FEDERAL RESERVE BANK
OF DALLAS

November 26, 2001

DALLAS, TEXAS
75265-5906

Notice 01-88

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

SUBJECT

Final Rule on Regulation K (International Banking Operations); Amendments to Rules Regarding Delegation of Authority

DETAILS

The Board of Governors of the Federal Reserve System has reviewed Regulation K, which governs international banking operations, and is amending subparts A, B, and C, effective November 26, 2001. A proposed rule to amend subpart D of Regulation K was issued in this Bank's Notice 01-82 dated November 2, 2001. There are also certain amendments to the Board's Rules Regarding Delegation of Authority.

Subpart A of Regulation K governs the foreign investments and activities of all member banks (national banks as well as state member banks), Edge and agreement corporations, and bank holding companies. Subpart B governs the U.S. activities of foreign banking organizations. Subpart C deals with export trading companies.

A copy of the Board's notice as it appears on pages 54346–98, Vol. 66, No. 208 of the *Federal Register* dated October 26, 2001, can be found on our web site at **http://www.dallasfed.org/banking/notices/2001/0188.pdf**. Additionally, you may obtain a hard copy of the document by contacting the Public Affairs Department at (214) 922-5254.

MORE INFORMATION

For more information, please contact Dick Burda, Banking Supervision Department, (713) 652-1503. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254 or access District Notices on our web site at **http://www.dallasfed.org/banking/notices/index.html**.

Friday,

October 26, 2001

Part II

Federal Reserve System

12 CFR Parts 211 and 265

International Banking Operations; Rules Regarding Delegation of Authority and International Lending Supervision; Final Rule and Proposed Rule

FEDERAL RESERVE SYSTEM

12 CFR Parts 211 and 265

[Regulation K; Docket No. R–0994]

International Banking Operations; Rules Regarding Delegation of Authority

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: Consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (the Regulatory Improvement Act), the Federal Reserve Act, and the International Banking Act of 1978 (the IBA), the Board has reviewed Regulation K, which governs international banking operations, and is amending subparts A, B, and C. A proposed rule to amend subpart D of Regulation K is being published in this same issue of the **Federal Register**.

Subpart A of Regulation K governs the foreign investments and activities of all member banks (national banks as well as state member banks), Edge and agreement corporations, and bank holding companies. The amendments streamline foreign branching procedures for U.S. banking organizations, authorize expanded activities in foreign branches of U.S. banks, and implement recent statutory changes authorizing a bank to invest up to 20 percent of capital and surplus in Edge corporations. Changes also have been made to the provisions governing permissible foreign activities of U.S. banking organizations, including securities activities, and investments by U.S. banking organizations under the general consent procedures.

Subpart B of Regulation K (Foreign Banking Organizations) governs the U.S. activities of foreign banking organizations. The amendments include revisions aimed at streamlining the applications procedures applicable to foreign banks seeking to expand operations in the United States, changes to provisions regarding the qualification of foreign banking organizations for exemption from the nonbanking prohibitions of section 4 of the Bank Holding Company Act (the BHC Act), and implementation of provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Interstate Act) that affect foreign banks.

In addition, there are a number of technical and clarifying amendments to subparts A and B, as well as subpart C, which deals with export trading companies. There are also certain amendments to the Board's Rules Regarding Delegation of Authority.

EFFECTIVE DATE: November 26, 2001.

FOR FURTHER INFORMATION CONTACT: Kathleen M. O'Day, Associate General Counsel (202/452–3786), regarding all subparts: Jon Stoloff, Senior Counsel (202/452–3269), or Alison MacDonald, Counsel (202/452–3236), regarding Subpart A; Ann Misback, Assistant General Counsel (202/452–3788), Janet Crossen, Senior Counsel (202/452–3281), or Melinda Milenkovich, Counsel (202/452–3274), regarding Subparts B and C; Legal Division; or Michael G. Martinson, Associate Director (202/452–2798), or Betsy Cross, Deputy Associate Director (202/452–2574), regarding all subparts; Division of Banking Supervision and Regulation. For users of Telecommunications Device for the Deaf (TDD) only, please contact 202/263–4869.

SUPPLEMENTARY INFORMATION:

Subpart A: International Operations of U.S. Banking Organizations

Statutory Framework

The Board is issuing amendments to Regulation K that will eliminate unnecessary regulatory burden, increase transparency, and streamline the approval process for U.S. banking organizations seeking to expand their operations abroad. The Federal Reserve Act, as amended by the IBA, requires the Board to review its regulations issued under section 25A of the Federal Reserve Act (the Edge Act) at least once every five years and make any changes necessary to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions and banking practices.[1] The Board has reviewed the provisions of Subpart A, which govern the operations of Edge corporations, with this statutory mandate in mind.

Edge corporations are international banking and financial vehicles through which U.S. banking organizations offer international banking or other foreign financial services and through which they compete with similar foreign-owned institutions in the United States and abroad. The purposes of the Edge Act, which amended the Federal Reserve Act in 1919, include enabling U.S. banking organizations to compete effectively with foreign-owned institutions; providing the means to finance international trade, especially U.S. exports; fostering the participation of regional and smaller U.S. banks in providing international banking and financing services to U.S. business and agriculture; and stimulating competition in the provision of international banking and financing services throughout the United States.

Congress, in enacting this legislation, recognized that U.S. banks needed vehicles that could exercise wider financial powers abroad than were permitted domestically in order to be competitive internationally and to serve the international needs of U.S. firms. At the same time, the Edge Act places limits on U.S. banks' exposure to these broader foreign activities, by limiting the amount that U.S. banks may invest in Edge corporations, establishing a number of statutory safety and soundness constraints, and granting the Board wide discretion in determining what activities should be permissible for such entities. In exercising its authority in this area, the Board is required by the IBA to implement the objectives of the Edge Act consistent with supervisory standards relating to the safety and soundness of U.S. banking organizations.

In December 1997, following a comprehensive review of the regulation, the Board requested public comment on proposed revisions to Regulation K (62 FR 68423) (the '97 Proposal). The Board received 28 comments from outside the Federal Reserve System on the proposed Subpart A revisions. Comments were received from twelve U.S. banks or bank holding companies; one Edge corporation; one bank-owned insurance agency; and thirteen trade associations. The Board also received comments from one state bank supervisory agency.

Subsequent to the Board issuing the '97 Proposal, financial modernization legislation was enacted. The Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat. 1338 (1999) (GLB or the GLB Act) was enacted on November 12, 1999. Many of the activities the Board had proposed to liberalize in the '97 Proposal are covered under the expanded authority available to financial holding companies (FHCs) under GLB. More specifically, under GLB, a bank holding company (BHC) that elects to become an FHC may engage in a broad range of financial activities, including securities underwriting and dealing, insurance sales and underwriting, and merchant banking.

Final action on the '97 Proposal was deferred pending implementation of the expanded authority available under GLB. The Board has issued a number of rules implementing GLB authority, including, for example, those governing

[1] The Board last issued final revisions to Subpart A of Regulation K in December 1995, at which time the investment authority for strongly capitalized and well-managed U.S. banking organizations was expanded significantly.

FHC elections and activities (66 FR 400, Jan. 3, 2001), real estate brokerage activities by FHCs (66 FR 307, Jan. 3, 2001), merchant banking activities (66 FR 8466, Jan. 31, 2001), the capital treatment of nonfinancial equity investments (66 FR 10212, Feb. 14, 2001), transactions between banks and their affiliates (66 FR 24186, May 11, 2001), and financial subsidiaries of state member banks (66 FR 42929, Aug. 16, 2001).

The Board has now reviewed its '97 Proposal in light of the significantly changed landscape in relation to provision of financial services post-GLB, as well as all comments filed on the '97 Proposal. The Board has concluded that a few of the changes proposed in 1997 that would have allowed expansion of activities now authorized under GLB no longer are appropriate, primarily those relating to equity dealing, portfolio investment, and insurance activities. However, consistent with the '97 Proposal, the Board has concluded that a number of provisions relating to foreign activities of U.S. banking organizations should be amended, including changes that would: (1) Expand permissible government bond trading by foreign branches of member banks; (2) streamline procedures for establishment of foreign branches by U.S. banking organizations; (3) expand permissible equity underwriting activities abroad for well-capitalized and well-managed U.S. banking organizations; (4) expand general consent authority for well-capitalized and well-managed U.S. banking organizations; (5) amend the debt/equity swaps authority to reflect changes in circumstances of eligible countries; and (6) implement the statutory provision allowing member banks to invest, with the Board's approval, up to 20 percent of capital and surplus in the stock of Edge and agreement corporations. Additional technical and clarifying amendments were also made. These changes to Regulation K, and the comments received on the '97 Proposal, are discussed below.

The Board also indicated in the '97 Proposal that it had not identified any changes to the permissible U.S. activities of Edge corporations that appeared necessary or appropriate to fulfill the purposes of the Edge Act, but sought comment on whether there was a need for any such changes. One commenter urged the Board to permit Edge corporations to provide incidental services generating insignificant revenues in the United States to U.S. persons affiliated with a foreign person or a foreign organization that is principally engaged in foreign business. The Board does not believe this change is necessary or appropriate or otherwise consistent with the purposes of the Edge Act.

Expansion of Government Bond Trading by Foreign Branches

Section 25 of the Federal Reserve Act permits the Board to authorize foreign branches of member banks to conduct abroad activities that are not permitted domestically. However, the statute states that the Board shall not ''except to such limited extent as the Board may deem necessary with respect to securities issued by any 'foreign state' * * * authorize a foreign branch to engage or participate, directly or indirectly, in the business of underwriting, selling, or distributing securities.''

Given the statutory language, the Board, to date, has only permitted foreign branches to underwrite and sell obligations of (i) the national government of the country in which the branch is located, (ii) an agency or instrumentality of the national government where supported by the taxing authority, guarantee, or full faith and credit of the national government, and (iii) a political subdivision of the country. This was determined to be appropriate on the basis that it is often necessary in the ordinary course of banking business for a branch to participate in the selling of the bonds of the host country.

In recent years, U.S. banking organizations have become more active in trading and underwriting foreign government securities. Increasingly, such business, where possible, is being conducted in the foreign branches of U.S. banks. Centralizing trading for all or for certain groups of countries in a single branch can be desirable to facilitate management and funding of this business. For example, a banking organization might wish to centralize government securities trading for all countries in the European Union in one European branch.

For these reasons, the Board proposed that banks be permitted to underwrite and deal through their foreign branches in obligations of governments other than the host government, provided that the obligations are of investment grade and the business is otherwise subject to sound banking practices and prudential regulations. The Board considered the requirement that the obligations must be investment grade would limit cross-border transfer risk to the bank because trading of government securities giving rise to such risk would be required to be conducted either directly through a local branch that is funded locally or through a subsidiary, instead of through the bank. The Board also proposed to retain the existing authority of foreign branches of member banks to underwrite and deal in host government bonds regardless of whether they are investment grade. The Board sought comment on these proposals, as well as on what ratings should be considered to be investment grade for these purposes.

Commenters expressed general support for the Board's proposal. Some commenters suggested that the Board treat any government obligation, investment grade or otherwise, of any country or, alternatively, any country in which a bank has a foreign branch, as eligible to be underwritten and traded in branches located outside of that country. Other commenters argued that safety and soundness is enhanced by having centralized underwriting and dealing of *all* government securities, since the local branch which has authority to engage in non-investment grade underwriting and dealing may not have the appropriate experience to manage such operations.

The Board continues to believe the investment grade requirement for obligations of governments other than the host government is appropriate for the reason set out in the proposal, namely, limitation of cross-border transfer risk to the bank. Non-investment grade government securities issued by foreign governments other than the host government are more likely to give rise to such risks. For this reason, the Board continues to be of the view that trading of non-investment grade securities should be conducted either directly through a local branch that is funded locally or through a subsidiary, instead of through the bank. Accordingly, in the final rule, the Board has retained the investment grade requirement for obligations of governments other than the host government.

A few commenters recommended that the Board permit foreign branches of U.S. banks to underwrite and deal in investment grade obligations of all political subdivisions, and of agencies and instrumentalities whether or not backed by the national government. After further consideration, the Board has determined that it is appropriate to adopt this suggestion at least in part, so long as all such obligations are investment grade. As at present, obligations of agencies and instrumentalities will be required to be supported by the taxing authority, guarantee, or full faith and credit of the national government.

Commenters also requested that foreign branches be permitted to underwrite and deal in all securities guaranteed by a foreign government. The Board notes that the authority granted in section 25 of the Federal Reserve Act in relation to this activity is with respect to securities ''issued by 'foreign state','' and declines to adopt this change.

With respect to the Board's request for comment on which ratings should be considered to be investment grade for these purposes, commenters urged the Board to adopt the definition of ''investment grade'' set out in the Office of the Comptroller of the Currency's (OCC) investment securities regulation. 12 CFR 1.2(d). The OCC defines the term to mean a security that is rated in one of the four highest rating categories by two or more ''nationally recognized statistical rating organizations'' (NRSROs) as designated by the Securities and Exchange Commission (SEC), or one such agency if the security has been rated by only one NRSRO. The Board considers this definition to be appropriate for purposes of this activity of foreign branches of U.S. banks; accordingly, that definition is incorporated into the final rule.

A few commenters also urged the Board to adopt a procedure that would permit the addition of agencies to the list of permissible rating agencies beyond those that have been approved by the SEC because of concern that a rating by a NRSRO may not be available for some foreign government securities. The Board is not inclined to adopt such a procedure at this time in view of the number of NRSROs that rate foreign government securities. Board staff should be consulted if any issues arise in relation to application of the ''investment grade'' requirement. If it appears that additional guidance is warranted, the Board will consider the matter further.

Comments also suggested that securities that are not speculative in nature and are deemed by the investor to be the credit equivalent of a security that is rated investment grade should be considered ''investment grade'' under this provision of Regulation K. The Board believes that such an approach would essentially mean that there would be no requirement that the obligations be investment grade and rejects it for this reason. Finally, commenters sought clarification as to whether the limits applicable to government obligations, whether as a percentage of capital or of local deposits, may be calculated on a net basis rather than a gross basis. The limits applicable to government obligations under this section may be calculated on a net basis, provided that the banking organization otherwise has received no objection to its internal models being employed for purposes of compliance with these limits.

Foreign Branching

The Board's responsibilities as home country supervisor under the *Minimum Standards for the Supervision of International Banking Groups and their Cross-border Establishments* issued by the Basle Committee on Banking Supervision (the Minimum Standards) call for its specific authorization of a U.S. banking organization's outward expansion. Outward expansion for these purposes means the initial establishment of a banking presence in a country by the bank or any affiliate.

Regulation K currently requires the specific consent of the Board for the establishment of branches by a member bank, an Edge or agreement corporation, or a foreign bank subsidiary in its first two foreign countries. The Board proposed to amend Regulation K to require only 30 days' prior notice to the Board before establishment of branches in the first two countries, on the basis that such a requirement also would fulfill the Board's responsibilities under the Minimum Standards. The Board also proposed that 30 days' prior notice would be required, consistent with the Minimum Standards, if the initial banking presence abroad would be in the form of a subsidiary bank; such notice would be required even if the amount to be invested were below the general consent limits.

Under Regulation K at present, no prior Board approval is required for a banking entity to establish additional branches in any foreign country where it already operates one or more branches. However, a banking entity must give the Board prior notice before establishing a branch in a foreign country where it has no branches even though a banking affiliate operates a branch in that country.

The Board proposed to liberalize Regulation K such that if any of the member banks, their Edge or agreement corporation subsidiaries, or a foreign bank subsidiary (whether a subsidiary of the bank or of the bank holding company) already has a branch in a particular foreign country, a banking affiliate would be authorized to branch there without prior notice to the board. After-the-fact notice, however, would still be required.

The Board also proposed that the 45 days' prior notice currently required in order to branch into additional countries where there is no affiliated banking presence (after the organization has branches engaged in banking in two foreign countries) should be reduced to 12 business days. In taking this approach, the foreign branching establishments of the entire banking organization would be taken into account in determining whether the banking entity would be subject to the 30 day or 12 day prior notice procedure. Where a U.S. banking organization as a whole already operates foreign branches of banking entities in two countries, any banking affiliate would be able to open a branch in a country where such organization has no banking presence, pursuant to the 12 days' prior notice procedure.

Finally, currently under Regulation K, nonbanking subsidiaries may branch into any country in which any affiliate has a branch without prior notice, but a 45-day prior notice must be submitted to establish a branch in a country where no affiliate has a presence. The Board proposed permitting nonbanking subsidiaries held pursuant to Regulation K to establish foreign branches without prior review, subject only to an after-the-fact notice requirement.

The Board sought comment on these proposed changes, including in particular whether the proposed modified notice periods would sufficiently accommodate foreign expansion plans. Commenters supported the Board's proposed changes. Accordingly, the Board is adopting the foreign branching provisions as proposed. The Board wishes to clarify that filing Form FR 2058 fulfills the after-the-fact notice requirements of the foreign branching provisions. Additionally, the Board notes that the streamlined procedures for establishment of foreign branches are not limited to well-capitalized, well-managed institutions. However, the Board retains the authority to suspend general consent authority in whole or in part should circumstances warrant.

Permissible Activities of Foreign Subsidiaries of U.S. Banking Organizations

One aspect of bank regulation to which the Federal Reserve subscribes is the fostering of a level competitive playing field for financial intermediaries. Thus, in the United States, the Board has advocated that expansion by banking organizations into nonbanking activities should generally occur through the bank holding company and not the bank. Banks in the United States benefit from the implicit support of the national government and its sovereign credit rating through federal deposit insurance, Federal Reserve discount window access, and final riskless settlement of payment system transactions. Extension of this system would make the existing playing field in the United States unlevel for nonbank competitors and create unnecessary distortions in competition.

The same principle applies to U.S. banking organizations abroad. Other nations have chosen to allow their banks to engage in a broad array of financial activities, especially investment banking activities, thereby extending to these activities the implicit support of their governments. In those markets, U.S. banking organizations would be at a disadvantage if unable to offer their customers an equivalent range of key services with the convenience and efficiency of their local bank competitors. In many of these markets, banks are the only significant providers of capital markets services. Independent securities firms are not generally substantial competitors in these markets, both for historical reasons and because they may be unable to compete effectively with banks that have the explicit and implicit support of their governments.

Congress has recognized the existence of conflicting policy objectives and competitive pressures faced by U.S. banking organizations operating abroad and through legislation has struck a balance. In relation to the United States, Congress in enacting GLB demonstrated a strong preference that expanded nonbanking financial activities be conducted in a structure that does not involve the federal bank subsidy. Expanded activities authorized by GLB are required to be conducted either in nonbank subsidiaries of a financial holding company or in a financial subsidiary of a bank, which would be subject to the restrictions on funding by a parent bank set out in sections 23A and 23B of the Federal Reserve Act. In relation to competitive pressures arising from abroad, Congress preserved the Board's authority under the Edge Act to permit Edge corporations, which may be owned by U.S. banks, to engage in a wider range of activities outside the United States than permitted to U.S. banks domestically, where such powers are considered necessary to enable them to compete effectively with similar foreign-owned institutions in the United States and abroad and liberalization otherwise is consistent with safety and soundness considerations. Congress, in enacting the Edge Act, recognized that U.S. banks in some circumstances may need vehicles that could exercise broader financial powers abroad in order to remain competitive internationally and to serve the needs of U.S. firms. Congress granted the Board similar broad discretion to allow bank holding companies to engage in activities outside the United States.

In exercising its statutory authority under the Edge Act, the Board has sought to balance the need for U.S. banking organizations to be competitive abroad with the public interest in assuring the safety and soundness of the banks, protecting the deposit insurance fund, and limiting the extension of the federal safety net. In adopting final revisions to Regulation K, the Board has sought to grant expanded authority only in relation to those activities where: (i) The existing restrictions of Regulation K appear to result in a competitive harm to the ability of an Edge corporation to provide financial services necessary to attract and retain customers; and (ii) requiring the activities to be conducted outside the bank chain of ownership appears to compromise significantly the competitive position of U.S. banking organizations. The Board has concluded that equity underwriting is one such activity, and the expansion of authority proposed in 1997 with regard to this activity has been adopted, as discussed further below. The Board has concluded, however, that liberalization set out in the '97 Proposal in relation to other activities, such as equity dealing, venture capital investments and insurance activities, should not be adopted at this time in light of the passage of GLB. These latter activities appear to be able to be conducted competitively outside the bank chain of ownership under authority granted in GLB.

Two-Tier Capital Test for Edge Corporations

As the Board noted in the '97 Proposal, tying applicable limits to the capital of the parent bank is particularly important for subsidiaries of Edge corporations. Congress has limited a member bank's investment in Edge and agreement corporations to 20 percent of the bank's capital.[2] However, for various reasons, Edge corporations historically have tended to retain their earnings rather than dividending them to the parent bank. In some cases due to such retained earnings, the capital of a bank's Edge and agreement corporations may be in excess of 20 percent of the parent bank's consolidated capital, even though its *investment* in the Edge subject to the above-referenced statutory limit is below 20 percent.

In these circumstances, the Board considered that the capital of an Edge corporation that is in excess of 20 percent of the parent bank's consolidated capital, when retained earnings are counted, generally should be excluded for purposes of determining applicable limits for activities of the Edge and its subsidiaries. Accordingly, the Board proposed that Edge and agreement corporations, as well as foreign bank subsidiaries of member banks (which are treated as Edge corporations for purposes of their limits), would be subject to two limits, one tied to a percentage of the Edge corporation's tier 1 capital and the other tied to a percentage of the parent bank's tier 1 capital. Limits tied to the parent bank's capital would be 20 percent of the limits otherwise applicable to Edge corporations, and the lower limit would be binding. For example, if a limit proposed for a given activity of an Edge corporation is 10 percent of the Edge corporation's capital but the Edge corporation's capital is in excess of 20 percent of the bank's total capital, the binding limit for the Edge corporation would be two percent of the parent bank's tier 1 capital. For those U.S. banks that do not have significant levels of retained earnings at the Edge, the binding limit more than likely would be the separate limit tied to the Edge corporation's capital.

The Board considered that this approach would be consistent with the intent underlying the provisions of the Edge Act limiting the total amount of capital a bank may invest in Edge corporations. This approach effectively would place a cap on the percentage of total *bank* capital that could be placed at risk through activities or investments not otherwise permitted to the bank directly, regardless of the capital level of the Edge corporation. This approach also would reduce any regulatory incentive to retain earnings at the Edge because any regulatory benefit from such retained earnings, in terms of expanded limits on activities abroad, would be denied.

The Board proposed that all limits applicable to Edge corporations under the '97 Proposal would proceed on this basis. Comment was requested on these proposals and whether any other approach might achieve similar objectives.

