the home country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(7) The relationship of the U.S. operations to the other operations of the foreign bank, including whether the foreign bank maintains funds in its U.S. offices that are in excess of amounts due to its U.S. offices from the foreign bank's non-U.S. offices;

(8) The soundness of the foreign bank's overall financial condition;

(9) The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors and the integrity of its principal shareholders;

(10) The scope and frequency of external audits of the foreign bank;

(11) The operating record of the foreign bank generally and its role in the banking system in its home country;

(12) The foreign bank's record of compliance with relevant laws, as well as the adequacy of its money laundering controls and procedures, in respect of its worldwide operations;

(13) The operating record of the U.S. offices of the foreign bank;

(14) The views and recommendations of the Office of the Comptroller of the Currency or the state banking regulators in those states in which the foreign bank has operations, as appropriate;

(15) Whether the foreign bank, if requested, has provided the Board with adequate assurances that such information will be made available on the operations or activities of the foreign bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the International Banking Act, the Bank Holding Company Act, and other applicable federal banking statutes; and

(16) Any other information relevant to the safety and soundness of the U.S. operations of the foreign bank.

(c) *Restrictions on U.S. operations.—*

(1) *Terms of agreement.* Any foreign bank that the Board determines is not subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor may be required to enter into an agreement to conduct its U.S. operations subject to such restrictions as the Board, having considered the criteria set forth in paragraph (b) of this section, determines to be appropriate in order to assure the safety and soundness of its U.S. operations.

(2) *Failure to enter into or comply with agreement.* A foreign bank that is required by the Board to enter into an agreement pursuant to paragraph (c)(1) of this section and either fails to do so or fails to comply with the terms of such agreement may be subject to enforcement action in order to assure safe and sound banking operations under 12 U.S.C. 1818, or to termination or a recommendation for termination of its U.S. operations under § 211.25 (a) and (e) of this subpart and section (7)(e) of the IBA (12 U.S.C. 3105(e)).

By order of the Board of Governors of the Federal Reserve System, February 15, 1996.

William W. Wiles,
Secretary of the Board.

[FR Doc. 96-3910 Filed 2-22-96; 8:45 am]

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