One commenter opposed the Board's proposal to impose a two-tier capital test on Edge corporations, arguing that the proposal penalized organizations that achieve strong earnings in a

[2] The Edge Act prohibited member banks from investing more than 10 percent of their capital and surplus in the capital stock of Edge and agreement corporations. In September 1996, congress amended this limit to permit investments in excess of 10 percent of capital and surplus with the specific approval of the Board, provided the amount invested shall not exceed 20 percent of capital and surplus of the bank. *See* The Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), Pub. L. 104–208, sec. 2307 (12 U.S.C. 618).

subsidiary of a bank rather than a subsidiary of the holding company. It further maintained that the limitation on the amount a bank can invest in an Edge corporation creates a practical limit on the risk to the bank's own capital. Therefore, it argued the Board should look only at the capital of the Edge corporation in setting limits as a percentage of capital. The Board continues to believe this two-tier approach is consistent with the intent underlying provisions of the Edge Act that limit the total amount of capital a bank may invest in Edge corporations. The Board notes that, due to the accumulation of large amounts of retained earnings in Edge corporations, the limitation on the amount a bank can invest in an Edge corporation may not limit the overall risk to the bank's consolidated capital.

Two other commenters argued the Board should look only at the capital of the parent bank in setting limits under the Edge corporation. The Board believes, however, that activity limits for Edge corporations should be tied to the capital of both the Edge corporation and the parent member bank, in order to ensure that Edge corporations are not a source of potential weakness to the U.S. parent bank.

Securities Activities

Current Restrictions on Securities Activities

Foreign subsidiaries of U.S. banking organizations have been permitted broad authority to underwrite and deal in debt securities for over 25 years, subject to the provision that the securities must be included with loans for purposes of compliance with the parent bank's lending limit. No separate dollar limits have been placed on underwriting and dealing in debt securities.

Since 1979, Regulation K also has specifically authorized foreign subsidiaries of both U.S. banks and bank holding companies to underwrite and deal in equity securities outside the United States, subject to certain limitations and restrictions. These activities were determined to be permissible, within the applicable limits, on two bases. First, it became clear that it was necessary for U.S. banking organizations to be able to engage in these activities abroad, if they were to compete successfully with foreign banks in the provision of services to foreign customers. Indeed, for some time, virtually all the major foreign competitors of U.S. banking organizations have been foreign banks that conduct equity securities activities either directly in the bank or in a subsidiary of the bank. Thus, consistent with the purposes underlying the Edge Act and the BHC Act, there is clear statutory authority for U.S. banking organizations to engage in these activities through subsidiaries abroad. Second, in any event, the provisions of the Glass-Steagall Act did not apply extra-territorially to the operations of foreign subsidiaries of U.S. banking organizations.

While equity underwriting and dealing have been permissible activities for U.S. banking organizations' foreign subsidiaries for some time, as noted above, the level of such activity is subject to limits under Regulation K. Restrictions *currently* applied to equity securities underwriting and dealing activities under Regulation K include the following.

Underwriting limits—Through a foreign subsidiary, an investor [3] may underwrite equity securities in amounts up to the lesser of $60 million or 25 percent of its tier 1 capital. These limits do not include amounts covered by binding commitments from sub-underwriters or other purchasers. If the underwriting is done in a subsidiary of the member bank, the amount of the uncovered underwriting must be included in computing the bank's single borrower lending limit with respect to the issuer.

Dealing limits—Through a foreign subsidiary, an investor may hold a dealing position in the equity securities of any one issuer in amounts up to the lesser of $30 million or 10 percent of its tier 1 capital. An investor must include any shares of a company held in an affiliate's dealing account in determining compliance with any percentage limits placed on ownership of that company.

Aggregate limit—There is an aggregate limit on the total amount of equity securities that may be held in investment and dealing accounts, aggregating all shares held by subsidiaries: for a bank holding company, the limit is 25 percent of tier 1 capital; for an Edge corporation,[4] the limit is 100 percent of the Edge's tier 1 capital.[5]

Prior review—Banking organizations must submit to a review of their foreign securities operations prior to engaging in foreign equity securities activities to the extent of these limits. They may also seek Board approval for higher underwriting limits, subject to certain conditions.

Revisions of Equity Securities Authority

Equity Underwriting

'97 Proposal

Although, as discussed above, the existing limits on underwriting equity securities in Regulation K are expressed both in terms of percentages of tier 1 capital of the investor and absolute dollar limits, as a practical matter it has been the dollar limits that have constrained the extent to which U.S. banking organizations may engage in these activities through their foreign subsidiaries. In the '97 Proposal, the Board noted the $60 million limit on underwriting equity securities significantly impedes the ability of U.S. banking organizations to compete for this business in foreign markets, where securities underwriting is a service routinely offered by local banks. At the same time, the risks associated with the activity suggest that such a stringent limit is not required for safety and soundness purposes for well-capitalized and well-managed banking organizations. While initial underwriting commitments may involve large sums, in most cases by the time the underwriting goes to market, large portions of the exposure have been passed on to sub-underwriters or presold. Thus, in most cases, the initial underwriting commitment substantially overstates the risk being assumed.

In order to reduce further these constraints, the Board proposed in 1997 to replace the dollar limits for underwriting activity with limits based solely on percentages of the investor's tier 1 capital for well-capitalized and well-managed organizations. The Board considered that, if a banking organization is well-capitalized and well-managed, tying the underwriting limits solely to capital levels would have the benefit of more closely linking the limits to the ability of the company to support the activity. It would also provide U.S. banking organizations with greater flexibility in responding to changing market conditions, because the amount of capital devoted to an activity is, after meeting regulatory constraints, determined by the firm.

Accordingly, the Board proposed to amend Regulation K in relation to those banking organizations that are well-capitalized and well-managed by removing the existing dollar limits applicable to equity underwriting

[3] An investor for these purposes means an Edge corporation, agreement corporation, bank holding company, member bank and any foreign bank owned directly by a member bank.

[4] Any foreign bank directly owned by a U.S. bank is treated as an Edge corporation for purposes of its limits.

[5] Investments in companies must be added to any shares of such companies held in the dealing account for purposes of this limit.

activities, and instead providing that such activities would be limited to percentages of the investor's tier 1 capital. For well-capitalized and well-managed organizations, the Board proposed applicable limits to be determined as follows.[6] In relation to securities activities of subsidiaries of bank holding companies, their limits would be determined by reference to percentages of the tier 1 capital of the holding company. The Board proposed that limits applicable to such activities undertaken by subsidiaries of Edge and agreement corporations, as well as foreign banks that may be direct subsidiaries of member banks, would be determined by reference to the tier 1 capital of the parent bank as well as to the tier 1 capital of the bank subsidiary. More specifically, limits for underwriting exposure to a single company would be established at 15 percent of the bank holding company's tier 1 capital for its subsidiaries and, for subsidiaries of Edge corporations, the lesser of three percent of tier 1 capital of the bank or 15 percent of the tier 1 capital of the Edge.

Under the '97 Proposal, these limits on underwriting exposure to a single company would be applied on an aggregate basis. A bank holding company's limit would include all underwriting exposure to one issuer by all of the holding company's direct and indirect subsidiaries, including exposures held through its bank subsidiaries. The bank's and Edge's limits would include all exposures held by their respective subsidiaries. The Board proposed, however, that this expanded underwriting authority would be available to U.S. banking organizations only if each of the bank holding company, bank, and Edge or agreement corporation qualify as well-capitalized and well-managed.[7]

For organizations that fail to meet the well-capitalized and well-managed criteria, the Board proposed that the existing dollar limits (*i.e.*, $60 million) on commitments by an investor and its affiliates for the shares of an organization would be retained.

The Board proposed that, in order to engage in such activities, all banking organizations would be required to implement internal systems and controls adequate to ensure proper risk management. Controls would have to be in place to assure that underwriting positions do not result in violations of limits on securities held in the trading account or exceed the parent bank's lending limits when the underwriting positions are combined with other credit exposures. Sanctions (such as temporary suspension of underwriting authority) may be imposed for violations of such limits.

Final Rule on Equity Underwriting Limits.

The Board continues to believe that there is a strong competitive need for liberalization of the $60 million Regulation K limit on equity underwriting. Subsidiaries of Edge corporations have been able to gain some underwriting business through obtaining commitments in advance from subunderwriters in order to reduce their own exposure to $60 million, but the limit clearly is a material constraint. Underwriting abroad continues to be a business that is conducted by local banking firms and does not lend itself readily to cross-border activity, thus requiring foreign subsidiaries of U.S. banks to compete with much larger local competitors.

Further, as noted above, the risks associated with equity underwriting activities suggest that stringent limits are not required for safety and soundness purposes for well-capitalized and well-managed banking organizations. Although the percentage limits proposed in the '97 Proposal would significantly increase the amount of underwriting authorized under Regulation K, underwriting is a shorter term activity than, *e.g.*, dealing. Moreover, under Regulation K, positions undertaken in connection with an underwriting and unplaced after 90 days must be moved to the dealing account and counted against the dealing limit. Consequently, the exposure of the banking organization to the activity is minimized.

Commenters strongly supported the Board's proposed liberalization of the equity underwriting limits, and made a few additional suggestions. One commenter recommended that the proposed underwriting limits be doubled. Another expressed concern that the proposed limits might result in some Edge corporations having less underwriting authority than the existing $60 million limit. Some commenters also objected to the disparity between the limits proposed for BHC and bank subsidiaries.

The Board does not believe further expansion of the underwriting limits beyond those proposed is warranted, particularly given that portions of an underwriting that are covered by binding commitments obtained from subunderwriters or other purchasers are not counted in determining compliance with the limits. U.S. banking organizations wishing to engage in underwriting equity securities in amounts larger than those permitted under Regulation K may do so by qualifying for GLB authority. The Board also continues to believe it is appropriate to tie the expanded limits to the investor's capital. If the underwriting limit resulting from an Edge's capital is considered to be too low, it is of course open to the organization to increase its capital and thereby increase its limit.[8]

Commenters also suggested that the existing additional Regulation K underwriting authority, whereby an organization may request the Board's approval to exceed the $60 million underwriting limit so long as the excess amount is deducted from capital and the organization would remain strongly capitalized after such deduction, also should be extended to the expanded limits. The Board does not believe it is appropriate to retain this authority in view of the significant increase in the underwriting limits that would be otherwise authorized under the expanded limits. Moreover, because the limits are determined by reference to capital, banking organizations seeking greater underwriting authority may expand their limits by increasing their capital.

For these reasons, the Board is adopting the expanded underwriting limits for well-capitalized and well-managed banking organizations set out in the '97 Proposal essentially without change. As proposed, the limits would apply to all underwriting exposures held under authority of Regulation K by the relevant entity and all of its subsidiaries (*e.g.*, a BHC's limit would include all underwriting exposures to one issuer by all of the holding company's direct and indirect subsidiaries, including exposures held through its bank subsidiaries, and a

[6] The Board proposed that existing dollar limits would be retained for companies that are not well-capitalized and well-managed.

[7] The Board proposed that what, if any, action should be taken in relation to banking organizations' limits if they ceased to be well-capitalized and well-managed would be addressed on a case-by-case basis through supervisory action.

[8] Commenters recommended that banking organizations also should be able to net underwriting exposures for purposes of determining compliance with the limits. As a practical matter, Regulation K presently essentially authorizes netting for these purposes given that, where the underwriter is covered by binding commitments from subunderwriters or other purchasers, such commitments are excluded in determining compliance with the limits. Compliance with the limits will continue to proceed on this basis. The Board does not believe a persuasive case has been made for any additional netting authority in relation to equity underwriting at this time.

bank subsidiary's limits would include all exposures held by its subsidiaries).[9]

Equity Dealing

'97 Proposal

The Board also proposed for comment liberalization of dealing activities for well-capitalized and well-managed banking organizations. As with underwriting limits, the proposed expansion of dealing limits would have been based on percentages of capital of the organization and, thus, on the ability of the organization to accommodate risk. The Board also noted its belief that dealing activities presented somewhat greater risk of loss than underwriting, which resulted in somewhat more restrictive limits being proposed for dealing activities relative to underwriting activities.

For well-capitalized and well-managed organizations, the Board proposed to remove the current dollar limits and revise the existing percentage of capital limits as follows. First, in order to provide diversification in the trading account, the Board proposed a limit on holdings of any one stock in the trading account of 10 percent of the tier 1 capital of the bank holding company for its subsidiaries and, for subsidiaries of an Edge corporation, the lesser of two percent of the bank's tier 1 capital or 10 percent of the Edge corporation's tier 1 capital.

Second, the Board proposed an aggregate limit applicable to all holdings of equities in the trading accounts of all direct and indirect subsidiaries authorized pursuant to Subpart A.[10] Without such an aggregate ceiling, the Board was concerned that a banking organization could have excessive exposure to movements in equity markets. The Board proposed aggregate limits of 50 percent of the bank holding company's tier 1 capital for its subsidiaries and, in the case of an Edge's subsidiaries, the lesser of 10 percent of the tier 1 capital of the bank or 50 percent of the Edge's tier 1 capital.

The Board proposed that the limits on equity dealing would apply to net positions across legal vehicles held, directly or indirectly, by the regulated entity to which the limit applied (that is, the bank holding company, the bank or the Edge corporation). Long equity positions in a single stock could be netted against short positions in the same stock and against derivatives referenced to the same stock.[11] For purposes of the aggregate limits, all physical and derivative long positions could be netted against physical and derivative short positions. It was further proposed that, for purposes of measuring compliance with these limits, banks would be permitted to use internal models to calculate the value of derivative positions used to offset exposures and net dealing positions in individual stocks, as well as the value of total net equity holdings in the trading account.[12] The Board considered that the adequacy of such models is subject to review during the exam process, and proposed that no special review would be required for their use in connection with the proposed limits on dealing activities.

For organizations that failed to satisfy the well-capitalized and well-managed criteria, the Board proposed to retain the existing dollar limit on individual shares held in the trading account (*i.e.*, $30 million), which would be calculated in the same manner as at present. As noted, it is generally the dollar limits that currently constrain organizations in their ability to conduct these activities. This is because, at present, only the largest banking organizations are engaged in these activities. The Board noted, however, that in the future a relatively small organization may seek to enter these lines of business and, for it, exposures of $30 or $60 million may be large relative to its capital. The Board therefore also sought comment on whether, in addition to dollar limits, limits based on percentage of capital also should be adopted for organizations that are not well-capitalized and well-managed in order to address the relative exposure of such organizations to these activities.

In addition, for organizations that are not well-capitalized and well-managed, the Board also proposed an aggregate limit on shares held in the trading account, including all dealing positions and investments held pursuant to Regulation K authority, of 25 percent of the holding company's capital for its subsidiaries and, for subsidiaries of Edges and any foreign bank held directly by a member bank, the lesser of 5 percent of the bank's tier 1 capital or 25 percent of the Edge's tier 1 capital. These limits were proposed on the basis that they would be half of those applicable to organizations that were well-capitalized and well-managed.

The Board also sought comment on whether, instead of imposing the limits discussed above in relation to equity underwriting and dealing activities by subsidiaries of well-capitalized and well-managed bank holding companies, it would be appropriate to lift all limits on these activities for such entities except for the limits on individual stocks held in the trading account discussed above (*i.e.*, 10 percent of the holding company's tier 1 capital). The Board considered that, at a minimum, this limit should be imposed on holding companies in order to assure diversification in individual stock holdings. Under this alternative, banking organizations also would be required to implement internal systems and controls adequate to ensure proper risk management and that underwriting positions do not result in violations of limits on investments in any one company.

Developments Since the '97 Proposal

Since the time the Board issued the '97 Proposal for public comment, the statutory and regulatory environment governing the equity dealing activities of U.S. banking organizations, as well as the market demand for such services, have changed significantly. One significant change noted above was the enactment and implementation of GLB. Under GLB, FHCs may engage in unlimited equity dealing activities. While the GLB Act did not make any revisions to the Edge Act, the Board believes that it demonstrates a Congressional intent that significant equity dealing activities should be conducted through FHC powers, absent a competitive need for U.S. banking organizations to engage in such activities through bank subsidiaries.

A second important change since the '97 Proposal has been the dramatic growth in the equity markets over the past few years. The growth in demand in the U.S. market for equity securities since the early 1990s, growing acceptance of equity investments by European investors since the establishment of the Euro, and the global equity market volatility of the past several years have combined with advances in financial engineering to create significant customer demand for

[9] Additional comments relevant to the Board's final action on equity underwriting authority also were submitted with regard to the Board's proposed criteria for determining whether banking organizations would be considered to be well-capitalized and well-managed for purposes of the expanded authority, as well as with regard to the two-tiered capital test for Edge corporations for purposes of determining eligibility. Each of these issues is discussed separately.

[10] As at present, shares held as an investment pursuant to Subpart A also would be included in determining compliance with the applicable aggregate limits.

[11] The Board also proposed that a basket of stocks, specifically segregated by the banking organization as an offset to a position in a stock index derivative product, as computed by the bank's internal model, may be netted as a whole against the stock index.

[12] Currently, the use of internal models in computing net positions in stocks is subject to prior Board review and the limitation that no net long position in a security shall be deemed to have been reduced through netting by more than 75 percent.

equity derivative instruments. In particular, the wide variety of sophisticated investment strategies employed by institutional investors and hedge funds, as well as the increasing focus of financial institutions on providing high net worth private banking clients with sophisticated portfolio diversification, hedging, and stock option monetization services, have translated into increasing volumes of equity derivatives at global banking organizations. For example, from December 31, 1996 to December 31, 2000, the notional value of equity derivatives held by U.S. banking organizations has more than tripled to roughly $940 billion. In meeting this demand, institutions generally avoid taking significant net open equity positions and hedge their customer equity derivative transactions either with other equity derivatives or with physical securities.

Finally, although, as noted above, GLB did not expand the authority of banks to acquire equity securities, the Office of the Comptroller of the Currency (OCC) determined last year that several national banks could take positions in equity securities solely to hedge bank permissible, customer-driven equity derivative transactions, as an activity incidental to the business of banking. The OCC imposed no quantitative limit on such equity positions, but rendered the banks' authority to take such positions subject to the following constraints:

(a) The banks committed that they will use equities solely for hedging and not for speculative purposes;

(b) The banks will not take anticipatory or maintain residual positions in equities except as necessary to the orderly establishment or unwinding of a hedging position;

(c) The banks may not acquire equities for hedging purposes that constitute more than 5 percent of a class of stock of any issuer; and

(d) Banks must obtain OCC supervisory approval prior to engaging in this activity in order to demonstrate that they have an appropriate risk management process in place.

These developments, along with all comments received on the '97 Proposal, have been taken into account by the Board in taking action on the final rule.

Final Rule on Equity Dealing Limits

Equity Securities Acquired To Hedge Equity Derivatives

Existing Regulation K and the '97 Proposal both proceed generally on the basis that acquisition of shares of a company by a subsidiary of a U.S. bank must be authorized by and conform to limits established for dealing in shares of a single issuer and limits applicable to portfolio investments. In other words, both presume that all such acquisitions of equity securities must conform to Regulation K limits because, absent the authority of the Federal Reserve Act and Regulation K, such acquisitions of shares of nonfinancial companies would be impermissible for the bank and its subsidiaries. The OCC's recent determinations, however, render the Regulation K limits largely irrelevant for national banks with respect to their equity derivatives business.

Regulation K, however, also presently authorizes for both subsidiaries of bank holding companies and subsidiaries of member banks abroad "commercial and other banking activities", which encompass all activities in which banks are permitted to engage in the United States. 12 CFR 211.5(d)(1). Accordingly, the Board takes this opportunity to clarify that the effect of the determination that banks may take positions in equity securities solely to hedge bank permissible, customer-driven equity derivative transactions as an activity incidental to the business of banking is to render this activity "commercial or other banking activity" for purposes of Regulation K. The consequence of this change is that, as an otherwise permissible banking activity, positions taken in equity securities for this purpose may be excluded in determining compliance with the separate Regulation K dealing limits, so long as taking such positions continues to be bank permissible and all constraints placed upon the conduct of this activity in determining its permissibility are observed, namely:

(a) The equities are used solely for hedging and not for speculative purposes;

(b) no anticipatory or residual positions in equities will be acquired or maintained, except as necessary to the orderly establishment or unwinding of a hedging position;

(c) no equities may be acquired for hedging purposes that constitute more than 5 percent of a class of stock of any issuer; and

(d) the banking organization has obtained approval from its primary federal regulator prior to engaging in such hedging practices in order to demonstrate that they have appropriate risk management processes in place.

The Board is concerned, however, that the first two constraints imposed by the OCC on the conduct of this activity (specifically, requiring the equities to be used solely for hedging and not for speculative purposes, and limiting residual positions to those necessary to the orderly establishment or unwinding of a hedging position) are ambiguous and potentially difficult to apply, particularly in light of the generally integrated nature of equity derivatives business. Indeed, the Board notes that it is usually the case that, even where a bank seeks to fully hedge equity derivatives with physical securities, residual positions will arise. It also is not unusual for traders in this line of business to seek to maximize returns by taking a view on price movements of the underlying security at the same time as putting in place the hedges necessary to cover the unwanted portion of derivative exposures. For this reason, the Board has concluded that, where after full netting and offset of equity securities against derivatives any residual positions in a single issuer remain, the value of all such residual positions as calculated by the organization's internal models must be included in determining the organization's compliance with the dealing limit, as discussed further below.

The Board notes that the effect of this clarification is to place the constraints of the Regulation K dealing limits on those activities involving the acquisition of equity securities that are not bank permissible. Any subsequent regulatory or legislative determination that acquiring equity securities to hedge bank permissible equity derivatives is not a bank permissible activity would have the effect of rendering all such positions subject again to the dealing limits.

Equity Dealing Limits

Comments on the '97 Proposal generally supported the Board's proposed expansion of the equity dealing limits for well-capitalized, well-managed organizations.[13] As noted above, however, in light of the enactment of the GLB Act expanding authority to engage in this activity, the

[13] Some commenters argued that banking organizations should be able to exceed individual and aggregate dealing limits, provided the amount in excess of the limits was deducted from capital and, after deduction, the organization remained well-capitalized. Other commenters were concerned that the proposed limits tied to capital might actually result in a decrease in dealing authority, and recommended higher limits. Another commenter noted that the terms "shares" and "equity" are both used in the '97 Proposal and recommended using "shares" to ensure that convertible debt and participating loans are not included in the limits. In view of its conclusions regarding the absence of justification for any significant expansion of dealing authority under Regulation K, the Board rejects these suggestions. The Board does wish to clarify that convertible debt prior to conversion and participating loans are not encompassed within the dealing limit.

Board no longer believes it is appropriate to increase the equity dealing limits under Regulation K. Instead, the Board considers that GLB authority should be the vehicle for any significant increase in equity dealing authority for subsidiaries of bank holding companies and of banks, unless concerns regarding the ability of U.S. banking organizations to compete in the provision of financial services abroad otherwise support additional liberalization under Regulation K. The Board is of the view that no such concerns appear to be raised in relation to dealing activities such as market-making and proprietary trading.

To the contrary, with respect to market-making, a limit of $30–40 million per single issuer appears generally consistent with being able to make a market in a stock, which is necessary to being competitive in foreign securities markets. With respect to proprietary or speculative positions, the Board considers that this is not an area that should be the subject of liberalization under Regulation K. Any banking organization that wishes to take larger speculative positions than Regulation K allows can do so without limit in an FHC subsidiary or a financial subsidiary of the bank.

Accordingly, the Board does not consider that there is sufficient justification at this time for any significant increase in the single issuer dealing limit. However, the Board believes it would be appropriate to make a small incremental increase in the equity dealing limit, raising it from $30 million to $40 million, in recognition of the increased experience of organizations engaged in this activity and the fact that the $30 million limit was adopted 10 years ago. This approach is consistent with the Board's action in the past.

As noted above, all residual positions in equity securities of a single issuer resulting from bank-permissible equity derivatives business must be included in calculating compliance with the $40 million limit. Additionally, while underwriting commitments and shares held for up to 90 days in connection with an underwriting would be excluded from these limits, positions unplaced after 90 days must be moved to the dealing account and counted against the dealing limit.

Otherwise, the Board has determined that the existing dealing authority should remain essentially unchanged.[14] This would include the existing 25 percent constraint on the availability of derivative hedges as a means of reducing net long positions in physical securities for purposes of compliance with the single issuer limit. More specifically, under existing Regulation K, even if an organization has full netting authority and its net long positions in physical securities of a single company are fully hedged by derivative instruments referenced to the same security, $.25 of each $1 in net long physical securities nevertheless continues to count toward the $30 million single issuer limit. As at present, this additional limit or constraint will only apply to net long positions in physical securities after longs and shorts are netted, and additional derivative hedges may reduce net long positions in physical securities by up to 75 percent. The increase in dealing limit to $40 million will result in an overall cap on net long positions in physical securities of $160 million even where the positions are fully hedged. The Board has determined that, going forward, this additional constraint on dealing activity will only apply to net long positions in physical securities held under Regulation K dealing authority, not to physical securities acquired in connection with bank permissible hedging transactions.

Netting and Otherwise Determining Compliance With Dealing Limits

The Board has determined that it should adopt one additional aspect of the '97 Proposal as it would apply to equity securities activities, namely, allowing netting based on internal models for purposes of determining compliance with the single issuer dealing limit. Comments submitted were overwhelmingly in support of the use of internal models for this purpose.

Thus, consistent with the '97 Proposal, the equity dealing limit will apply to net positions across legal vehicles held, directly or indirectly, by the regulated entity to which the limit is applicable (that is, the bank holding company or the bank subsidiary). Long equity positions in a single stock may be netted against short positions in the same stock and against derivatives referenced to the same stock. Also consistent with the '97 Proposal, a basket of stocks, specifically segregated by the banking organization as an offset to a position in a stock index derivative product, as computed by the bank's internal model, may be netted as a whole against the stock index. For purposes of the aggregate equity limits, all physical and derivative long positions may be netted against physical and derivative short positions. Organizations may use their internal models to calculate the value of derivative positions used to offset exposures and net dealing positions in individual stocks, as well as the value of total net equity holdings in the trading account.

For those banking organizations that wish to rely on netting based on their internal models for purposes of determining compliance with the dealing limits, the valuations generated by those models based upon current market values of the organization's residual positions in a single issuer will count toward the single issuer dealing limit. The Board considers it only appropriate that, if a banking organization uses its internal models for purposes of netting and valuing residual exposures in its equity derivatives line of business, it must use current market values (and not historical cost) for calculating compliance with the dealing limits under Regulation K for all of its equities lines of business. The organization may not ''mix and match'' the use of historical cost and mark-to-market valuations where internal models are used for these purposes.

However, the Board notes that netting based on internal models is not the mandatory method of compliance with the dealing limit. In this regard, Regulation K dealing limits presently encompass only net long positions in physical securities, after netting long and short positions in the same security. As is presently the case, organizations not wishing to determine compliance with the dealing limits by netting and offsetting positions in physical securities against positions in derivatives referenced to the same security may continue to determine compliance with the $40 million dealing limit solely by reference to the historical cost of its net long physical positions.

Commenters requested clarification of one aspect of the '97 Proposal regarding netting, namely, whether positions in a single stock would qualify for netting so long as the hedge for the position is held directly or indirectly by the entity to which the limit applies (*i.e.*, somewhere within the investor chain, but not necessarily in the same legal entity holding the related investment.) The Board confirms that netting of positions on this basis will be permissible. This approach reflects the market or economic risk of positions held by the entity on a consolidated basis.

Finally, the '97 Proposal would have allowed netting based on a banking organization's internal models without prior Board approval. The Board continues to believe that prior approval

[14] As discussed further below, however, the Board has adopted the expanded netting authority proposed in 1997 with a few minor changes.

should not be required to engage in netting through the use of internal models for this purpose. After further consideration, however, the Board believes prior notice of an organization's intention to use its internal models for this purpose is appropriate so that the Board may object if it considers the models inadequate for any reason. Banking organizations that have previously received approval under Regulation K to engage in netting through the use of their internal models may continue to do so without additional notice to the Board.[15]

Authority To Engage in Equity Underwriting and Dealing Activities

In the '97 Proposal, the Board noted that its approval currently is required to engage in underwriting and dealing in equity securities pursuant to Regulation K and sought comment on whether banking organizations that are well-capitalized and well-managed should be allowed to engage in equity securities activities at the proposed expanded levels without seeking prior Board approval. In response to this request, commenters urged allowing U.S. banking organizations meeting the well-capitalized, well-managed criteria to engage in the expanded activities without Board approval, particularly if the organization already has experience in such activities under Regulation Y or K.

As discussed above, the Board has adopted the '97 Proposal with regard to expanded equity underwriting authority for organizations that are well-capitalized and well-managed, but has only increased the equity dealing authority from $30 to $40 million. The latter increase in authority will be available to all organizations regardless of whether they meet the well-capitalized, well-managed criteria. The Board has concluded that, in view of the significant liberalization in underwriting authority under Regulation K, all organizations that wish to engage in the expanded underwriting activities must first provide 30 days' prior notice to the Board. With regard to the increased dealing authority, all organizations that wish to engage in dealing activities under the $40 million limit also must provide 30 days' prior notice to the Board, unless the organization already has received the Board's consent to engage in dealing activities under the $30 million limit. Organizations presently engaging in dealing activities under the $30 million limit may avail themselves of the additional $10 million in dealing authority without prior notice to the Board.

Venture Capital Activities Through Portfolio Investments

Current Restrictions

Regulation K currently allows U.S. banking organizations to make portfolio investments, that is, limited, noncontrolling investments in foreign commercial and industrial companies. This authority was adopted to enhance the competitiveness of U.S. banking organizations by increasing the range of financial services they may provide abroad. Many foreign financial institutions, including foreign banks, engage in venture capital activities, at times in connection with the provision of other financial services to the company.

'97 Proposal

The Board proposed in the '97 Proposal that existing dollar limits on portfolio investments made by well-capitalized, well-managed bank holding companies under the Board's general consent authority would be replaced by limits tied solely to a percentage of the holding company's tier 1 capital. More specifically, such bank holding companies (and their nonbanking subsidiaries) would be permitted to invest up to 2 percent of the holding company's tier 1 capital in any individual investment and would be subject to an aggregate limit of 25 percent of the holding company's tier 1 capital for all such investments. In determining compliance with the individual limit, shares in such companies held in the trading account by the investor and its affiliates under Regulation K would be included.

For all other investors (*i.e.*, Edge corporations, foreign bank subsidiaries of member banks, and bank holding companies that are adequately capitalized but fail to meet the well-capitalized and well-managed standards), the Board proposed retaining limits of $25 million on investments in any one organization under general consent authority, although larger investments would continue to be eligible for prior notice or specific approval treatment on a case-by-case basis. An aggregate limit on such investments would be imposed. For bank holding company investors, that limit would be 25 percent of tier 1 capital, and for Edge or foreign bank investors, it would be the lesser of 5 percent of the parent bank's tier 1 capital or 25 percent of the Edge's tier 1 capital.

With respect to the limit on voting shares in the target company, the Board proposed that investors would be permitted to make noncontrolling investments in up to 24.9 percent of a company's voting shares. These investments would only be permissible if, as at present, the investor does not control the company in which the investment is made. Accordingly, the Board noted an investor may not: (i) Control a majority of the board of directors or have disproportionate representation on the board; (ii) have a management contract with the company or exercise veto power over its actions; or (iii) use any other means to control the operations of the company.

The Board requested comment on all of the foregoing revisions to the portfolio investment authority. It specifically requested comment on the relative risk of portfolio investments and whether there is a competitive need for foreign subsidiaries of banks also to have expanded authority in relation to such investments.

Final Rule on Portfolio Investment Authority

Comments submitted on this aspect of the Board's '97 Proposal strongly supported the liberalization proposed in relation to limits applicable to portfolio investments made by bank holding companies, as well as in relation to the proposed increase in permissible individual investments up to 24.9 percent of voting shares. Certain of the comments argued that the proposed liberalization for bank holding companies also should be extended to bank subsidiaries, and various clarifications were requested on the interaction between the proposed changes and the existing rule. Clarification of these matters is provided below.

As discussed above, however, the major development in this area since the Board issued the '97 Proposal was enactment of the GLB Act, which authorizes FHCs to make merchant banking investments without regard to dollar limits or geographic restrictions. The Board notes that expanded merchant banking authority under GLB is only available to holding company subsidiaries; such authority may not be exercised in the bank chain.

The Board has therefore reconsidered the '97 Proposal in the light of passage of GLB and has determined not to adopt

[15] In response to comments, the Board notes that organizations would not be required to create a new model separate from existing internal models used for purposes of market risk assessment in order to engage in netting under Regulation K. Indeed, the Board would expect that organizations would use for this purpose the same internal models otherwise currently employed for purposes of risk management.

the proposal to increase the general consent limit and the permissible percentage of shares for portfolio investments. The Board considers that the GLB Act established the framework for engaging in merchant banking activities generally, and Regulation K should not establish an alternative framework for expansion of this activity absent a compelling competitive need. The Board does not believe that any such compelling competitive need has been demonstrated. Bank holding companies wishing to engage in merchant banking activities other than under the existing constraints of Regulation K should seek FHC status.

Investment Limits

A number of additional comments were submitted that are also relevant to the operation of existing provisions of Regulation K in relation to portfolio investments. In particular, certain commenters suggested that investors should be permitted to make portfolio investment under Regulation K in excess of the $25 million general consent limit, so long as the amount in excess were deducted from capital. Other commenters suggested that organizations should be permitted to use netting for purposes of calculating compliance with portfolio investment limits. The Board considers that neither of these changes would be appropriate in view of the nature of portfolio investments and the availability of other authority for making such investments.

A few commenters also requested clarification regarding whether the calculation of limits on portfolio investments will continue to be on an historical cost basis. One expressed the concern that an increase in the aggregate portfolio limit would be necessary if these investments would be valued at current market value, not historical cost. The Board considers that limits on portfolio investments should be calculated consistent with their treatment for capital purposes. More specifically, the amount of the investment subject to the Regulation K limit will equal the carrying value of the investment, or the value of the investment on the balance sheet, reduced by any unrealized gains on the investment that are reflected in the carrying value but are excluded from the organizations' tier 1 capital.

Commenters also opposed combining portfolio investments with dealing positions, either for purposes of a single company limit or aggregate limit, noting that these activities have important differences and are managed through separate lines of business. They argued that portfolio investments generally are made with longer time horizons and tend to involve privately held companies, whereas dealing positions generally are taken for short periods of time and involve public companies. The Board considers these points to be well-founded. In view of these comments and the Board's determination not to adopt any significant liberalization either in relation to portfolio investments or dealing authority, the Board believes it is appropriate to amend the single company limits for purposes of portfolio investments and for equity dealing such that the limits will apply to each activity separately. However, the Board notes that *all* equity shares held in a single company, including those held in connection with dealing activity (but excluding underwriting commitments and shares held for up to 90 days pursuant to an underwriting), must be combined for purposes of determining compliance with the control limitations of: (i) section 4(c)(6) of the BHC Act (with respect to U.S. companies); and (ii) the voting and total equity limits for portfolio investments under Regulation K (with respect to foreign companies).

Additionally, the Board is retaining an overall aggregate equity limit that will apply to all shares held under Regulation K portfolio investment and dealing authority, for the reasons discussed in the section below entitled ''Aggregate Equity Limits for Dealing and Portfolio Investments.''

Finally, commenters recommended that the Board specifically grandfather any investments that might be rendered impermissible by revision to Regulation K, or include a phase-in period for divestiture of such investments. The Board notes that, in view of the fact that it is not diminishing in any way existing authority in relation to these investments, no issues relating to the need for grandfathering arise.

Percentage of Permissible Voting Shares

Commenters expressed support for the '97 Proposal which would have increased the percentage of voting shares permissible for portfolio investments from 19.9 percent to 24.9 percent. A few commenters recommended higher levels of permissible voting shares, as well as increasing the 40 percent nonvoting equity limit, arguing that such increases would better enable U.S. banking organizations to compete with foreign financial institutions.

As noted above, FHCs may now make investments in nonfinancial companies under merchant banking authority without limitation as to the percentage of voting or nonvoting shares held and without restriction geographically. Consequently, the Board believes it is no longer appropriate to alter in any way the existing Regulation K limits on voting and nonvoting shares of portfolio investment companies. U.S. banking organizations wishing to invest in nonfinancial companies outside the United States beyond the existing limits of Regulation K should do so through obtaining FHC status. In these circumstances, the existing Regulation K voting and nonvoting equity limits on qualifying portfolio investments do not appear to affect the ability of U.S. banking organizations to compete abroad.

As noted above, portfolio investments are only permissible within these limits if the investor otherwise also does not control the company in which the investment is made. In this regard, several commenters urged the Board to clarify that restrictive and negative covenants, such as are commonly found in senior debt, also are permissible in connection with portfolio investments on the basis that they would not give the investor control over the company. The Board believes that such covenants may be permissible so long as their purpose is to protect the minority rights of the investor. However, such covenants may not be used as a means to obtain control over a portfolio investment by preventing the company from making normal business decisions. For example, the Board considers that it would be inconsistent with the mandatory noncontrolling nature of portfolio investments for investors to have the right to veto a company's choices for senior management positions. Should questions of this nature arise in connection with a proposed portfolio investment, banking organizations should seek the views of Board staff as to whether the proposed investment would qualify as a portfolio investment.

In this regard, commenters suggested that the Board should adopt for Regulation K a process similar to that adopted in Regulation Y in relation to advisory opinions regarding the scope of financial activities. The Board has adopted this suggestion and will seek to respond to requests for advisory opinions under Regulation K within 45 days of receipt of a complete written request, unless the request raises significant policy issues.

Finally, another commenter sought clarification as to whether the proportionality test for directors should be measured against the investor's voting interest or economic interest, favoring the latter measure. The Board believes that an investor in a portfolio investment should have representation on the board proportionate to its voting interest, and not economic interest, in the company. More specifically, in view of the restriction on voting shares held to 19.9 percent, the Board would expect that an investor would have no more than one director for every five seats on the board. In addition, an investor may not have a disproportionate participation on a board's executive committee.

''Incidental'' Activities in the United States

'97 Proposal

In the '97 Proposal, the Board proposed one additional change related to portfolio investments, primarily to provide some relief to U.S. banking organizations with regard to the U.S. activities of their foreign portfolio investments. As a result of limitations in the Federal Reserve Act and the BHC Act, U.S. banking organizations are prohibited from investing in more than 5 percent of the voting shares of foreign companies that engage in impermissible activities in the United States other than those activities that are an incident to their international or foreign business.[16] The Board previously has taken the view that such permissible incidental activities in the United States are limited to those activities that the Board has determined are permissible for Edge corporations to conduct in the United States.[17]

However, as discussed above, companies in which portfolio investments are made generally are engaged in industrial or commercial activities, which are not permissible activities for Edge corporations. Consequently, under Regulation K at present, if a portfolio investment company decides to engage in activities in the United States, the U.S. banking organization is forced to sell its interest in the portfolio investment, even if market considerations are inconsistent with selling the shares at that time. This divestiture would be required despite the fact that the U.S. banking organization, by reason of the mandatory noncontrolling nature of portfolio investments, is unlikely to be in a position to influence the decision to enter the U.S. market. In the '97 Proposal, the Board expressed the concern that, with the increasing globalization of economies around the world, this situation may become more common in the future.

In order to address these changes in circumstances and in view of the minority nature of portfolio investments, the Board proposed that, consistent with the Federal Reserve Act and the BHC Act, investors may retain portfolio investment companies that derive no more than 10 percent of their total revenue from activities in the United States that are not permissible for Edge corporations to conduct in the United States.

In proposing this change, the Board noted the nature of portfolio investments. In particular, most portfolio investments are venture capital investments that are not intended to be permanent holdings of the banking organization and instead are intended to be sold after a period of time. In addition, the preponderance of the value of portfolio investments is derived from their foreign business.

The Board invited comment on this proposed change. It also sought comment on what might be regarded as an appropriate period for divestiture of non-conforming investments, as well as on whether a time limit should be placed on the period for holding these types of investments in view of their supposedly medium-term nature.

Final Action

Commenters strongly endorsed the Board's proposed change in interpretation of U.S. activities considered ''incidental'' to international or foreign activities for this purpose, although some comments recommended that Regulation K should allow portfolio companies to derive a larger percentage of their total revenues (*e.g.*, 20 or 25 percent) from activities in the United States. Some commenters recommended that the Board employ a percentage of total tangible assets test either in lieu of or as an alternative to the revenues test, suggesting that tangible assets are a more stable indicator of the extent of a company's business in the United States and are easier to measure.

The Board adopts the change as set forth in the '97 Proposal. Thus, for purposes of determining whether a portfolio investment may continue to be held or must be divested, portfolio investment companies that derive no more than 10 percent of their total revenue in the United States may be considered to be engaged only in business that is an incident to their international or foreign business and therefore may continue to be held under portfolio investment authority. The Board continues to believe that the 10 percent revenue limit is appropriate to address globalization concerns and is consistent with the provisions of the Federal Reserve Act and the BHC Act. The Board further considers that the revenue test is a better indicator of the level of U.S. activity, rather than the amount of tangible assets in the United States which may be more susceptible to manipulation.

A few commenters requested clarification of the operation of this limit. In response to these requests, the Board notes that revenue derived from activities in the United States in its view would include all revenue derived from activities performed in U.S. offices, but not business that may originate from the United States but is performed offshore. It is, of course, also the case that this revenue test would only be applied to U.S. activities of portfolio investments that are *not* otherwise permissible for Edge corporations to conduct in the United States.

In response to the Board's request for comment on an appropriate divestiture period for investments that exceed the 10 percent revenue limit, a number of suggestions were made, including allowing U.S. revenues of up to 40 percent for up to five years. Other commenters variously suggested that the Board should adopt existing debts previously contracted (''DPC'') time periods for divestiture; allow some other specified period to divest (*e.g.*, a six month period, with an opportunity for extensions of up to a total of two years); or establish divestiture deadlines on a case-by-case basis. The Board is retaining the current Regulation K requirement of a ''prompt'' divestiture of all nonqualifying portfolio investments, which allows for a case-by-case determination as to the appropriate period of time within which an impermissible investment must be divested.

Aggregate Equity Limits for Dealing and Portfolio Investments

In the '97 Proposal, in view of the significant liberalization in authority proposed for bank holding companies in relation to portfolio investments, an aggregate limit on all portfolio investments was proposed. The Board also proposed an additional aggregate equity limit that would apply to all shares held as portfolio investments and in connection with dealing activities. The proposed aggregate limit for all such investments for banking organizations meeting the well-capitalized and well-managed tests was:

BHC Subsidiaries: 50 percent of tier 1 capital.

[16] In particular, the Federal Reserve Act prohibits investments in companies engaging in ''the general business of buying or selling goods, wares, merchandise or commodities in the United States.'' 12 U.S.C. 615. Section 4(c)(13) investments under the BHC Act are limited only by a requirement that the company do ''no business in the United States except as incident to its international or foreign business.''

[17] *See* 12 CFR 211.4(e).

Bank Subsidiaries: The lesser of 10 percent of tier 1 capital of the bank, or 50 percent of the bank subsidiary's tier 1 capital.

Underwriting commitments and shares acquired pursuant to an underwriting commitment and held for less than 90 days were excluded from the proposed aggregate equity limit.[18]

Commenters opposed the aggregation of shares held as portfolio investments with those held in connection with dealing activity in determining compliance with this limit, again arguing that these are two separate lines of business that should not be aggregated. Commenters also opposed the proposed reduction in the combined aggregate limit for Edge corporation investors, from the current 100 percent of tier 1 capital to 50 percent of tier 1 capital, notwithstanding the ability to net dealing positions and the exclusion of underwriting commitments and shares held for up to 90 days pursuant to an underwriting.

In view of the fact that the Board has determined that it will not adopt the liberalization proposed in relation to portfolio investments, it has also decided not to adopt the separate limit on total portfolio investments for any given banking organization. In the absence of expanded authority in this area, no need arises for such a limit.

However, consistent with the provisions of current Regulation K, the Board continues to believe that an aggregate equity limit is necessary with respect to all shares held under Regulation K (whether held under portfolio investment authority or in connection with dealing activity) in companies engaged in activities that would be impermissible for a subsidiary or a joint venture under Regulation K. Accordingly, the Board generally is adopting the aggregate limits on equity securities held under Regulation K previously proposed. Consistent with the '97 Proposal, underwriting commitments and shares held pursuant to an underwriting commitment for up to 90 days would be excluded from the aggregate equity limit.

However, in light of comments received, the Board is not adopting the proposed reduction in the aggregate limit for investors that are subsidiaries of a member bank. Nevertheless, the Board continues to believe it is important to tie the aggregate limit for bank subsidiaries to the capital levels of both the member bank and the bank subsidiary investor. Accordingly, the aggregate equity limit for subsidiaries of banks will be the lesser of 20 percent of the tier 1 capital of the member bank or 100 percent of the tier 1 capital of the bank subsidiary.[19]

Commenters also requested clarification on whether the aggregate equity limits include: (i) only equity securities held by the investor and its downstream subsidiaries or securities held by all its affiliates; and (ii) only shares held under the authority of Regulation K . The Board notes that, with respect to a particular investor, these limits will include all equity securities held by the investor and its downstream subsidiaries under Regulation K authority, whether arising in connection with portfolio investments or dealing activity.[20] Thus, the aggregate equity limit will not include investments in joint ventures or subsidiaries under Regulation K, or merchant banking or any other investments made under authority other than Regulation K.

One commenter recommended that the Board permit aggregate dealing positions to be calculated on a quarterly average and suggested a ''preclearance'' program for additional authority beyond the regulatory limits. The Board considers that determining compliance with these limits on the basis of a quarterly average would be inappropriate and potentially be subject to considerable manipulation. As noted above, should an organization wish to engage in equity securities activities without limit it should do so under FHC status subject to the FHC qualifying criteria. For these reasons, the Board declines to adopt these proposals.

Insurance Activities

Reinsurance Proposal

Section 211.5(d)(16) of Regulation K presently authorizes bank holding companies to own foreign companies that underwrite and reinsure life, annuity, pension-fund related, and other types of insurance, where the associated risks have been previously determined by the Board to be actuarially predictable. Prompted by the Board's consideration in 1997 of a bank holding company's request, the Board requested comment on whether the reinsurance (via a retrocession agreement with an unaffiliated offshore reinsurer) by a foreign subsidiary of U.S. bank holding company of all or a portion of the risk of policies or annuities sold in the United States by U.S. affiliates of the bank holding company or unrelated parties could be considered to fall within this authority. It queried whether the fact that the risk to be reinsured is in the United States could cause the activity to be considered located in the United States, particularly given the potentially significant involvement of the bank holding company's U.S. affiliates.

Several insurance trade associations opposed any expansion of authority in this area. They argued that the reinsurance activity necessarily would be domestic because of its complete dependence on U.S. insurance sales. In addition, they suggested the reinsurance activity would expose U.S. banks to unnecessary risk and conflicts of interests, be contrary to Board precedent, transfer regulatory scrutiny of domestically-originated risks from the state regulators to less rigorous and untested international regimes, and set the stage for U.S. banking organizations to underwrite and reinsure all types of insurance through foreign subsidiaries. Ultimately, they argued, any liberalization in this area should come from Congress, not the Board.

Several U.S. banking trade associations and banking organizations expressed support for expanded authority as described in the '97 Proposal. They emphasized that the proposal would only modestly extend an activity (i.e., underwriting and reinsuring life insurance abroad) long regarded as permissible by the Board. In addition, they maintained that the permissible U.S. insurance sales would be only an incidental, and not a primary, feature of an activity—reinsurance—having an essentially foreign character. They noted that many activities in which U.S. banking organizations are permitted to engage abroad are related to their U.S. activities (*e.g.*, securities activities) and asserted that the relation in this instance between the reinsurance activity and the U.S. insurance sales similarly should not result in rejection of the proposed activity. These commenters also argued that the proposal would further the Edge Act's stated purpose of enhancing U.S.

[18] The Board also proposed aggregate limits for investors that do not meet the well-capitalized and well-managed standards of half that applicable to well-capitalized and well-managed organizations (*i.e.*, 25 percent of tier 1 capital for bank holding company subsidiaries, and, for bank subsidiaries, the lesser of 5 percent of the parent bank's tier 1 capital or 25 percent of the bank subsidiary's tier 1 capital.

[19] An additional comment recommended that the aggregate equity limit should be expressed as a percentage of assets, rather than as a percentage of tier 1 capital. The Board believes that tying the equity limit to tier 1 capital is a more appropriate restriction on the level of aggregate equity activities under Regulation K and therefore is not adopting this recommendation.

[20] The Board also notes that application of the dealing limit on shares held in a single issuer will also proceed on this same basis, except that shares held as a portfolio investment will not be included in determining compliance with the single company dealing limit as discussed above.

banking organizations' competitiveness abroad.

As noted above, the GLB Act was enacted subsequent to the issuance of the Board's reinsurance proposal. The GLB Act allows FHCs to conduct insurance activities on a worldwide basis and demonstrates a Congressional preference for conducting such activities through subsidiaries of FHCs. The Board does not believe, and the comments on the Board's proposal have not shown, that competitive concerns require U.S. banking organizations to proceed under Regulation K in the conduct of this activity rather than GLB authority. Accordingly, the Board declines to adopt the reinsurance proposal. As at present, however, a banking organization may seek the Board's specific consent to engage in insurance activities more expansive than those expressly authorized under the regulation.

Other Comments

Supporters of the Board's reinsurance proposal urged the Board to liberalize Regulation K's insurance provisions further in several respects. First, they recommended that the Board eliminate the requirement that U.S. banks obtain Board approval before engaging in insurance activity through foreign subsidiaries, asserting that banking organizations should be given maximum flexibility to determine how to structure these activities. One commenter suggested that the Board replace the proposed prior approval requirement with a 30-day prior notice requirement. On balance, the Board believes it is appropriate to continue to require prior Board approval for such activities. Further, absent demonstration of a compelling need for competitive reasons, the Board expects insurance underwriting (other than credit life insurance and credit accident and health insurance) to be conducted through subsidiaries of the holding company, or otherwise under the expanded authority provided in GLB.

The commenters also argued that U.S. banking organizations should not be required to deconsolidate and deduct investments in foreign insurance companies from the holding company's capital for capital adequacy purposes, arguing that such a requirement is inappropriate and disproportionate to the risks involved. The Board disagrees and declines to eliminate this requirement. The consolidation of insurance activities may result in overstated capital ratios because the risk-based capital adequacy framework does not take into account traditional insurance risks. Although FHCs currently may consolidate their insurance companies for purposes of their capital ratios, for supervisory purposes their capital ratios also are analyzed after deconsolidation and deduction of such companies. Retaining the deconsolidation and deduction requirement in Regulation K also would be consistent with proposed revisions to the Basel Capital Accord.

In addition, the commenters urged the Board to expand the types of insurance foreign subsidiaries of bank holding companies may underwrite and reinsure, to encompass all credit-related insurance (including insurance incidental to leasing activities or mortgage transactions, and motor vehicle comprehensive insurance in connection with car loans). In the Board's view, in light of passage of GLB, there should be no general expansion of permissible types of insurance underwriting under Regulation K. As at present, however, application may be made on a case-by-case basis for the Board's approval to engage in additional types of insurance activities usual in connection with the business of banking abroad.

Debt/Equity Swaps

Regulation K currently permits banking organizations to swap certain developing country debt for equity interests in companies of any type. Established in 1987 to assist banking organizations in managing large amounts of nonperforming, illiquid sovereign debt, these foreign investment provisions are more liberal than Regulation K's other investment provisions. Under certain conditions set out in Regulation K, investors may invest under general consent authority up to one percent of their tier 1 capital in up to 40 percent of the shares, including voting shares, of private sector companies in eligible countries. Such an investment must be held through the bank holding company, unless the Board specifically permits it to be held through the bank or a bank subsidiary. Eligible countries are defined as those that have rescheduled their debt since 1980, or any country the Board deems to be eligible.

Since the debt/equity swap provisions were introduced, a well developed secondary market in developing country debt has emerged. The vast bulk of developing country problem debt has been repackaged in the form of long-term Brady bonds, mostly denominated in U.S. dollars and fully collateralized as to principal by U.S. government bonds. Many banking organizations actively trade these instruments in the secondary market.

Due to the development of the secondary markets for emerging market debt, U.S. banks now have the same options with regard to many of these assets as they have with other bank assets—namely, they can hold the asset with a view toward collecting at maturity or sell the asset for cash to invest in other bank eligible assets. Indeed, the sovereign debt of most of the historically ''eligible countries'' is no longer illiquid, and those eligible countries that account for the vast share of rescheduled debt have largely regularized their relations with commercial banks.

In light of these changed circumstances and to redirect this special authority to the asset quality problem it was originally intended to help resolve, in the '97 Proposal the Board proposed to redefine the term ''eligible country.'' Under the proposed definition, only countries with currently impaired sovereign debt (*i.e.*, debt for which an allocated transfer risk reserve would be required under the International Lending Supervision Act and for which there is no liquid market) would be eligible for investments through debt/equity swaps under Regulation K. Existing holdings of such investments would be grandfathered, subject to the existing divestiture periods applicable to such investments (*i.e.*, generally, 10 years from the date of acquisition).

The Board solicited comment on these proposed changes. It also sought comment on whether, alternatively, the debt/equity swap authority should be eliminated as obsolete.

Several commenters supported the proposed changes. Only one comment opposed the change to the definition of an ''eligible country''. Another commenter urged the Board to extend the general consent authority for debt/equity swaps to such investments made by banks and bank subsidiaries. The Board continues to believe the additional authority granted under the debt/equity swap provisions should be limited to countries with currently impaired debt, in light of the developments described above and, accordingly, adopts the proposed change to the definition of an ''eligible country.'' The Board also considers that general consent authority for engaging in debt/equity swaps under the bank continues to be inappropriate. As at present, a bank or bank subsidiary may seek authority from the Board to hold such an investment on a case-by-case basis.

Streamlining Application Procedures

General Consent Limits

The Board noted in the '97 Proposal that, although existing Regulation K procedures have proved effective in maintaining the safety and soundness of U.S. banks' international operations, they have become increasingly complex over the years. For example, under prior notice procedures, the Board has reviewed all foreign investments made by banking organizations above a *de minimis* level as a principal mechanism for overseeing the safety and soundness of the investing organization. In view of the shift in emphasis to supervision based upon risk management capabilities, the Board believes that prior review of relatively small investments is no longer useful as a fundamental supervisory tool, especially where the investor is well-capitalized and well-managed. Accordingly, the Board proposed that only significant investments, as determined solely on the basis of the investor's capital, would be subject to prior review by the Board, provided that the investors are well-capitalized and well-managed.[21] The proposed changes to the general consent procedures attempt to balance safety and soundness considerations with the objective of enhancing the ability of U.S. banking organizations to compete with foreign banks overseas.

Limits on Investments in One Company

Historically, all general consent investments under Regulation K were subject to absolute dollar limits. Currently, the general consent limit for most investments is $25 million. However, as a result of amendments to Regulation K implemented in December 1995, certain investments by strongly capitalized and well-managed banks are subject to Board review only to the extent they exceed a percentage of the investor's capital.

In the '97 Proposal, the Board proposed expanding upon this approach by eliminating the absolute dollar limits on foreign investments permissible under general consent authority for well-capitalized and well-managed investors (with the exception of those applicable to portfolio investments made under the bank). Under the proposal, general consent limits for all investors (bank holding companies, banks, and Edge corporations) would be based solely on a percentage of their tier 1 capital.[22]

The limits on individual investments made under general consent authority would vary according to the investor (bank holding company, bank, or Edge corporation) and the type of entity in which the investment is made. For well-capitalized and well-managed investors, the Board proposed the following percentage limits.

General consent limits on investment in a subsidiary

Bank holding company: 10 percent of tier 1 capital of the bank holding company.

Bank: 2 percent of tier 1 capital of the bank.

Bank subsidiaries: the lesser of 2 percent of tier 1 capital of the bank or 10 percent of tier 1 capital of the bank subsidiary.

General consent limits on investment in a joint venture

Bank holding company: 5 percent of tier 1 capital of the bank holding company.

Bank: 1 percent of tier 1 capital of the bank.

Bank subsidiaries: the lesser of 1 percent of tier 1 capital of the bank or 5 percent of tier 1 capital of the bank subsidiary.

These limits were proposed on the basis that they reflected the risk involved in the type of investment. A higher percentage of capital would be permitted in the case of an investment in a subsidiary as opposed to an investment in a joint venture because the latter is considered to carry a greater risk of loss. Thus, with joint ventures, investors acquire less than full control, and the record on such investments has shown that they experience a higher rate of loss. As a result, most U.S. banks do not now make sizeable joint venture investments. In light of these considerations, the Board believed that lower general consent limits may be appropriate for joint venture investments.

For investors that fail to meet the well-capitalized or well-managed standards, the Board proposed the following limits. Individual investments under general consent authority would be limited to the lesser of $25 million or 5 percent of tier 1 capital in the case of an investor that is a bank holding company, and the lesser of $25 million or 1 percent of tier 1 capital if the investor is a member bank. Limits on individual investments for an Edge corporation would be $25 million or the lesser of 1 percent of the parent bank's tier 1 capital or 5 percent of the Edge's tier 1 capital. The Board also proposed, however, that authority would be delegated to the Director of Banking Supervision and Regulation to approve higher investment limits on a case-by-case basis or as part of an investment program as described further below.

The Board sought comment on these proposed limits, noting that these limits would only cover investments made under general consent authority; larger investments may continue to be made with 30 days' prior notice. Noting that an argument could be made that, in cases involving investments by an Edge corporation, the well-capitalized and well-managed tests should be based on a review of the parent bank, not the Edge corporation, the Board also sought comment on the Board's proposal to impose limits tied to the condition of the Edge.

Commenters expressed general support for the Board's percentage-of-capital limits approach and proposal to reserve the greatest liberalization to well-capitalized and well-managed investors. Several, however, objected to the proposed general consent limits for bank subsidiaries, arguing that they will have the effect of reducing the general consent investment authority of some investors. Comments advanced a number of rationales for either retaining the existing limits, at least for well-capitalized and well-managed bank subsidiaries, or for increasing the proposed limits.

The Board believes the proposed general consent limits for investments by bank subsidiaries are sufficient. The Board therefore is adopting the limits as proposed. Should investors desire increased general consent authority, they may increase capital levels at the bank and/or bank subsidiary level, as warranted. Additionally, as noted above, an investment in excess of the general consent limits may still be made following prior notice procedures or with the specific consent of the Board. In any event, the Board notes that, in most instances, the binding constraint is the member bank's capital.

Two commenters, however, noted that the proposed general consent limits might be especially constraining for organizations whose Edge corporations are minimally capitalized. They recommended that the Board allow a well-capitalized, well-managed parent

[21] The proposed definitions of well-managed and well-capitalized for these purposes are discussed *infra* under the heading ''Well-capitalized/Well-managed Standards.''

[22] Under the proposal, if the Edge corporation were making the investment, then the Edge corporation, the member bank, and the bank holding company would be required to meet the well-capitalized and well-managed tests. If the member bank were making the investment, then the bank and the bank holding company would be required to meet the tests.

bank to make *de minimis* general consent investments through its Edge corporation, even if that investment would be greater than otherwise would be allowed under the limits applicable to the Edge. The Board disagrees and continues to be of the view that it is important to retain the well-capitalized and well-managed tests for the Edge corporation itself as one of the bases for determining limits applicable to general consent investments. This approach will help to ensure the safety and soundness of Edge corporations in their own right and is consistent with the statutory (and supervisory) rationale underlying Edge corporations. As discussed above, Congress limited the amount of capital that banks could invest in Edge corporations, which in turn could invest in activities otherwise prohibited to banks that were perceived to be higher risk. Congress also subjected Edge corporations to regulation and examination by the Federal Reserve. For these reasons, the Board considers that Edge corporations should themselves be operating satisfactorily and not be a source of potential weakness to its parent bank. The Board therefore is adopting in final the proposed general consent limits that are tied to the condition of the Edge.

In response to the Board's request for comment on the imposition of different general consent limits on investments in subsidiaries and joint ventures, two commenters maintained that imposing different limits on these investments is unjustified, arguing that the activities present similar risks. The Board disagrees and continues to be of the view stated in the '97 Proposal that investments in joint ventures involve greater risks than investments in subsidiaries. Consequently, the Board adopts the limits on investments in subsidiaries and joint ventures as proposed.

Two commenters noted the lack of a general consent mechanism for incremental investments in a subsidiary or joint venture once the individual company investment limit is reached. They recommended the inclusion of such a provision to allow investors to make additional small investments quickly, without encumbering both the investor and the Board with a case-by-case regulatory review. They further suggested that such investments be excluded from the 12-month rolling aggregate general consent limits. The Board does not believe that these changes should be made to the proposal. As noted above, an investor may increase its investment limit by increasing its capital. Moreover, an investor that has reached its individual company investment limit may apply to the Director of the Division of Banking Supervision and Regulation for appropriate relief or may submit a long-range investment plan for preclearance, as discussed further below. Accordingly, the Board is retaining the requirement that investments beyond those permissible under general consent authority must be made under the prior notice procedures unless relief is otherwise granted.

One commenter proposed allowing investors to carry forward and accumulate for five years unused investments of cash dividends, as is presently authorized under Regulation K. The Board believes that this provision is no longer necessary in light of the expansion of the general consent limits and the ability of investors to seek waivers or obtain preclearance of an investment program.

Another commenter noted that the Board's proposal would render investments in general partnerships and unlimited liability companies in amounts of less than $25 million ineligible for the general consent provisions and recommended that the Board preserve the general consent status quo for such investments by well-capitalized, well-managed banking institutions. The final rule adopts this recommendation.

Commenters also urged the Board to clarify that investments in single-purpose subsidiaries formed solely for the purpose of facilitating a specific financing transaction (*e.g.,* special purpose corporations formed by Edge corporations engaged in specific leasing transactions with a single customer) would not be subject to the individual or aggregate general consent limits. The Board will continue to exclude such investments from the application or prior notice procedures provided the investment serves solely to finance a leasing transaction.

Aggregate Limits

The limits on general consent investments in any one company are intended to address the fact that individual foreign investments above a certain size may be a source of potential concern, and therefore prior review of such investments should be required. In addition, the Board is also concerned with any rapid increase in an organization's foreign investments overall, made without prior review. Accordingly, in the '97 Proposal, the Board proposed that when the cumulative investments made under general consent reach a certain amount over a given period, new or additional investments would become subject to prior review. Investments by all affiliates of a bank holding company would be taken into account in determining compliance of the holding company with the aggregate limits; investments of subsidiaries of a bank or of an Edge, respectively, would be aggregated in determining compliance with their limits. Under the proposed liberalized general consent procedures, the new aggregate limit for all investments during any 12-month period for investors meeting the well-capitalized and well-managed tests would be:

Bank holding companies: 20 percent of tier 1 capital.

Bank: 10 percent of tier 1 capital of the bank.

Bank subsidiaries: the lesser of 10 percent of tier 1 capital of the bank or 50 percent of the bank subsidiary's tier 1 capital.

The Board considered that, because the bank would have the exposure on a consolidated basis for investments by either the bank or the Edge, these investments should have a combined aggregate limit. However, the Board proposed that this limit could be waived, in whole or in part, by the Director of the Division of Banking Supervision and Regulation under delegated authority, based upon a review of the financial strength of the investor and its investment strategy and business plans.

For bank holding companies, banks or Edge corporations that are adequately capitalized but do not meet the well-capitalized and well-managed standards, the Board proposed that the aggregate limits on all investments made under authority of general consent in any 12-month period would be half that applicable to well-capitalized and well-managed organizations (*i.e.,* 10 percent of tier 1 capital for bank holding companies, 5 percent of tier 1 capital for banks, and, for Edge corporations, the lesser of 5 percent of the parent bank's tier 1 capital or 10 percent of the Edge's tier 1 capital). In determining compliance with the aggregate limits, investments under Regulation K by all subsidiaries of the investor would be taken into account.

A number of comments were submitted regarding these provisions. Some argued that there should be separate rolling 12-month aggregate limits for portfolio investments and investments in subsidiaries and joint ventures. Other commenters objected to the inclusion of dealing positions in the rolling 12-month limits, and one argued that the percentage limits should be increased if portfolio investments and dealing activities are both included in determining compliance with the limits. A few commenters also requested clarification of whether additional investments in a company equal to cash dividends from the company, investments acquired from an affiliate, and investments made under the prior notice and specific consent provisions would be included within the proposed rolling 12-month aggregate limits. They recommended that the final regulation explicitly exclude these investments from the aggregate limits.

As discussed above, the aggregate limits are designed to address concerns that a banking organization may use expanded general consent investment authority, including that available in relation to portfolio investments, to expand excessively within a short time period. The Board notes that these limits are set at fairly high levels as a percentage of tier 1 capital. In order to provide a meaningful constraint on excessively rapid growth, in the Board's view all amounts invested during the rolling 12-month period should be included in the aggregate limit. The Board does not consider that any action should be taken to exclude portfolio investments from other investments in subsidiaries and joint ventures for purposes of the aggregate general consent limit. After further consideration, however, the Board considers that shares acquired in connection with Regulation K dealing activity should be excluded from the rolling 12-month aggregate limit, in view of the important differences in the nature of dealing activity. Aside from this change, in view of the ability of a banking organization to increase its general consent limits by increasing capital, and the availability of other procedures for securing authority to make investments should the limits prove constraining (such as seeking a waiver of limits on a case-by-case basis or obtaining preclearance for an investment program), the Board adopts the proposed aggregate general consent limits.

Preclearance of Investment Program

In connection with the foregoing, the Board also in 1997 proposed establishing a procedure that would allow U.S. banking organizations to obtain preclearance of an investment program, even though one or more of the investments would be in excess of the individual or aggregate general consent investment limits and would be made over a time period longer than one year. Preclearance authority would be delegated to the Director of Banking Supervision and Regulation, with the consent of the General Counsel. The Board solicited comment on whether such a program would be useful to U.S. banking organizations and whether it should be available to all banking organizations, including those organizations that are not well-capitalized and well-managed.

In response to the Board's request for comment, several commenters recommended that the Board adopt the proposed preclearance investment program as enhancing U.S. banking organizations' international competitiveness. Commenters believed that the preclearance process should focus on the merits of the applicant, rather than the specifics of the investment program. They argued that, for the preclearance option to be effective, the regulatory review process must be rapid and must not impose excessively narrow parameters on the types of investments permitted.

The Board is adopting the proposed preclearance program that would allow investors to seek authority to exceed the individual or rolling 12-month aggregate general consent investment limits. Because of the differing foreign investment needs of U.S. banking organizations, the Board is not at this time placing specific limitations on the scope of the preclearance process, but rather will assess each proposal on a case-by-case basis. The Board believes this approach provides maximum flexibility and will increase the utility of the process to all investors. Any preclearance request should be in writing and should indicate: (i) The amount of preclearance authority sought; (ii) the period of time for which such authority is sought; (iii) the strategic plan detailing the reasons for seeking preclearance authority; (iv) whether the applicant satisfies the well-capitalized and well-managed criteria; and (v) capital projections based upon anticipated investments made under the preclearance authority.

Commenters also recommended that investors be permitted to present their investment programs as prior notices, rather than as applications for specific consent. One commenter recommended that such authority be delegated to individual Reserve Banks, rather than to the Director of Banking Supervision and Regulation. In light of the fact that the preclearance process under Regulation K is new, the Board believes that it is important, at least initially, for these requests to be processed at the Board under specific consent. The procedures for obtaining preclearance authority will be reviewed after the Board gains experience with the process.

Authorization To Invest More Than Ten Percent of a Bank's Capital in Its Edge and Agreement Corporation Subsidiaries

Under a September 1996 amendment to section 25A of the Federal Reserve Act, member banks may invest more than 10 percent and up to 20 percent of capital and surplus in the stock of Edge and agreement corporation subsidiaries with the Board's prior approval. The Board may not approve such investments unless it determines that the investment of an additional amount by the bank would not be unsafe or unsound.

The Board proposed to implement this provision by adding an application requirement to Regulation K for banks to obtain the Board's approval to invest in excess of 10 percent of a bank's capital in the stock of Edge and agreement corporations. The Board noted that it would take the following criteria into account in reaching a decision on such an application: (i) The composition of the assets of the bank's Edge and agreement corporations; (ii) the total capital invested by the bank in its Edge and agreement corporations when combined with retained earnings of the Edge and agreement corporations (including retained earnings of any foreign bank subsidiaries) as a percentage of the bank's capital; (iii) whether the bank, bank holding company, and Edge and agreement corporations are well-capitalized and well-managed; and (iv) whether the bank is adequately capitalized after deconsolidating and deducting the aggregate investment in and assets of all Edge or agreement corporations and all foreign bank subsidiaries.

The Board invited comment on whether the enumerated criteria are appropriate for determining whether these investments are unsafe or unsound. Additionally, the Board sought comment on whether only the well-capitalized and well-managed criteria should apply in those instances in which the total Edge and agreement corporation capital (including retained earnings) on a pro forma basis would not exceed 20 percent of the bank's capital. As discussed above, due to the accumulation of retained earnings in Edge corporations, some member banks now have over 20 percent of their consolidated capital in Edge corporations.

Comments submitted generally supported this proposal. One commenter urged the Board to state that the evaluative criteria are not all-inclusive, to permit the Board to consider other issues as they may arise on a case-by-case basis. Another commenter recommended that the Board include among the criteria an evaluation of the reasons for the proposed capital increase. The Board believes these suggestions are implicit in the enumerated criteria. The Board therefore adopts the regulation as proposed, including applying only the well-capitalized and well-managed criteria in those instances in which the total Edge and agreement corporation capital (including retained earnings) on a pro forma basis would not exceed 20 percent of the bank's capital. While the Board expects the enumerated criteria will be sufficient in most circumstances, the Board may take into account additional criteria if necessary to fully evaluate a proposal and ensure safety and soundness of member banks.

Finally, commenters recommended that a well-capitalized, well-managed bank should not be required to obtain prior approval for these investments but, instead, should be subject only to a prior notice requirement in order to make such an investment. The Board considers, however, that the prior approval requirement should be maintained even for well-capitalized, well-managed banks in light of the significant amounts of retained earnings that may be held through Edge or agreement corporations.

Well-Capitalized/Well-Managed Standards

As discussed above, the Board's '97 Proposal generally allowed well-capitalized and well-managed banking organizations to engage in expanded securities activities and to make larger general consent investments. The Board proposed criteria for determining whether banking organizations would be considered well-capitalized [23] and well-managed.[24] Whether an institution is well-capitalized and well-managed also was proposed as a factor in the Board's determination regarding whether investments in Edge corporations greater than 10 percent of a member bank's capital and surplus should be permitted.

Commenters expressed widespread support for additional flexibility for well-capitalized, well-managed investors. However, they noted that the well-managed test under Regulation K differs from that for expedited action under Regulation Y by including a requirement that an institution not be subject to any supervisory enforcement action. They expressed concern that this provision would not provide the Board with sufficient flexibility to determine when an institution is not well-managed, as some enforcement actions may involve matters that would not be considered material. Commenters also noted that the existence of supervisory enforcement actions could be reflected in either the management rating or the composite rating of an institution, and that such ratings may be changed at any time during an examination cycle. In response to these concerns, the Board is amending the proposed definition of well-managed to delete the reference to supervisory enforcement actions and, instead, to require that the organization's management rating must be at least satisfactory. Accordingly, a U.S. banking organization meets the well-managed definition if its composite and management ratings are at least satisfactory.

Some commenters suggested that the Board should provide transitional periods and arrangements for institutions disqualified from well-capitalized and/or well-managed status to conform to the lower limits. Since the circumstances of disqualification may vary, the Board believes transitional periods and arrangements should be addressed on a case-by-case basis. Other commenters suggested that grandfathering should be available for institutions that no longer qualify as well-capitalized or well-managed, particularly where activities at issue are being conducted prudently and profitably and are not a factor in the failure to meet the eligibility tests. The Board does not believe grandfathering is appropriate in this context, as the well-capitalized, well-managed status of an institution is designed to mitigate the additional risks created by the expanded authority granted to such institutions. Moreover, the ability to conduct expanded activities should also be an incentive for achieving and maintaining well-capitalized, well-managed status.

Several commenters objected to application of the well-capitalized test to Edge corporations. They argued that, since the capital of an Edge corporation is consolidated with that of the parent bank, an independent well-capitalized test for Edge corporations would not add to safety and soundness within the bank chain. They also maintained that an independent capital test for Edge corporations may encourage uneconomic booking decisions between the bank and the Edge corporation. The Board, however, continues to believe it is important to retain these tests with reference to both the Edge corporation and the member bank in order to be eligible for the expanded authority granted to well-capitalized institutions. As noted above, this approach would help to ensure the safety and soundness of the Edge corporation in its own right and is consistent with the statutory (and supervisory) rationale underlying Edge corporations. The Board considers that Edge corporations should themselves be operating satisfactorily and not be a source of potential weakness to the U.S. parent bank.

Other Revisions to Subpart A

Harmonization of Regulation K With Other Regulatory Changes

The '97 Proposal noted that, as a result of liberalizations of other Board regulations, authority under Regulation K is now more restrictive than the authority available to engage in certain activities domestically. The Board proposed changes to address these disparities and has determined to adopt all such harmonizing changes.

Leasing Activities

The Board proposed to interpret Regulation K's leasing provision consistent with a revision to Regulation Y's authority for BHCs, eliminating the requirement that leasing activities conducted under authority of Regulation K serve as the functional equivalent of an extension of credit to the lessee with respect to high residual value leasing. Commenters expressed support for this proposal and recommended that the change be made explicit in the text of the final rule. The Board is adopting this proposal, and a conforming change has been made to Regulation K. As required under Regulation Y, however, the estimated residual value of real property must be limited to 25 percent of the value of the property at the time of the initial lease,

[23] Under the proposal, a bank holding company would be considered well-capitalized if, on a consolidated basis, it maintains total and tier 1 risk-based capital ratios of at least 10 percent and 6 percent, respectively. In the case of an insured depository institution, well-capitalized means that the institution maintains at least the capital levels required to be well-capitalized under the capital adequacy regulations or guidelines applicable to the institution that have been adopted under section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o. The Board proposed that an Edge or agreement corporation would be considered well-capitalized if it maintains total and tier 1 capital ratios of 10 and 6 percent, respectively.

[24] Under the proposal, a bank holding company or insured depository institution would be considered well-managed if, at its most recent inspection or examination or subsequent review, the holding company or institution received at least a satisfactory composite rating. The Board noted that, under standards adopted by the Board in connection with the December 1995 expansion of Regulation K's general consent authority, an Edge or agreement corporation would be considered to be well-managed for these purposes if it received a composite rating of 1 or 2 at its most recent examination or review and it is not subject to any supervisory enforcement action.

to distinguish real property leasing from real estate development and investment activities.

Commodities Swaps Activities

In light of changes to Regulation Y, the Board proposed to eliminate the requirement that commodity-related swaps must provide an option for cash settlement that must be exercised upon settlement. Comments generally supported this proposed revision, and the Board has adopted the change in final.

Other commenters recommended that the commodities swaps provision be expanded to include activities relating to the trading, sale, or investment in commodities and underlying physical properties (and, hence, to make it fully consistent with the corresponding provision of Regulation Y). The Board rejects these additional changes at this time as inconsistent with section 25A of the Federal Reserve Act, 12 U.S.C. 617, which prohibits Edge corporations from engaging in commerce or trade in commodities except as specifically provided therein.

Loans to Officers at Foreign Branches

In the '97 Proposal, the Board noted that existing Regulation K imposes limits on mortgage loans to executive officers of foreign branches of member banks that are more restrictive than limits imposed under analogous provisions in Regulation O. The Board proposed to eliminate the Regulation K provision to address this disparity. None of the public commenters addressed this proposed change, and it is adopted as proposed. Accordingly, the limits in Regulation O apply with respect to such loans.

Data Processing Activities

The Board expressly declined to alter or expand Regulation K's data processing provision. It noted, however, that this authority extends only to the processing of information and does not authorize the general manufacture of hardware for such services. Some commenters presumed that the activity of data processing pursuant to Regulation K is unrestricted rather than limited to banking, financial, or economic data to the extent such data processing is limited in Regulation Y.[25] Moreover, some commenters read the language in the preamble to the proposed revisions to Regulation K to preclude the offering of hardware in connection with software that is designed and marketed for the processing of financial, banking, or economic data where the general purpose hardware does not constitute more than 30 percent of the cost of any packaged offering. The Board notes that an interpretation issued in 1999 clarified that the scope of the data processing authority of Regulation K is coextensive with the data processing authority of Regulation Y, absent Board authorization for additional activities. 64 FR 58780, Nov. 1, 1999.

Additional Areas of Liberalization

Authorizing Foreign Branches of Operating Subsidiaries of Member Banks

The Board proposed to codify prior Board determinations permitting member banks to establish foreign branches of domestic operating subsidiaries with the Board's approval (under the prior notice or general consent procedures, as appropriate), provided that those branches would engage only in activities directly permissible for the member bank parents. Commenters expressed support for this proposal, and the Board is adopting the revision as proposed.

FCM Activities

The Board proposed to eliminate the requirement that an investor seek Board approval before acting as a futures commission merchant (FCM) for financial instruments, and on exchanges, not previously approved by the Board. The Board also proposed to eliminate the requirement that investors obtain prior Board approval for FCM activities conducted on any exchange or clearing house that requires members to guarantee or otherwise to contract to cover losses suffered by other members (*i.e.*, a mutual exchange).[26] The Board sought comment on whether the prior notice requirement should be eliminated where: (i) the activity is conducted through a separately incorporated subsidiary; and (ii) the parent bank does not provide a guarantee or otherwise become liable to the exchange or clearing house for an amount in excess of the applicable general consent limits. One commenter agreed that a prior notice requirement should not be imposed in these circumstances. The Board is adopting the revisions to the FCM authority under Regulation K as proposed.

Changes With Respect to Edge and Agreement Corporations: Voluntary Liquidation Procedures

The Board proposed changes relating to the liquidation and receivership of Edge and agreement corporations, including adding provisions: (i) Providing for 45 days' prior notice to the Board of an Edge or agreement corporation's intent to dissolve; (ii) specifying the grounds for determining that an Edge corporation is insolvent; and (iii) specifying the powers of a receiver of an Edge corporation. One commenter expressed general support for the voluntary liquidation proposal, and this provision is adopted as proposed. In light of the recent amendment of the Edge Act's receivership provision, 12 U.S.C. 624, the Board is not adopting the regulatory proposal with respect to receivership.

Additional Commenter Recommendations Under Subpart A

Commenters urged the Board to revise Subpart A of Regulation K in the following respects not addressed by the Board's proposals.

Advisory Opinions Under Regulation K

A commenter suggested that the Board harmonize Regulations Y and K further by establishing a procedure in Regulation K whereby questions arising under the regulation could be submitted by any person and the Board would issue an advisory opinion within 45 days. The Board agrees that this procedure would enhance regulatory transparency and facilitate regulatory compliance. As noted above in the section on portfolio investment authority, the Board is adopting the recommendation and including a procedure in the final rule under which advisory opinions may be requested on the scope of activities permissible under Regulation K. Board staff will endeavor to respond to any such requests within 45 days of receipt of all relevant information, provided the request does not raise significant supervisory issues.

Divestiture Period for Debts Previously Contracted (''DPC'') Assets

Commenters recommended that the Board adopt the OCC's DPC divestiture rules, which provide for an initial holding period of up to five years, with an opportunity to extend for up to an additional 5 years. Existing Regulation K, which the Board did not propose to amend, requires divestiture within two years after acquisition, unless the Board authorizes retention for a longer period. The Board believes the existing DPC divestiture period is adequate given that investors may request extensions of time

[25] Regulation Y allows up to 30 percent of data processing revenues to be derived from data processing that is not financial, banking, or economic in nature.

[26] In this regard, Regulation Y has been revised to allow subsidiaries of BHCs to act as FCMs for futures contracts traded on an exchange provided the parent BHC does not provide a guarantee or otherwise become liable to the exchange or clearing association other than for proprietary trades.

and therefore declines to adopt this proposal.

Changes to Capitalization Requirements for Edge Corporations

Commenters recommended that the Board revise the provisions regarding the capitalization of Edge corporations to facilitate their clearing activities by either exempting sales of Fed funds to parent banks from the 10 percent capital adequacy guideline applicable to Edge corporations or eliminating the 10 percent capital limitation applicable to Edges. The Board does not believe this proposal is consistent with the safety and soundness concerns the capital adequacy guidelines for Edge corporations are designed to address. Accordingly, it declines to adopt this proposal.

Subpart B: Foreign Banking Organizations

Subpart B of Regulation K governs the U.S. activities of foreign banking organizations. It implements the IBA and provisions of the BHC Act that affect foreign banks.

This final rule for Subpart B seeks to eliminate unnecessary regulatory burden, increase transparency, and streamline the application/notice process for foreign banks operating in the United States based on the Board's recent experience with foreign bank applications. The final rule also would liberalize the standards under which certain foreign banking organizations qualify for exemptions from the nonbanking prohibitions of section 4 of the BHC Act.

The rule also implements a number of statutory changes including certain application-related provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (the 1996 Act) and several provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Interstate Act) and the Gramm Leach Bliley Act (the GLB Act) that affect foreign banks. The Board is also requesting comment on issues that arise in connection with the change in the definition of representative office made in the GLB Act. Finally, several technical changes to various other provisions in Subpart B are being adopted.

Streamlining the Regulatory Process

The Board is required to approve the establishment by foreign banks of branches, agencies, commercial lending companies, and representative offices in the United States. This authority is contained in the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), which amended the IBA, and was intended to close perceived gaps in the supervision and regulation of foreign banks. Prior to FBSEA, there was no federal approval required for the establishment of most types of direct U.S. offices of foreign banks, nor were uniform standards applicable to these offices.

In the ten years since the enactment of FBSEA, the Board has gained substantial experience with the issues presented by applications by foreign banks to establish direct offices. The revisions streamline the applications process based on experience gained over this period. In addition, the final rule implements new discretionary authority and time limits contained in the 1996 Act.

Adoption of a Single Standard for Representative Offices

Under FBSEA, in order to approve an application by a foreign bank to establish a branch, agency or commercial lending company, the Board generally is required to determine, among other things, that the applicant bank, and any parent bank, are subject to comprehensive supervision on a consolidated basis by its home country authorities (the CCS determination).[27] A lesser standard, however, applies under FBSEA to representative office applications. While the Board is required to ''take into account'' home country supervision in evaluating an application by a foreign bank to establish a representative office, a CCS determination is not required to approve such an application. The law simply requires the Board to consider the extent to which the applicant bank is subject to CCS. A lesser standard applies because representative offices do not conduct a banking business, such as taking deposits or making loans, and therefore present less risk to U.S. customers and markets than do branches or agencies.

Regulation K currently restates the statutory ''take into account'' standard and does not define a minimum supervision standard that a foreign bank must meet in order to establish a representative office. Instead, the Board has developed standards in the context of specific cases. To date, the Board has used two different supervision standards in approving applications by foreign banks to establish representative offices.[28]

Under one, the Board has permitted a foreign bank to establish a representative office able to exercise all powers available under applicable law and regulation on the basis of a finding that the home country supervisors exercise a significant degree of supervision over the bank.[29] Under the second, the Board has approved the establishment of the office on the basis of a finding that the foreign bank is subject to a supervisory framework that is consistent with approval of the application, taking into account any limits placed on the activities of the proposed office and the operating record of the bank.[30]

Based on experience in dealing with representative office applications, the Board believes that the existence of two standards can be confusing and is unnecessary, particularly in light of the generally minimal risk presented to U.S. customers or markets by representative offices. Consequently, the Board proposed Regulation K be amended to establish only one flexible standard. Under the proposal, assuming all other factors were consistent with approval, the Board could approve an application to establish a representative office if it were able to make a finding that the applicant bank was subject to a supervisory framework that is consistent with the activities of the proposed office, taking into account the nature of such activities and the operating record of the applicant.

The record necessary to support the required finding would depend on the nature of the activities the applicant proposed to conduct in the representative office and the level of home country supervision. The Board expects that most applicants would be able to conduct all permissible activities. In those instances in which the Board had particular concerns regarding the consistency of the applicant's home country supervision with the proposed activities of the office, the applicant could commit to restrict the activities. A less comprehensive record on home country supervision would be required where the applicant committed to limit the activities of the office to those posing minimal risk to the U.S. customers.

[27] As discussed later, the law was amended in 1996 to allow the Board to approve an application if the bank is not subject to CCS under certain conditions.

[28] Wherever the record submitted by an applicant in a representative office case is sufficient to support a CCS finding, the Board generally has done so. *See, e.g., Caisse Nationale de Credit Agricole,* 81 Fed. Res. Bull. 1055 (1995). The two representative office standards have been applied in those cases where the record is not sufficient to support a CCS finding.

[29] *See, e.g., Citizens National Bank,* 79 Fed. Res. Bull. 805 (1993).

[30] *See. e.g., Promstroybank of Russia,* 82 Fed. Res. Bull. 599 (1966).

Commenters generally supported this proposal and the Board is adopting the proposal as set forth above.

Reduced Filing Requirements for the Establishment of U.S. Offices

A major thrust of the proposed revisions was reduction of burden in the application process by streamlining existing application procedures for the establishment of new U.S. offices of foreign banks. Under the current Subpart B, the establishment by a foreign bank of a U.S. branch, agency, commercial lending company subsidiary, or representative office generally requires the Board's specific approval. Once the Board has approved the establishment of a foreign bank's first office under the standards set out in FBSEA, additional offices with the same or lesser powers may be approved by the Reserve Banks under delegated authority. Prior notice and general consent procedures are currently available for the establishment of certain kinds of representative offices. The Board's proposed revisions would allow additional types of applications to be processed under prior notice and general consent procedures. The Board has determined to adopt the revisions as proposed. The specific instances in which additional prior notice and general consent authority will be available are discussed below.

Prior Notice Available for Additional Offices After First CCS Determination

The Board proposed that any foreign bank which the Board has determined to be subject to CCS in a prior application or determination under FBSEA or the BHC Act may establish additional branches (other than interstate branches), agencies, commercial lending company subsidiaries, and representative offices pursuant to a 45 day prior notice procedure.[31] This time frame would allow for review of whether any material changes had occurred with respect to home country supervision, a determination of whether the bank continues to meet capital requirements, and a review of any other relevant factors. The current delegation to the Reserve Banks for such applications would be deleted as no longer necessary.

Four commenters expressed support for the Board's proposal. In response to the comments submitted, the Board is adopting the proposal with language clarifying that the prior notice procedure ordinarily would be available for foreign banks with a CCS determination that seek to establish additional branches (other than interstate branches under section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3))), limited branches, agencies, commercial lending company subsidiaries, and representative offices.[32]

Prior Notice Available for Certain Representative Offices

Many foreign banks have a U.S. banking presence and therefore are subject to the provisions of the BHC Act, but have not received a CCS determination. If a foreign bank is subject to the provisions of the BHC Act through ownership of a bank or commercial lending company or operation of a branch or agency, it is also subject to supervision and oversight through the Board's Foreign Banking Organization (FBO) program. Through the FBO program, the Board gains knowledge of the bank, its policies and procedures, and forms a general view on home country supervision. In these instances, the Board believes that an expedited procedure may be adopted for the establishment of representative offices by these banks, even where the foreign bank had not previously been reviewed under the standards of FBSEA.

The Board proposed that these foreign banks be permitted to establish representative offices using a 45-day prior notice procedure. In addition, the Board also proposed to permit the establishment by prior notice of additional representative offices by any foreign bank not subject to the BHC Act but previously approved by the Board to establish a representative office, regardless of the type of supervision finding made by the Board in the prior case. Such applications are currently delegated to the Reserve Banks. The Board sees no reason to continue to require full applications from such banks. The Board proposed that banks in these two categories be permitted to use the 45-day prior notice procedure for opening a representative office, rather than requiring them to use the application procedure.

Commenters generally supported this proposal. One commenter additionally requested that foreign banks that have been approved to establish branches and agencies under the limited exception to the CCS standard—which permits the Board to approve applications to establish branches and agencies if it is able to find, among other things, that the home country supervisor of the applicant bank is ''actively working'' toward achieving CCS—be permitted to use a 45 day prior notice procedure for additional offices with the same or lesser powers.

The Board is adopting the proposed revisions. In addition, the Board is adopting the commenter's proposal to permit establishment by prior notice of representative offices, but not additional branches, agencies or commercial lending companies, by foreign banks previously approved under the ''actively working'' standard. This would be consistent with the Board's proposal.

New General Consent Authority

The Board proposed to permit the establishment by general consent of a representative office by a foreign bank that is both subject to the BHC Act and has been previously determined by the Board to be subject to CCS. Establishment of a representative office by such a foreign bank is currently subject to the prior notice procedure. The proposal was based on an assessment that a foreign bank that is subject to supervision under the FBO program and has been judged subject to CCS should generally qualify to establish a representative office. The Board also proposed that a foreign bank that is subject to the BHC Act could establish a regional administrative office by general consent, whether or not the Board had determined the bank to be subject to CCS. Regional administrative offices currently can be established using the prior notice procedure. Commenters generally supported this proposal and the Board is adopting the revisions as proposed.

One commenter requested that the general consent procedure also be available for additional offices with the same or lesser powers in a state in which the foreign bank already operates an office where the foreign bank is subject to the BHC Act and has a CCS determination. The Board does not believe it would be appropriate to adopt the commenter's proposal because the proposal implicitly assumes that a CCS determination would never need to be reconsidered. In addition, in connection with each branch and agency case, the

[31] An editing error in the draft regulatory language unintentionally limited the types of offices eligible for the prior notice procedure. Commenters requested that the proposed 45-day prior notice provision be extended to the establishment of limited branches outside the foreign bank's home state. This was the intent of the proposal.

[32] As described further in the preamble, upgrades of limited branches and agencies outside the foreign bank's home state would be eligible for prior notice if other requirements were met. In response to a comment, the Board considered whether it might be possible to process under the 45-day notice procedure proposals to establish full interstate branches. Approval of full interstate branches requires consideration of factors in addition to those required to be considered in a normal FBSEA application, as well as consultation with the Department of the Treasury. For this reason, an application requirement is being retained for the establishment of full interstate branches under section 5(a)(3) of the IBA.

Board also must confirm that the foreign bank's capital meets the statutory requirements.

Suspension of Prior Notice and General Consent Procedures

The proposed revisions also provided that the Board, upon notice, may modify or suspend the prior notice and general consent procedures described above for any foreign bank. For example, modification or suspension of these procedures might be appropriate if the composite rating of the foreign bank's combined U.S. operations was less than satisfactory,[33] if the foreign bank were subject to supervisory action, or if questions were raised about the foreign bank's home country supervision or anti-money laundering policy and procedures. The proposal would ensure that any streamlining of the applications process would not compromise the Board's ability to make the determinations necessary in connection with the establishment of offices.

The proposed revision did not elicit specific comment and it is adopted as proposed.

After-the-Fact Approvals

In implementing FBSEA in 1993, the Board recognized that it would be impractical to require prior approval for the establishment of foreign bank offices acquired in certain types of overseas transactions, such as a merger of two foreign banks, and provided for an after-the-fact approval in such cases. The regulation currently requires the foreign banks involved to commit to file an application to retain acquired U.S. offices as soon as possible after the occurrence of such transactions.

Since the enactment of FBSEA, a number of applicants using the after-the-fact procedure have chosen to wind down and close acquired offices or consolidate them with existing offices, in each case within a reasonable time frame. In most instances, no regulatory purpose was served by requiring the filing of an application. The regulation currently does not address this possibility. The Board proposed to amend the rule to address both after-the-fact applications to retain, as well as decisions to wind-down and close, U.S. offices acquired in a transaction eligible for the after-the-fact approval process. Where the foreign bank chooses to close the acquired U.S. office, the Board generally would not require the filing of an application but could impose appropriate conditions on the U.S. operations until the winding-down is completed.

The proposed revision did not elicit specific comment and it is adopted as proposed.

Implementation of the 1996 Act

As noted above, FBSEA generally requires the Board to determine that a foreign bank applicant is subject to CCS in order to approve the establishment of a branch, agency, or commercial lending company. The 1996 Act gave the Board discretion to approve the establishment of such offices by a foreign bank where the application record is insufficient to support a finding that the bank is subject to CCS, provided the Board finds that the home country supervisor is actively working to establish arrangements for the consolidated supervision of the bank, and all other factors are consistent with approval. This discretion gives the Board flexibility to approve applications on an exceptional basis where the home country authorities are making progress in upgrading the bank supervisory regime but the record may not yet be sufficient to support a full CCS finding. The Board has stated that this authority should be viewed as a limited exception to the general requirement relating to CCS.[34] The statutory standards are being included in the final rule.

Two commenters expressed support for the Board's proposed revision.

The Board has proposed to incorporate into Regulation K the statutory time limits in the 1996 Act for Board action on applications for branches, agencies, and commercial lending companies. The 1996 Act provided that the Board must act on such an application within 180 days of its receipt. The time period may be extended once for an additional 180 days, provided notice of the extension and the reasons for it are provided to the applicant and the licensing authority; the applicant may also waive the time periods. Although the regulation will reflect these statutory time periods, the Board will maintain existing internal time schedules that would require faster processing where possible.

New Standard

In light of the increasing attention being paid to the problem of money laundering, the Board currently requests that a foreign bank applying to establish U.S. offices provide information on the measures taken to prevent the bank from being used to launder money, the legal regime to prevent money laundering in the home country, and the extent of the home country's participation in multilateral efforts to combat money laundering. The Board considers this information in reaching its decision on applications. In light of this practice, the proposed revision included as a standard for the establishment of U.S. offices by foreign banks that the Board may consider the adequacy of measures for the prevention of money laundering.

One commenter expressed support for this proposal and it is adopted as proposed.

Qualifications of Foreign Banks for Nonbank Exemptions

Changes to the QFBO Test

Regulation K implements statutory exemptions from the BHC Act for certain activities of foreign banks. These exemptions are available to qualifying foreign banking organizations (QFBOs) and are found in sections 2(h) and 4(c)(9) of the BHC Act. Section 2(h) allows a foreign company principally engaged in banking business outside the United States to own foreign affiliates that engage in impermissible nonfinancial activities in the United States, subject to certain requirements. These include that the foreign affiliate must derive most of its business from outside the United States and it may engage in the United States only in the same lines of business it conducts outside the United States. Section 4(c)(9) allows the Board to grant foreign companies an exemption from the nonbank activity restrictions of the BHC Act where the exemption would not be substantially at variance with the BHC Act and would be in the public interest. Under this authority, the Board has exempted, among other things, all foreign activities of QFBOs from the nonbanking prohibitions of the BHC Act.

In order to qualify as a QFBO, a foreign banking organization must demonstrate that more than half of its business is banking and more than half of its banking business is outside the United States. Banking business is defined to include the activities permissible for a U.S. banking organization to conduct, directly or indirectly, outside of the United States.[35] Under the current regulations

[33] *See* 12 CFR 225.2(s) (definition of ''well-managed'' foreign banking of such transactions organization).

[34] *See Housing & Commercial Bank,* 83 Fed. Res. Bull. 935 (1997); *National Bank of Egypt,* 86 Fed. Res. Bull. 344 (2000); *Banco de Bogota,* 87 Fed. Res. Bull. 552 (2001).

[35] These activities include, in addition to traditional banking activities, underwriting various types of insurance (credit life, life, annuity, pension fund-related, and other types of insurance where the associated risks are actuarially predictable); underwriting, distributing, and dealing in debt and equity securities outside the United States; providing data processing, investment advisory,

Continued

such activities can be counted as banking business for the purposes of the QFBO test only if they are conducted in the foreign bank ownership chain; that is, by the foreign bank or a subsidiary of the foreign bank. Activities conducted by a parent holding company or sister affiliate do not count toward qualification.

Modification of Proposal To Remove the Banking Chain Requirement from One Prong of the QFBO Test

The Board proposed liberalizing the QFBO test by removing the banking chain requirement from the prong of the QFBO test that measures whether more than half of a foreign banking organization's business is banking. By eliminating the banking chain requirement from that prong of the test, a foreign banking organization that has, for example, substantial life insurance activities outside of the banking chain would be able to count such activities toward meeting the QFBO test. The commenters supported this liberalization.

When this proposal was made in 1997, the Board was aware of relatively few foreign banking organizations, primarily those engaged in insurance, that would have benefitted from such liberalization. Significantly, at that time, the BHC Act would have prevented such a foreign insurance company from conducting insurance activities in the United States. Accordingly, the proposed change was expected to have limited application and not to provide any significant competitive advantage for foreign banking organizations.

The enactment of the Gramm-Leach-Bliley Act has changed the regulatory landscape and the consequences of the proposed QFBO test. The BHC Act is no longer a legal bar to companies that wish to engage in insurance and merchant banking activities in the United States, and a broader range of foreign companies may acquire foreign banks with U.S. activities than was possible in 1997. If the proposed test were adopted, a foreign insurance group that qualified as a financial holding company would be able to make commercial and industrial investments in the United States beyond those permissible under insurance or merchant banking authority even though a domestic insurance company with financial holding company status could not. In light of these changes, the Board has reconsidered its proposed change to the QFBO test and determined to adopt a modified form of the 1997 proposal.

The existing QFBO test has been retained and foreign banking organizations that are able to qualify under that test will continue to be eligible for all of the exemptions. A new provision will permit those foreign banking organizations that meet only the test proposed by the Board in 1997 nevertheless to be eligible for all of the exemptions other than the exemption for limited commercial and industrial activities provided under § 211.23(f)(5)(iii).[36] Such a foreign banking organization will, however, be eligible for the limited exemptions only if the foreign banking organization includes a foreign bank that could itself meet the current QFBO test.

Although the foreign banking organization that is able to meet only the modified test generally would be limited in its ability to make investments under the exemption in section 2(h)(2) of the BHC Act, the Board considers that a foreign bank within the group should not be so limited. In this regard, the Board notes that, in enacting section 2(h)(2), Congress recognized that banks in other countries have traditionally been permitted to make commercial and industrial investments. Accordingly, any foreign bank within such a group that itself is able to meet the current QFBO test by reference to its and its subsidiaries' assets, revenues and net income, will be eligible for all of the exemptions.

Limiting the eligibility for exemptions in this way is consistent with the statutory language in section 2(h)(2) of the BHC Act, which provides that it applies to shares held by a foreign company that is ''principally engaged in the banking business outside the United States.'' At the same time, modifying the test in this manner would limit the extraterritorial effect of the BHC Act on foreign firms, and would not penalize a consolidated group that engages mostly in activities permissible for a U.S. banking organization.

Applications for Special Determination of Eligibility for QFBO Treatment

The Board recognizes that there may be types of ownership structures above foreign banks that would not meet even the modified QFBO test. It also is possible that foreign banking organizations that meet only the modified test might need limited relief for commercial and industrial activities in the United States. In addition, there may be foreign financial organizations that do not include a foreign bank and wish to acquire a U.S. bank. Such financial organizations would fail the QFBO test, and it is not possible to know the extent to which requiring such an organization to conform its worldwide operations to those permissible for a U.S. financial holding company would interfere, in particular, with its foreign business. The Board is prepared to consider requests beyond the current QFBO authority on a case-by-case basis. In considering such cases, the Board will take into account the principles of national treatment and equality of competitive opportunity and may grant exemptions that are not substantially at variance with the purposes of the BHC Act and are in the public interest.

Regulation K currently permits a foreign banking organization that ceases to qualify as a QFBO to request a special determination of eligibility. That provision has been modified to give the Board greater flexibility to grant special determinations that will permit foreign banking organizations and foreign organizations that do not include foreign banks to be eligible for some or all of the exemptions in appropriate cases.

The Board has also adopted the proposal made in 1997 that would permit a former QFBO that has applied for a specific determination of eligibility to continue to conduct its business as if it were a QFBO, except with respect to making investments in U.S. companies under section 2(h)(2) of the BHC Act for which Board consent would be required. The proposal reflects the approach taken in a prior case considered by the Board, and no comments were received on the proposal.

Other Comments on the QFBO Test

The QFBO test in Regulation K permits foreign banking organizations to count in the measurement of ''banking'' only those assets, revenues, or net income related to activities that are permissible for a U.S. banking organization to conduct outside of the United States. The Board requested comment with respect to a possible expansion of the list of activities that would be considered banking for purposes of the QFBO test. Three commenters suggested some expansion in the list. Two proposed that the QFBO

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and management consulting services; and organizing, sponsoring, and managing a mutual fund.

[36] The exemption in § 211.23(f)(5)(iii) implements section 3(h)(2) of the BHC Act. Any foreign banking organization that qualifies as a financial holding company would be able to make merchant banking investments, and investments in connection with its insurance business, in the United States to the extent permitted for a financial holding company. The lack of eligibility for the exemption provided in § 211.23(f)(5)(iii) would not negate or otherwise affect such authority.

test be expanded to include all financial activities which are usual in connection with the banking business in those countries in which the foreign banking organization is active. One proposed that the Board consider other activities on a case-by-case basis to reflect changes in foreign financial markets.

To date, there have been very few cases in which a foreign banking organization failed the QFBO test because certain types of financial activities were not included on the list. In light of this, and in view of the modified QFBO test and the ability of the Board to make special determinations of eligibility for some or all of the QFBO exemptions, the Board has determined not to make any changes at this time to the list of activities that would be considered banking for purposes of the QFBO test.

Two commenters suggested that the requirement that a QFBO conduct more banking than nonbanking activities is not required by the statute. These same commenters also proposed that even if that requirement is retained, the QFBO test should be revised to allow U.S. banking business to be included when calculating the extent of an organization's banking business. The Board has not adopted these proposals because they would be inconsistent with section 2(h)(2) of the BHC Act, which provides exemptions for foreign companies principally engaged in banking business outside the United States. Moreover, a U.S. nonfinancial company is not permitted to own a U.S. bank, and altering the test to permit a predominantly nonfinancial foreign group to engage in banking in the United States would be inconsistent with the principle of national treatment.

U.S. Activities of QFBOs

Securities Activities. Subpart B currently provides that a foreign banking organization may not own or control shares of a foreign company that directly underwrites, sells or distributes, or that owns or controls more than 5 percent of the shares of a company that underwrites, sells or distributes, securities in the United States, except to the extent permitted bank holding companies. The Board proposed that the 5 percent limit be raised to 10 percent. Two commenters suggested that the limit be raised to 24.9 percent and one proposed that no change be made. The Board has determined to adopt the 10 percent limit as proposed. The Board continues to hold the view expressed in the 1997 proposal that a foreign bank should not be able to exert a significant influence over such a securities firm. Investments above the 10 percent level would be permitted if the foreign bank met the requirements to be treated as a financial holding company under the GLB Act.

Change in meaning of ''incidental''. Two commenters requested that the Board apply an expanded definition of ''incidental'' U.S. activities in Subpart B. Under the current rule in Regulation K, a QFBO is permitted to own up to 100 percent of a foreign company that conducts activities in the United States that are ''incidental'' to the foreign company's international or foreign business. The Board's longstanding interpretation, for purposes of both Subparts A and B of Regulation K, has been that such incidental activities in the United States are limited to those activities that the Board has determined are permissible for Edge corporations to conduct in the United States. The Board proposed changes to Subpart A governing foreign portfolio investments by U.S. banking organizations to expand the interpretation of ''incidental'' for such investments to permit U.S. banking organizations to hold foreign portfolio investments (maximum of 19.9 percent of voting and 40 percent of total equity) that derive no more than 10 percent of their total consolidated revenue in the United States. The commenters proposed that the Board apply the same expanded definition of ''incidental'' U.S. activities to permit a QFBO to hold up to 100 percent of a foreign company with U.S. activities so long as those activities account for no more than 10 percent of the total consolidated revenue of the company.[37] The change to Subpart A, which has been adopted, is intended to deal with investments in companies over which the U.S. banking organization has no control. The commenters are proposing liberalized treatment for investments by foreign banks where the foreign bank is in a position to prevent the company from entering the United States. There does not appear to be any public interest justification for the request and the Board has not adopted the commenters' proposal.

[37] Foreign banking organizations already have greater leeway than U.S. banking organizations with respect to their noncontrolling investments in foreign companies engaged in U.S. activities that are not ''incidental''. The U.S. assets of such foreign companies can account for up to 49.9 percent of total consolidated assets, and the foreign companies can derive up to 49.9 percent of their consolidated revenues from the United States. Accordingly, the commenters' proposal would only affect the foreign banking organization's ability to make controlling investments in foreign companies with U.S. activities.

Determining Extent of Non-U.S. operations

Under Regulation K, a foreign bank may own or control voting shares of a foreign company that is engaged in business in the United States, subject to a number of restrictions. The first of these restrictions is that more than 50 percent of the foreign company's consolidated assets must be located, and consolidated revenues derived from, outside the United States. One commenter proposed that this assets plus revenues test be replaced with a requirement that more than 50 percent of the organization's business be outside the United States as measured by two out of three indicia: location of assets, derivation of revenues, and derivation of net income. There have been very few cases of an investment failing to comply with the assets/revenue test as currently applied, and the commenter gave no indication that any foreign bank has been harmed by it. The Board did not propose such a revision and, in the absence of an actual problem, has determined not to adopt it.

Increasing Amount of Equity in Noncontrolling Investments

One commenter suggested increasing the equity interest limit on non-controlling portfolio investments made by QFBOs from 24.9 percent of voting stock and total equity to 24.9 percent of voting stock and 40 percent of total equity to comport with limits applicable to U.S. banking organizations. Foreign banking organizations already are able to conduct a greater range of activities both in and outside the United States than are U.S. banking organizations. The analogy to portfolio investments of U.S. banking organizations is not valid; the new authority for U.S. organizations in this area is more limited than the existing authority for QFBOs. The Board does not consider that the additional authority proposed by this commenter for investments by foreign banking organizations is warranted.

Exception for Line-of-Business Requirement

Section 2(h)(2) requires that the U.S. commercial and industrial holdings of a foreign banking organization be in the same general line of business as the foreign investor company, or in a business related to the business conducted outside the United States. Consistent with the intent of Congress when it adopted this provision, Regulation K uses the Standard Industrial Classification (SIC) system for determining the comparability of U.S. and foreign nonbanking activities. One commenter noted that the provision does not permit any exceptions and suggested that the Board establish a procedure to permit a QFBO, when SIC establishment categories are not matching, to demonstrate on a case-by-case basis that the U.S. activities of a foreign subsidiary are nonetheless the same kind of activities, or related to the activities, engaged in directly or indirectly by the foreign subsidiary outside the United States.

The Board is not aware of a significant number of cases where U.S. and foreign investments of QFBOs have not met the requirements of this provision and sees no reason to modify it at this time. However, in view of the fact that the SIC classification system is being replaced by the North American Industry Classification System, the Board will be reviewing the provision and may consider if a procedure to exempt investments that do not comply with the relevant classification system would be appropriate.

This same commenter suggested that the Board review its reporting requirements to seek ways to address the difficulty of monitoring compliance with the requirements of section 211.23(f) of Regulation K within a complex, multi-tiered global organization. In the aftermath of the Gramm-Leach-Bliley Act, the Board is undertaking a review of reporting requirements for foreign banking organizations and is seeking to reduce burden where appropriate.

The Conduct of Unregulated Activities Abroad through U.S. Companies

Pursuant to section 4(c)(9) of the BHC Act, Regulation K currently exempts from the BHC Act any activity conducted by a QFBO outside the United States. In 1997, the Board noted the growing trend by foreign banks to use this exemption to conduct unregulated activities abroad through foreign subsidiaries of U.S. companies operating under section 4(c)(8) of the BHC Act. U.S. bank holding companies, in contrast, are not able to conduct unrestricted activities abroad through foreign subsidiaries of their section 4(c)(8) companies. Under the BHC Act, a U.S. bank holding company may own foreign subsidiaries only under the authority of Subpart A of Regulation K which set limits on the activities that can be conducted in such subsidiaries. The Board requested comment on whether it is consistent with the policy of national treatment to permit QFBOs to continue to use the exemption to conduct unrestricted activities abroad in foreign subsidiaries of companies regulation by the Board under section 4(c)(8).

The commenters generally favored permitting foreign banks to have unrestricted 4(c)(9) foreign subsidiaries of 4(c)(8) companies. A number of commenters stated that a foreign banking organization should be permitted to organize its non-U.S. activities in the manner that best suits its business, and that the home country supervisor and not the Federal Reserve is regarded by the market as the supervisor of the activities of such foreign companies. None of the commenters expressed any views as to whether such practice may provide foreign banks with a competitive advantage over U.S. banking organizations in using and marketing the name and operations of the regulated U.S. company, but they did state that foreign banks could achieve the same benefits by establishing a foreign affiliate of the 4(c)(8) company with a similar or identical name.

The Board has determined to take no action at this time to prevent the practice from continuing, but reserves the right to review any of these situations as the facts warrant and require a change in the relationship if the structure in fact results in competitive inequality.[38]

Implementation of New Interstate Rules

In addition to application procedures and rules on nonbanking activities, Regulation K implements the restrictions on interstate operations of foreign banks provided in the IBA and the BHC Act. The Interstate Act amended the IBA and the BHC Act to remove geographic restrictions on interstate acquisitions of banks by foreign banks, permitted foreign banks to branch interstate by merger and *de novo* on the same basis as domestic banks with the same home state as the foreign bank, and modified the definition of a foreign bank's home state for purposes of interstate branching. The Interstate Act became fully effective in June 1997.

In May 1996, the Board published a final rule to implement certain of the changes made by the Interstate Act. The rule required certain foreign banks to select a home state for the first time, or have a home state designated by the Board, removed obsolete provisions of Regulation K that restricted the ability of a foreign bank to effect major bank mergers through U.S. subsidiary banks located outside the foreign bank's home state, and deleted certain other obsolete rules governing home state selection.

[38] The Board notes that material alterations in nonbanking activities carried on by a particular section 4(c)(8) company may require notice to the Board. 12 CFR 225.25(c)(3).

The Board's 1997 proposal sought to implement and interpret certain other changes made by the Interstate Act. The proposal would permit foreign banks to make additional changes in home state under certain circumstances and clarified the extent to which a foreign bank changing its home state would be required to conform its existing network of bank subsidiaries and banking offices.

In addition, the proposal set forth the additional standards for approval of applications by foreign banks to establish interstate branches. It also clarified that the ''upgrade'' of agencies and limited branches to full branches required Board approval and that the Board would approve such upgrades (absent a merger transaction) only if the host state had enacted laws permitting *de novo* interstate branching. Finally, the proposal deleted the Board's home state attribution rule, which provides that a foreign bank (or other company) and all other foreign banks which it controls must have the same home state.

The commenters were generally supportive of the Board's proposals in the interstate area. With the exception of the ''upgrades'' proposal which, as described below, has been mooted by subsequent legislation, the Board has adopted the changes as proposed.

Changes of Home State

In 1980, the Board allowed foreign banks a single change of home state as a compromise between the need for comparable treatment with domestic banks and Congress' intent, in adopting the IBA, that foreign banks be allowed some flexibility to change home state. The basic framework for interstate banking, however, has changed substantially since 1980, when domestic banks generally could not branch interstate and rarely, if ever, could change home states. Domestic and foreign banks may now branch into other states either *de novo* or by merger in certain circumstances; interstate branching by merger between banks is now possible in all but one state (all states will allow interstate branching by merger as of year end 2001), and *de novo* interstate branching is permitted in 17 states. As a result, many domestic banks with interstate branches now have significant opportunities to change home state, although these opportunities are not available to all banks under all circumstances.

In light of these changes, the Board proposed giving foreign banks additional opportunities to change home state in a way that affords comparable treatment to foreign and domestic banks. The proposal retained the ability of foreign banks under current rules to change their home state once by filing a notice with the Board. Changes made by foreign banks prior to the entry into effect of the final rule would count toward this one-time limit. The proposal also established a new procedure for foreign banks to change home state an unlimited number of times, by applying for the prior approval of the Board for each such change. A foreign bank applying to change its home state under the new procedure would be required to show that a domestic bank with the same home state would be able to make the same change.

The Board has adopted the change in home state provision as proposed. The commenters supported the provision but questioned the need for prior Board approval; instead they recommended a 45 day notice requirement. The Board has considered whether the issues presented by a request for an additional change of home state could be dealt with adequately during a 45 day prior notice period. The Board expects such changes to be comparatively rare. In addition, each such request presents unique facts. For these reasons, the Board has elected to retain the prior approval requirement set forth in the proposal. As the Board gains experience processing such requests, it may consider replacing the prior approval with a prior notice requirement.

One of the commenters sought assurance that the Board would be flexible in interpreting the requirement that a foreign bank seeking to make an additional change of home state demonstrate that a domestic bank with the same home state would be able to make the same change. The Board believes the new procedure advances the policies of national treatment and equality of competitive opportunity underlying the IBA by allowing foreign banks to take advantage of changes in laws concerning interstate branching in order to change home state, when and to the extent those laws make it possible for similarly situated domestic banks to change home state. Although the Interstate Act made it possible for domestic banks to change home state in some cases, there are other cases where such a change in home state may be difficult or impossible. The new procedure also seeks to prevent foreign banks from gaining an unfair competitive advantage over domestic banks. Accordingly, the new procedure would allow foreign banks to change home state only in cases where a domestic bank could effect a comparable change.

Changes in home state would generally have no impact on which Reserve Bank will supervise the operations of a foreign bank nor on which Reserve Bank will receive a foreign bank's reports and applications.

Conforming U.S. Operations Upon Change in Home State

Regulation K currently requires a foreign bank that changes its home state to conform its banking operations outside the new home state to what would have been permissible at the time of the bank's original home state selection. The requirement, adopted in 1980, implemented section 5 of the IBA which sought to prevent foreign banks from using a home state change to acquire and maintain subsidiary banks or branches in more than one state in circumstances where a domestic bank or bank holding company would be unable to do so.

The Interstate Act liberalized the rules on interstate branches and eliminated the geographic restrictions on the purchases of banks by domestic bank holding companies and foreign banks under the BHC Act and the IBA. Consequently, the Board proposed that the provisions on conforming operations upon a foreign bank's change of home state be revised to reflect changes made by the Interstate Act. For example, with respect to subsidiary banks, a foreign bank would no longer be required to divest a subsidiary bank outside its new home state; the Interstate Act authorizes interstate acquisitions of bank subsidiaries.

With respect to conforming branches outside the foreign bank's new home state, the proposal reflected the liberalized interstate branching rules applicable to foreign and domestic banks as a result of the Interstate Act. A foreign bank changing its home state would be permitted to retain all branches which the foreign bank could establish (under current law) if it already had its new home state. This relaxation is appropriate given that domestic, as well as foreign banks, now have significant opportunities to establish and retain interstate branches.

The commenters supported this proposal and the Board adopted it as proposed. One commenter was concerned, however, that a rigid interpretation of the limitation on retention of existing branch operations outside the new home state to only those branches that the foreign bank could establish under current law if it already had its new home state would severely limit changes of home state by banks with established, nongrandfathered operations in the old home state. The Board intends to apply the rule consistent with the scope of the changes to the interstate rules. The Board also notes that the GLB Act provides opportunities for banks to upgrade existing operations outside the home state. These opportunities should reduce the need for foreign banks to change home states.

Additional Standards for Interstate Offices

The proposal also contained the additional standards required by the Interstate Act for approval by the Board of the establishment by a foreign bank of branches located outside of the bank's home state. These standards were designed to insure that foreign banks seeking to establish interstate branches meet requirements comparable to those imposed on domestic banks seeking to operate interstate. The Board received no comments on this aspect of the interstate proposal and has adopted it as proposed.

Upgrading of Agencies and Limited Branches to Full Branches

Section 5 of the IBA, as amended by the Interstate Act, generally allows a foreign bank to establish full branches outside its home state only if a domestic bank with the same home state could establish branches in the same host state under the Interstate Act. The GLB Act contained a new exception to this general limitation. The new provision allows a foreign bank, with the Board's approval, to upgrade an existing agency or limited branch outside the bank's home state to a full service branch provided the state would permit the upgrade and the office has been is existence the minimum amount of time that the state requires for the acquisition of an interstate bank.

In response to inquiries and requests from trade groups, the Board, in its 1997 proposal, stated its view that upgrades of existing agencies and limited branches outside of a foreign bank's home state constituted a ''change in status'' of an office requiring Board approval under FBSEA. In addition, the Board stated that such upgrades would be approved only in situations where the state in which the upgraded office was located permitted *de novo* branching.

The Board's proposal elicited responses from three commenters, each of which urged liberalization and/or flexibility to some degree. The proposal and the comments received have been superseded to a significant degree by the GLB Act provision permitting upgrades. The new statutory provision confirmed that upgrades require Board approval but made such upgrades more widely available than the Board had proposed. Upgrades may now be approved provided the state permits the upgrade and the office to be upgraded has been in existence in that state for the minimum amount of time (no more than 5 years) required for the acquisition of an interstate bank. The Board is amending its interstate rules to implement the GLB provision. Upgrades, like other branch proposals under FBSEA, generally require full applications. Prior notice may be available, as provided elsewhere in this final rule, if the foreign bank has previously received a CCS determination from the Board.

Home State Attribution Rule Deleted

Regulation K currently provides that a foreign banking organization and all its affiliates are entitled to only one home state. This would be true even if the foreign banking organization owned several different foreign banks with operations in the United States.

At the time the rule was adopted, domestic banks generally could not branch into states other than the ones in which they were located, nor could bank holding companies generally acquire banks outside their home state. In that context, the Regulation K provision was structured to prevent affiliated groups of foreign banks from gaining an unfair advantage over domestic banks by having each of the affiliated foreign banks select a different home state. Having done so, the foreign banks would be able to open and operate branches in more than one state. The rule sought to prevent this by stating that a foreign banking organization and any foreign bank that it controls would be entitled to only one home state.

The Interstate Act has substantially changed the rules on interstate expansion since this provision was originally adopted. Under current law, a bank holding company may own many banks in different states; each of these banks is entitled to its own home state regardless of the home states of its affiliates. Consequently, in 1997 the Board proposed that Regulation K be amended to eliminate the requirement that a foreign bank and all its affiliates are entitled to only one home state. The proposal would preserve national treatment for foreign banks and would not put U.S. banking organizations at any competitive disadvantage. The commenters supported the proposal, and the Board has adopted it.

Representative Offices

Definition of Representative Office

The GLB Act amended the definition of representative office such that a subsidiary of a foreign bank may now be considered a representative office. The definition of representative office in Regulation K has been modified to conform with the change in law. The statutory amendment closed a potential ''loophole'' that made it possible for foreign banks to set up subsidiaries to engage in representative activities, thus avoiding both the FBSEA application process and ongoing supervision of such subsidiary as a representative office. However, the fact that subsidiaries can now be deemed to be representative offices raises new issues.

The Board is aware of only a few cases in which banks sought to make use of this loophole and does not believe that there are significant current issues with respect to representative functions being conducted out of subsidiaries. It is possible that a foreign bank could attempt to evade the IBA's requirements by using a nonbank subsidiary; it would be difficult, however, to anticipate and try to prohibit all potential schemes. The Board thus is not proposing to amend Regulation K to clarify all situations in which a nonbank subsidiary or affiliate would be considered a representative office. Rather the Board is providing general guidance and seeks views on whether more explicit guidance is warranted.

As a general matter, any subsidiary established for the purpose of acting as a representative office clearly would be a representative office. Similarly, a subsidiary would be considered to be a representative office when it holds itself out to the public as a representative of the foreign bank, acting on behalf of the foreign bank, even if the subsidiary engages in other nonbank business. In addition, an individual or a unit of a subsidiary that acts as a representative of a foreign bank from the location of the nonbank subsidiary would be treated as a representative office. An important limitation on this general approach is that a subsidiary generally would *not* be considered a representative office if it makes customer referrals or cross-markets the foreign bank's services in a manner that would be permissible for a nonbank affiliate of a U.S. bank.

The Board is also interested in receiving views on whether a money transmitter subsidiary of a foreign bank should be prohibited from also engaging in representative functions or employing individuals who act as bank representatives. A money transmitter is a nonbank company that for a fee will send funds to persons outside the United States. Often, the funds are first transmitted to the affiliated foreign bank for the benefit of the ultimate recipient. A foreign bank is not entitled to use the money transmitter to engage in deposit-taking. If a representative office were combined with a money transmitter, it would be extremely difficult if not impossible to monitor or enforce compliance with this restriction. Customers could also be confused about the status of funds given to the money transmitter.

Registration of Existing Incorporated Representative Offices

There may be some subsidiaries of foreign banks that will fall within the definition of ''representative office'' for the first time, and these subsidiaries will need to be identified. The Board has determined to impose a registration requirement similar to that imposed following the enactment of FBSEA, which subjected representative offices of foreign banks to Board approval requirements and supervision for the first time. All subsidiaries that are acting as representative offices will be required to complete a brief informational report. The form will be issued separately. Subsidiaries and affiliates of foreign banks that have been conducting representative functions on behalf of the foreign bank will be ''grandfathered'' and not required to apply to ''re-establish'' a representative office.[39]

Approval of Loans at a Representative Office

Regulation K currently includes as permissible activities for a representative office those in which a ''loan production office'' of a state member bank may engage as set forth in a 1978 Board interpretation. The portion of the interpretation restricting loan approvals at such offices has been superceded, and loan origination facilities of state member banks may approve loans in certain circumstances. The Board considers that representative offices of foreign banks that are subject to the BHC Act, and thus subject to supervision in the United States, should be permitted to engage in the same activities as such facilities. The Board is

[39] The grandfathering would be effective as of the date of the proposal but only for those affiliates engaged in activities clearly permissible to conduct in combination with representative office functions. Thus, should the Board determine that representative functions may not be conducted in a money transmitter subsidiary, such activities would have to be discontinued.

therefore amending Regulation K to remove the reference to the interpretation and clarify that representative offices may make credit decisions if (i) the foreign bank also operates one or more branches or agencies in the United States, (ii) the loans approved at the representative office are made by a U.S. branch or agency of the bank, and (iii) the loan proceeds are not disbursed in the representative office.

Additional Matters

Temporary Additional Office Location

From time to time, the Board has received requests from foreign banks that desire to have an additional temporary location, usually as an interim measure before moving into new office space that can accommodate the entire staff of the branch or agency. The earliest inquiries were prompted by space constraints at the existing office and the need to relocate some employees until renovations could be completed at a new larger location. To accommodate such situations, the Board proposed a new provision in Regulation K permitting the Board, in its discretion, to determine that a well-managed foreign bank would not be considered to have established an office if certain conditions were met. Since the proposal was made, staff has received additional inquiries where the proposed relocation of employees would not fit within the provision as proposed. These more recent requests have involved mergers or consolidations of bank and nonbank entities within a banking group. The Board therefore, has adopted a broadened form of the provision to cover these additional types of temporary relocation situations. Any foreign bank taking advantage of this authority would be required to advise the Board prior to the relocation, make certain commitments,[40] and provide periodic information, as requested. The Board generally would not make such determinations if the reason for the request is the bank's failure to file on a timely basis a notice or application for the additional office, and the bank could not maintain the temporary location for more than twelve months.

Changes to Definition Section

The revision makes certain technical changes in the definition section of Subpart B, including in the definitions of ''appropriate Federal Reserve Bank,'' ''change in status,'' ''foreign banking organization,'' ''regional administrative office,'' and ''representative office.''

Conforming Changes To Termination Provisions

The Board proposed to amend the provisions of Subpart B dealing with termination of a U.S. office of a foreign bank to add as a grounds for termination a finding that the home country supervisor of a foreign bank is not making demonstrable progress in establishing arrangements for the comprehensive supervision or regulation of such foreign bank on a consolidated basis. This change has been adopted.

Reduction of Reporting Requirements

The Board proposed reducing the periodicity of reporting of all acquisitions of shares in companies engaged in business in the United States from quarterly to annually. Since the issuance of the proposal, the Board has reconsidered this issue in connection with the development and issuance of a new Form FR Y–10F. On this form, foreign banking organizations are required to report some of the investments covered by the old quarterly report on an event-generated basis. Remaining U.S. investments will be reportable only annually in connection with the FR Y–7. The final rule reflects the decisions on reporting made in connection with the issuance of the FR Y–10F.

Subpart C: Export Trading Companies

Subpart C of Regulation K sets out the rules governing investments and participation in export trading companies (ETCs) by bank holding companies and other eligible investors. ETCs are companies in which bank holding companies and certain other eligible investors may invest for the purpose of promoting U.S. exports.

Currently, an eligible investor must give the Board 60 days prior written notice of an investment of any amount in an ETC. The Board proposed adding a general consent provision under which an eligible investor that is well-capitalized and well-managed may invest in an ETC without prior notice. Such an investor would have to provide certain information to the Board in a post-investment notice. The terms well-capitalized and well-managed, as used for this purpose, would have the same meanings as in the Board's Regulation Y.

The Board further proposed allowing an eligible investor, also under general consent authority, to reinvest an amount equal to dividends received from the ETC in the prior year and to acquire an ETC from an affiliate at net asset value. Other proposed revisions included moving all defined terms into a new definitions section; removing an obsolete provision relating to the calculation of an ETC's revenues; and making certain minor, technical amendments.

One commenter expressed general support for the Board's proposal. The Board is adopting the revisions as proposed.

Delegations of Authority

The Board proposed additional and modified delegations of authority with respect to certain matters arising under Regulation K. Foremost, the Board proposed to delegate additional authority to the Director of the Division of Banking Supervision and Regulation with respect to foreign branching by member banks, general consent investments under Subpart A, and the general consent procedures of Subpart C. The Board also proposed to delegate to the Director and to the Reserve Banks additional authority with respect to prior notice investments and the establishment of prior notice U.S. offices by foreign banks. In addition, the Board proposed to delete as no longer necessary the delegation to the Reserve Banks to approve an application by a foreign bank to establish an additional U.S. office or a commercial lending company under certain circumstances. These proposals did not elicit negative comment, and they are adopted as proposed.

The Board also is authorizing several additional delegations of authority, relating generally to the processing and approval of applications under all Subparts of Regulation K; investments in Edge and agreement corporation subsidiaries; amendments to Edge corporation charters; the establishment of agreement corporations; ''special-purpose foreign government-owned bank'' determinations under section 211.24(d)(3); the approval of requests arising under section 4(c)(9) of the BHC Act; and FHC elections by foreign banks. The delegations of authority and modifications to existing delegations authorized by this final rulemaking will be variously codified in Regulation K and the Board's Rules Regarding Delegation of Authority (12 CFR part 265).

Regulatory Flexibility Act

The Board has reviewed the final rule in accordance with the Regulatory Flexibility Act. This final rule makes amendments to subparts A, B and C of Regulation K based upon a review of the regulation consistent with section 303 of

[40] As a general rule, the Board would require that there be no signs at any temporary location identifying it as an office of the bank, and that no client meetings take place at a temporary location.

the Riegle Community Development and Regulatory Improvement Act of 1994 (the Regulatory Improvement Act) and the International Banking Act of 1978 (the IBA). The rule streamlines procedures for U.S. and foreign banking organizations, implements portions of the Interstate Act, EGRPRA and GLB, and authorizes expanded activities for U.S. banking organizations abroad. The overall effect of the final rule will be to reduce regulatory burden. Pursuant to the Regulatory Flexibility Act, the Board hereby certifies that the final rule will not have a significant economic impact on a substantial number of small business entities.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless the Board displays a currently valid OMB control number. The Board's OMB control numbers for the collections revised by this rule are 7100–0107 (the International Applications and Prior Notifications under Subparts A and C of Regulation K; FR K–1), 7100–0110 (the Notification Required Pursuant to Section 211.23(h) of Regulation K on Acquisitions by Foreign Banking Organizations; FR 4002), and 7100–0284 (the International Applications and Prior Notifications under Subpart B of Regulation K; FR K–2).

The collections of information that are revised by this rulemaking are found in 12 CFR 211.3, 211.5, 211.7, 211.9 through 211.11, 211.13, 211.22 through 211.24, and 211.34. These information collections are required to evidence compliance with the requirements of Regulation K. The respondents are for-profit financial institutions, including small businesses.

No comments specifically addressing the burden estimate were received. The current estimated annual burden for the 7100–0107 is 636 hours. The final rule would result in an estimated 25 percent reduction in the number of applications filed. The final rule would permit strongly capitalized and well-managed U.S. banking organizations making investments pursuant to general consent authority to file an abbreviated post-investment notice with the Board. This notice would take the place of certain requirements for prior notices or applications to the Board before any such investment could be made. The current estimated annual burden for the 7100–0284 is 600 hours. It is estimated that the final rule would reduce the burden by 10 percent due to a decrease in the average number of hours required to complete an application. The Board expects to publish a separate notice to revise these two applications to comply with the final rule's reporting requirements. In the interim, institutions may submit any new information requested in this rule in a letter format. The current estimated annual burden for the 7100–0110 is 80 hours. The final rule eliminates the need for this separate information collection. Similar information is collected on the Annual Report of Foreign Banking Organizations (FR Y–7; OMB No. 7100–0125) and the Report of Changes in FBO Organizational Structure (FR Y–10F; OMB No. 7100–0297). The Board estimates there would be no cost burden in addition to the annual hour burden.

For the 7100–0107 and the 7100–0284, the applying organization has the opportunity to request confidentiality for information that it believes will qualify for an FOIA exemption.

The Federal Reserve has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0107 or 7100–0284), Washington, DC 20503.

List of Subjects

12 CFR Part 211

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

12 CFR Part 265

Authority delegations (Government agencies), Banks, banking, Federal Reserve System.

For the reasons set out in the preamble, the Board of Governors amends 12 CFR parts 211 and 265 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, 1835a, 1841 *et seq.*, 3101 *et seq.*, 3109 *et seq.*

2. Subparts A, B, and C (consisting of §§ 211.1 through 211.34) are revised to read as follows:

Subpart A—International Operations of U.S. Banking Organizations

Sec.
211.1 Authority, purpose, and scope.
211.2 Definitions.
211.3 Foreign branches of U.S. banking organizations.
211.4 Permissible investments and activities of foreign branches of member banks.
211.5 Edge and agreement corporations.
211.6 Permissible activities of Edge and agreement corporations in the United States.
211.7 Voluntary liquidation of Edge and agreement corporations.
211.8 Investments and activities abroad.
211.9 Investment procedures.
211.10 Permissible activities abroad.
211.11 Advisory opinions under Regulation K.
211.12 Lending limits and capital requirements.
211.13 Supervision and reporting.

Subpart B—Foreign Banking Organizations

211.20 Authority, purpose, and scope.
211.21 Definitions.
211.22 Interstate banking operations of foreign banking organizations.
211.23 Nonbanking activities of foreign banking organizations.
211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.
211.25 Termination of offices of foreign banks.
211.26 Examination of offices and affiliates of foreign banks.
211.27 Disclosure of supervisory information to foreign supervisors.
211.28 Provisions applicable to branches and agencies: limitation on loans to one borrower.
211.29 Applications by state branches and state agencies to conduct activities not permissible for federal branches.
211.30 Criteria for evaluating U.S. operations of foreign banks not subject to consolidated supervision.

Subpart C—Export Trading Companies

211.31 Authority, purpose, and scope.
211.32 Definitions.
211.33 Investments and extensions of credit.
211.34 Procedures for filing and processing notices.

Subpart A—International Operations of U.S. 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 Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978 (IBA) (12 U.S.C. 3101 *et seq.*).

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

(c) *Scope.* This subpart applies to:

(1) 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

(2) Corporations organized under section 25A of the FRA (12 U.S.C. 611–631) (Edge corporations);

(3) Corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601–604a) (agreement corporations); and

(4) Bank holding companies with respect to the exemption from the nonbanking prohibitions of the BHC Act afforded by section 4(c)(13) of that act (12 U.S.C. 1843(c)(13)).

§ 211.2 Definitions.

Unless otherwise specified, for 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 Adequacy Guidelines* means the ''Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure'' (12 CFR part 208, app. A) or the ''Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure'' (12 CFR part 225, app. A).

(c) *Capital and surplus* means, unless otherwise provided in this part:

(1) For organizations subject to the Capital Adequacy Guidelines:

(i) Tier 1 and tier 2 capital included in an organization's risk-based capital (under the Capital Adequacy Guidelines); and

(ii) The balance of allowance for loan and lease losses not included in an organization's tier 2 capital for calculation of risk-based capital, based on the organization's most recent consolidated Report of Condition and Income.

(2) For all other organizations, paid-in and unimpaired capital and surplus, and includes undivided profits but does not include the proceeds of capital notes or debentures.

(d) *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.

(e) *Eligible country* means any country:

(1) For which an allocated transfer risk reserve is required pursuant to § 211.43 of this part and that has restructured its sovereign debt held by foreign creditors; and

(2) Any other country that the Board deems to be eligible.

(f) 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.

(g) *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.

(h) *Equity* means an ownership interest in an organization, whether through:

(1) Voting or nonvoting shares;

(2) General or limited partnership interests;

(3) 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; or

(4) Loans that provide rights to participate in the profits of an organization, unless the investor receives a determination that such loans should not be considered equity in the circumstances of the particular investment.

(i) *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.

(j) *Foreign bank* means an organization that:

(1) Is organized under the laws of a foreign country;

(2) Engages in the business of banking;

(3) Is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations;

(4) Receives deposits to a substantial extent in the regular course of its business; and

(5) Has the power to accept demand deposits.

(k) *Foreign branch* means an office of an organization (other than a representative office) that is located outside the country in which the organization is legally established and at which a banking or financing business is conducted.

(l) *Foreign person* means an office or establishment located outside the United States, or an individual residing outside the United States.

(m) *Investment* means:

(1) The ownership or control of equity;

(2) Binding commitments to acquire equity;

(3) Contributions to the capital and surplus of an organization; or

(4) The holding of an organization's subordinated debt when the investor and the investor's affiliates hold more than 5 percent of the equity of the organization.

(n) *Investment grade* means a security that is rated in one of the four highest rating categories by:

(1) Two or more NRSROs; or

(2) One NRSRO if the security has been rated by only one NRSRO.

(o) *Investor* means an Edge corporation, agreement corporation, bank holding company, or member bank.

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

(q) *Loans and extensions of credit* 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.

(r) *NRSRO* means a nationally recognized statistical rating organization as designated by the Securities and Exchange Commission.

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

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

(u) *Portfolio investment* means an investment in an organization other than a subsidiary or joint venture.

(v) *Representative office* means an office that:

(1) Engages solely in representational and administrative functions (such as

[1] Section 25 of the FRA (12 U.S.C. 601–604a), 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)

soliciting new business or acting as liaison between the organization's head office and customers in the United States); and

(2) Does not have authority to make any business decision (other than decisions relating to its premises or personnel) for the account of the organization it represents, including contracting for any deposit or deposit-like liability on behalf of the organization.

(w) *Subsidiary* means an organization that has more than 50 percent of its voting shares held directly or indirectly, or that otherwise is controlled or capable of being controlled, by the investor or an affiliate of the investor under any authority. Among other circumstances, an investor is considered to control an organization if:

(1) The investor or an affiliate is a general partner of the organization; or

(2) The investor and its affiliates directly or indirectly own or control more than 50 percent of the equity of the organization.

(x) *Tier 1 capital* has the same meaning as provided under the Capital Adequacy Guidelines.

(y) *Well capitalized* means:

(1) In relation to a parent member or insured bank, that the standards set out in § 208.43(b)(1) of Regulation H (12 CFR 208.43(b)(1)) are satisfied;

(2) In relation to a bank holding company, that the standards set out in § 225.2(r)(1) of Regulation Y (12 CFR 225.2(r)(1)) are satisfied; and

(3) In relation to an Edge or agreement corporation, that it has tier 1 and total risk-based capital ratios of 6.0 and 10.0 percent, respectively, or greater.

(z) *Well managed* means that the Edge or agreement corporation, any parent insured bank, and the bank holding company received a composite rating of 1 or 2, and at least a satisfactory rating for management if such a rating is given, at their most recent examination or review.

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

(a) *General*—(1) *Definition of banking organization.* For purposes of this section, a *banking organization* is defined as a member bank and its affiliates.

(2) A banking organization is considered to be operating a branch in a foreign country if it has an affiliate that is a member bank, Edge or agreement corporation, or foreign bank that operates an office (other than a representative office) in that country.

(3) For purposes of this subpart, a foreign office of an operating subsidiary of a member bank shall be treated as a foreign branch of the member bank and may engage only in activities permissible for a branch of a member bank.

(4) At any time upon notice, the Board may modify or suspend branching authority conferred by this section with respect to any banking organization.

(b) (1) *Establishment of foreign branches.* (i) 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, any subsidiary the shares of which are held directly by the member bank, or any other subsidiary held pursuant to this subpart.

(ii) The Board grants its general consent under section 25 of the FRA (12 U.S.C. 601–604a) for a member bank to establish a branch in the Commonwealth of Puerto Rico and the overseas territories, dependencies, and insular possessions of the United States.

(2) *Prior notice.* Unless otherwise provided in this section, the establishment of a foreign branch requires 30 days' prior written notice to the Board.

(3) *Branching into additional foreign countries.* After giving the Board 12 business days prior written notice, a banking organization that operates branches in two or more foreign countries may establish a branch in an additional foreign country.

(4) *Additional branches within a foreign country.* No prior notice is required to establish additional branches in any foreign country where the banking organization operates one or more branches.

(5) *Branching by nonbanking affiliates.* No prior notice is required for a nonbanking affiliate of a banking organization (*i.e.,* an organization that is not a member bank, an Edge or agreement corporation, or foreign bank) to establish branches within a foreign country or in additional foreign countries.

(6) *Expiration of branching authority.* Authority to establish branches, when granted following prior written notice to the Board, shall expire one year from the earliest date on which the authority could have been exercised, unless extended by the Board.

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

(d) *Reserves of foreign branches of member banks.* Member banks shall maintain reserves against foreign branch deposits when required by Regulation D (12 CFR part 204).

(e) *Conditional approval; access to information.* The Board may impose such conditions on authority granted by it under this section as it deems necessary, and may require termination of any activities conducted under authority of this section if a member bank is unable to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

§ 211.4 Permissible activities and investments of foreign branches of member banks.

(a) *Permissible activities and investments.* 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 and make the following investments, so far as is 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 (including, but not limited to, nonpayment of taxes, rentals, customs duties, or costs of transport, and loss or nonconformance of shipping documents) if the guarantee or agreement specifies a maximum monetary liability; however, except to the extent 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 section 5200(a)(1) of the Revised Statutes (12 U.S.C. 84) for loans and extensions of credit;

(2) *Government obligations.* (i) Underwrite, distribute, buy, sell, and hold obligations of:

(A) The national government of the country where the branch is located and any political subdivision of that country;

(B) An agency or instrumentality of the national government of the country where the branch is located where such obligations are supported by the taxing authority, guarantee, or full faith and credit of that government;

(C) The national government or political subdivision of any country, where such obligations are rated investment grade; and

(D) An agency or instrumentality of any national government where such obligations are rated investment grade and are supported by the taxing authority, guarantee or full faith and credit of that government.

(ii) No member bank, under authority of this paragraph (a)(2), may hold, or be under commitment with respect to, such obligations for its own account in relation to any one country in an amount exceeding the greater of:

(A) 10 percent of its tier 1 capital; or

(B) 10 percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or the date of acquisition of the branch, in the case of a branch that has not been so reported);

(3) *Other investments.* (i) Invest in:

(A) The securities of the central bank, clearinghouses, governmental entities other than those authorized under paragraph (a)(2) of this section, and government-sponsored development banks of the country where the foreign branch is located;

(B) Other debt securities eligible to meet local reserve or similar requirements; and

(C) Shares of automated electronic-payments networks, professional societies, schools, and the like necessary to the business of the branch;

(ii) The total investments of a bank's branches in a country under this paragraph (a)(3) (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 1 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 been so reported);

(4) *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;

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

(6) *Employee benefits program.* Pay to an employee of the branch, as part of an employee benefits program, a greater rate of interest than that paid to other depositors of the branch;

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

(8) *Investment in subsidiaries.* With the Board's prior approval, acquire all of the shares of a company (except where local law requires other investors to hold directors' qualifying shares or similar types of instruments) that engages solely in activities:

(i) In which the member bank is permitted to engage; or

(ii) That are incidental to the activities of the foreign branch.

(b) *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.

§ 211.5 Edge and agreement corporations.

(a) *Board Authority.* The Board shall have the authority to approve:

(1) The establishment of Edge corporations;

(2) Investments in agreement corporations; and

(3) A member bank's proposal to invest more than 10 percent of its capital and surplus in the aggregate amount of stock held in all Edge and agreement corporations.

(b) *Organization of an Edge corporation*—(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 of the Edge corporation shall include *international, foreign, overseas,* or a 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 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 U.S. 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.

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

(c) *Other provisions regarding Edge corporations*—(1) *Amendments to articles of association.* No amendment to the articles of association shall become effective until approved by the Board.

(2) *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 business 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 by a shareholder or authorized representative to attend such meeting in person or by proxy may result in removal or barring of the shareholder or representative from further participation in the management or affairs of the Edge corporation.

(3) *Nature and ownership of shares*—(i) *Shares.* Shares of stock in an Edge corporation may not include no-par-value shares and shall be issued and transferred only on its books and in compliance with section 25A of the FRA (12 U.S.C. 611 *et seq.*) and this subpart.

(ii) *Contents of share certificates.* The share certificates of an Edge corporation shall:

(A) Name and describe each class of shares, indicating its character and any unusual attributes, such as preferred status or lack of voting rights; and

(B) Conspicuously set forth the substance of:

(*1*) Any limitations on the rights of ownership and transfer of shares imposed by section 25A of the FRA (12 U.S.C. 611 *et seq.*); and

(*2*) Any rules that the Edge corporation prescribes in its bylaws to ensure compliance with this paragraph (c).

(4) *Change in status of shareholder.* Any change in status of a shareholder that causes a violation of section 25A of the FRA (12 U.S.C. 611 *et seq.*) shall be reported to the Board as soon as possible, and the Edge corporation shall take such action as the Board may direct.

(d) *Ownership of Edge corporations by foreign institutions*—(1) *Prior Board approval.* One or more foreign or foreign-controlled domestic institutions referred to in section 25A(11) 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.

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

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

(ii) Ensure that any transaction by an Edge corporation with an affiliate[2] 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;

(iii) 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; and

(iv) Comply with the limitation on aggregate investments in all Edge and agreement corporations set forth in paragraph (h) of this section.

(3) *Foreign institutions not subject to the BHC Act.* In the case of a foreign institution not subject to section 4 of the BHC Act (12 U.S.C. 1843), that institution shall:

(i) 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

(ii) Give the Board 30 days' prior written notice 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 (12 U.S.C. 1843); in connection with such notice, the Board may impose conditions necessary to prevent adverse effects that may result from such activity or investment.

(e) *Change in control of an Edge corporation*—(1) *Prior notice.* (i) Any person shall give the Board 60 days' prior written notice before acquiring, directly or indirectly, 25 percent or more of the voting shares, or otherwise acquiring control, of an Edge corporation.

(ii) The Board may extend the 60-day period for an additional 30 days by notifying the acquiring party.

(iii) A notice under this paragraph (e) 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).

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

(f) *Domestic branching by Edge corporations*—(1) *Prior notice.* (i) An Edge corporation may establish branches in the United States 30 days after the Edge corporation has given written notice of its intention to do so to its Reserve Bank, unless the Edge corporation is notified to the contrary within that time.

(ii) 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.

(iii) The newspaper notice may appear no earlier than 90 calendar days prior to submission of notice of the proposal to the Reserve Bank. The newspaper notice shall 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 (b)(4) of this section.

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

(g) *Agreement corporations*—(1) *General.* 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.

(2) *Factors considered by Board.* The factors considered in acting upon a proposal to establish an agreement corporation are enumerated in paragraph (b)(4) of this section.

(h) (1) *Limitation on investment in Edge and agreement corporations.* A member bank may invest up to 10 percent of its capital and surplus in the capital stock of Edge and agreement corporations or, with the prior approval of the Board, up to 20 percent of its capital and surplus in such stock.

(2) *Factors considered by Board.* The factors considered by the Board in acting on a proposal under paragraph (h)(1) of this section shall include:

(i) The composition of the assets of the bank's Edge and agreement corporations;

(ii) The total capital invested by the bank in its Edge and agreement corporations when combined with retained earnings of the Edge and agreement corporations (including retained earnings of any foreign bank subsidiaries) as a percentage of the bank's capital;

(iii) Whether the bank, bank holding company, and Edge and agreement corporations are well-capitalized and well-managed;

(iv) Whether the bank is adequately capitalized after deconsolidating and deducting the aggregate investment in and assets of all Edge or agreement corporations and all foreign bank subsidiaries; and

(v) Any other factor the Board deems relevant to the safety and soundness of the member bank.

(i) *Reserve requirements and interest rate limitations.* The deposits of an Edge or agreement corporation are subject to Regulations D and Q (12 CFR parts 204 and 217) in the same manner and to the same extent as if the Edge or agreement corporation were a member bank.

(j) *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:

(1) Cash;

(2) Deposits with depository institutions, as described in Regulation D (12 CFR part 204), and other Edge and agreement corporations;

(3) Money-market instruments (including repurchase agreements with respect to such instruments), such as bankers' acceptances, federal funds sold, and commercial paper; and

(4) Short- or long-term obligations of, or fully guaranteed by, federal, state, and local governments and their instrumentalities.

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[2] For purposes of this paragraph (d)(2), *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.

(k) *Reports by Edge and agreement corporations of crimes and suspected crimes.* An Edge or agreement corporation, or any branch or subsidiary thereof, shall file a suspicious-activity report in accordance with the provisions of § 208.62 of Regulation H (12 CFR 208.62).

§ 211.6 Permissible activities of Edge and agreement corporations in the United States.

(a) *Activities incidental to international or foreign business.* An Edge or agreement corporation may engage, directly or indirectly, in activities in the United States that are permitted by section 25A(6) of the FRA (12 U.S.C. 615) 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 or agreement corporation's international or foreign business:

(1) *Deposit-taking activities*—(i) *Deposits from foreign governments and foreign persons.* An Edge or agreement 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 foreign persons.

(ii) *Deposits from other persons.* An Edge or agreement 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 or agreement 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 or agreement corporation;

(E) Represent compensation to the Edge or agreement 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 Regulation D (12 CFR part 204)); or

(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, as defined in 26 U.S.C. 922; 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 established under subpart C of this part.

(2) *Borrowings.* An Edge or agreement corporation may:

(i) Borrow from offices of other Edge and agreement corporations, foreign banks, and depository institutions (as described in Regulation D (12 CFR part 204));

(ii) Issue obligations to the United States or any of its agencies or instrumentalities;

(iii) 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 or agreement corporation is obligated to repurchase; and

(iv) Issue long-term subordinated debt that does not qualify as a *deposit* under Regulation D (12 CFR part 204).

(3) *Credit activities.* An Edge or agreement 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 or agreement corporation could have financed, including acquisition of obligations of foreign governments;

(iv) Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events (including, but not limited to, nonpayment of taxes, rentals, customs duties, or cost of transport, and loss or nonconformance of shipping documents), so long as the guarantee or agreement specifies the maximum monetary liability thereunder and is related to a type of transaction described in paragraphs (a)(3)(i) and (ii) of this section; and

(v) Provide credit and other banking services for domestic and foreign purposes to foreign governments and their agencies and instrumentalities, foreign persons, and organizations of the type described in paragraph (a)(1)(ii)(G) of this section.

(4) *Payments and collections.* An Edge or agreement 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.

(5) *Foreign exchange.* An Edge or agreement corporation may engage in foreign exchange activities.

(6) *Fiduciary and investment advisory activities.* An Edge or agreement 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 are 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 or agreement corporation otherwise may 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,[3] and by providing advice on mergers and acquisitions, provided such services for U.S. persons are with respect to foreign assets only; and

(vi) Provide general economic information and advice, general economic statistical forecasting services, and industry studies, provided such

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

services for U.S. persons shall be with respect to foreign economies and industries only.

(7) *Banking services for employees.* Provide banking services, including deposit services, to the officers and employees of the Edge or agreement corporation and its affiliates; however, extensions of credit to such persons shall be subject to the restrictions of Regulation O (12 CFR part 215) as if the Edge or agreement corporation were a member bank.

(b) *Other activities.* With the Board's prior approval, an Edge or agreement corporation may engage, directly or indirectly, in other activities in the United States that the Board determines are incidental to their international or foreign business.

§ 211.7 Voluntary liquidation of Edge and agreement corporations.

(a) *Prior notice.* An Edge or agreement corporation desiring voluntarily to discontinue normal business and dissolve, shall provide the Board with 45 days' prior written notice of its intent to do so.

(b) *Waiver of notice period.* The Board may waive the 45-day period if it finds that immediate action is required by the circumstances presented.

§ 211.8 Investments and activities abroad.

(a) *General policy.* Activities abroad, whether conducted directly or indirectly, shall be confined to activities of a banking or financial nature and those that are necessary to carry on such activities. In doing so, investors [4] 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) *Direct investments by member banks.* A member bank's direct investments under section 25 of the FRA (12 U.S.C. 601 *et seq.*) shall be limited to:

(1) Foreign banks;

(2) Domestic or foreign organizations formed for the sole purpose of holding shares of a foreign bank;

(3) Foreign organizations formed for the sole purpose of performing nominee, fiduciary, or other banking services incidental to the activities of a foreign branch or foreign bank affiliate of the member bank; and

(4) Subsidiaries established pursuant to § 211.4(a)(8) of this part.

(c) *Eligible investments.* Subject to the limitations set out in paragraphs (b) and (d) of this section, an investor may, directly or indirectly:

(1) *Investment in subsidiary.* Invest in a subsidiary that engages solely in activities listed in § 211.10 of this part, or in such other activities as the Board has determined in the circumstances of a particular case are permissible; provided 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 5 percent of either the consolidated assets or consolidated revenues of the acquired organization;

(2) *Investment in joint venture.* 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 consolidated revenues are attributable to activities not listed in § 211.10 of this part; and

(3) *Portfolio investments.* Make portfolio investments in an organization, provided that:

(i) *Individual investment limits.* The total direct and indirect portfolio investments by the investor and its affiliates in an organization engaged in activities that are not permissible for joint ventures, when combined with all other shares in the organization held under any other authority, do not exceed:

(A) 40 percent of the total equity of the organization; or

(B) 19.9 percent of the organization's voting shares.

(ii) *Loans and extensions of credit.* Any loans and extensions of credit made by an investor or its affiliates to the organization are on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions between the investor or its affiliates and nonaffiliated persons; and

(iii) *Protecting shareholder rights.* Nothing in this paragraph (c)(3) shall prohibit an investor from otherwise exercising rights it may have as shareholder to protect the value of its investment, so long as the exercise of such rights does not result in the investor's direct or indirect control of the organization.

(d) *Investment limit.* In calculating the amount that may be invested in any organization under this section and §§ 211.9 and 211.10 of this part, there shall be included any unpaid amount for which the investor is liable and any investments in the same organization held by affiliates under any authority.

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

(1) The organization invested in:

(i) Engages in impermissible activities to an extent not permitted under paragraph (c) of this section; or

(ii) Engages directly or indirectly in other business in the United States that is not permitted to an Edge corporation in the United States; provided that an investor may:

(A) Retain portfolio investments in companies that derive no more than 10 percent of their total revenue from activities in the United States; and

(B) Hold up to 5 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

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

(f) *Debts previously contracted.* Shares or other ownership interests acquired to prevent a loss upon a debt previously contracted in good faith are not subject to the limitations or procedures of this section; provided that such interests shall be disposed of promptly but in no event later than two years after their acquisition, unless the Board authorizes retention for a longer period.

(g) *Investments made through debt-for-equity conversions.*

(1) *Permissible investments.* A bank holding company may make 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, including an additional cash investment not exceeding in the aggregate more than 10 percent of the fair value of the debt obligations being converted as part of such investment, are used to purchase the following investments:

(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

[4] For purposes of this section and §§ 211.9 and 211.10 of this part, a direct subsidiary of a member bank is deemed to be an investor.

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 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 extensions 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.

(2) *Investments by bank subsidiary of bank holding company.* Upon application, the Board may permit an indirect investment to be made pursuant to this paragraph (g) through an insured bank subsidiary of the bank holding company, where the bank holding company demonstrates that such ownership is consistent with the purposes of the FRA. 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.

(3) *Divestiture*—(i) *Time limits for divestiture.* A bank holding company shall divest the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (g) within the longer of:

(A) Ten years from the date of acquisition of the investment, except that the Board may extend such period if, in the Board's judgment, such an extension would not be detrimental to the public interest; or

(B) Two years from the date on which the bank holding company is permitted to repatriate in full the investment in the foreign company.

(ii) *Maximum retention period.* Notwithstanding the provisions of paragraph (g)(3)(i) of this section:

(A) Divestiture shall occur within 15 years of the date of acquisition of the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (g); and

(B) A bank holding company may retain such shares or ownership interests if such retention is otherwise permissible at the time required for divestiture.

(iii) *Report to Board.* The bank holding company shall report to the Board on its plans for divesting an investment made under this paragraph (g) two years prior to the final date for divestiture, in a manner to be prescribed by the Board.

(iv) *Other conditions requiring divestiture.* All investments made pursuant to this paragraph (g) are subject to paragraph (e) 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 that exceeds in the aggregate 10 percent of the company's consolidated assets or revenues calculated on an annual basis; provided that such company may not engage in activities in the United States that consist of banking or financial operations (as defined in § 211.23(f)(5)(iii)(B)) of this part, or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)), except under regulations of the Board or with the prior approval of the Board.

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

(ii) All other investments shall be made in accordance with the procedures of § 211.9(f) and (g) of this part, requiring prior notice or specific consent.

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

§ 211.9 Investment procedures.

(a) *General provisions.*[5] Direct and indirect investments shall be made in accordance with the general consent, limited general consent, prior notice, or specific consent procedures contained in this section.

(1) *Minimum capital adequacy standards.* Except as the Board may otherwise determine, in order for an investor to make investments pursuant to the procedures set out in this section, the investor, the bank holding company, and the member bank shall be in compliance with applicable minimum standards for capital adequacy set out in the Capital Adequacy Guidelines; provided that, if the investor is an Edge or agreement corporation, the minimum capital required is total and tier 1 capital ratios of 8 percent and 4 percent, respectively.

(2) *Composite rating.* Except as the Board may otherwise determine, in order for an investor to make investments under the general consent or limited general consent procedures of paragraphs (b) and (c) of this section, the investor and any parent insured bank must have received a composite rating of at least 2 at the most recent examination.

(3) *Board's authority to modify or suspend procedures.* The Board, at any time upon notice, may modify or suspend the procedures contained in this section with respect to any investor or with respect to the acquisition of shares of organizations engaged in particular kinds of activities.

(4) *Long-range investment plan.* Any investor may submit to the Board for its specific consent a long-range investment plan. Any plan so approved shall be subject to the other procedures of this section only to the extent determined necessary by the Board to assure safety and soundness of the operations of the investor and its affiliates.

(5) *Prior specific consent for initial investment.* An investor shall apply for and receive the prior specific consent of the Board for its initial investment under this subpart in its first subsidiary or joint venture, unless an affiliate previously has received approval to make such an investment.

(6) *Expiration of investment authority.* Authority to make investments granted under prior notice or specific consent procedures shall expire one year from the earliest date on which the authority could have been exercised, unless the Board determines a longer period shall apply.

(7) *Conditional approval; Access to information.* The Board may impose such conditions on authority granted by it under this section as it deems necessary, and may require termination of any activities conducted under authority of this subpart if an investor is unable to provide information on its activities or those of its affiliates that the

[5] When necessary, the provisions of this section relating to general consent and prior notice constitute the Board's approval under section 25A(8) of the FRA (12 U.S.C. 616) for investments in excess of the limitations therein based on capital and surplus.

Board deems necessary to determine and enforce compliance with U.S. banking laws.

(b) *General consent.* The Board grants its general consent for a well capitalized and well managed investor to make investments, subject to the following:

(1) *Well capitalized and well managed investor.* In order to qualify for making investments under authority of this paragraph (b), both before and immediately after the proposed investment, the investor, any parent insured bank, and any parent bank holding company shall be well capitalized and well managed.

(2) *Individual limit for investment in subsidiary.* In the case of an investment in a subsidiary, the total amount invested directly or indirectly in such subsidiary (in one transaction or a series of transactions) does not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 2 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 2 percent of the tier 1 capital of any parent insured bank or 10 percent of the investor's tier 1 capital, for any other investor.

(3) *Individual limit for investment in joint venture.* In the case of an investment in a joint venture, the total amount invested directly or indirectly in such joint venture (in one transaction or a series of transactions) does not exceed:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of the tier 1 capital of any parent insured bank or 5 percent of the investor's tier 1 capital, for any other investor.

(4) *Individual limit for portfolio investment.* In the case of a portfolio investment, the total amount invested directly or indirectly in such company (in one transaction or a series of transactions) does not exceed the lesser of $25 million, or

(i) 5 percent of the investor's tier 1 capital in the case of a bank holding company or its subsidiary, or Edge corporation engaged in banking; or

(ii) 25 percent of the investor's tier 1 capital in the case of an Edge corporation not engaged in banking.

(5) *Investment in a general partnership or unlimited liability company.* An investment in a general partnership or unlimited liability company may be made under authority of paragraph (b) of this section, subject to the limits set out in paragraph (c) of this section.

(6) *Aggregate investment limits*—(i) *Investment limits.* All investments made, directly or indirectly, during the previous 12-month period under authority of this section, when aggregated with the proposed investment, shall not exceed:

(A) 20 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(B) 10 percent of the investor's tier 1 capital, where the investor is a member bank; or

(C) The lesser of 10 percent of the tier 1 capital of any parent insured bank or 50 percent of the tier 1 capital of the investor, for any other investor.

(ii) *Downstream investments.* In determining compliance with the aggregate limits set out in this paragraph (b), an investment by an investor in a subsidiary shall be counted only once, notwithstanding that such subsidiary may, within 12 months of the date of making the investment, downstream all or any part of such investment to another subsidiary.

(7) *Application of limits.* In determining compliance with the limits set out in this paragraph (b), an investor is not required to combine the value of all shares of an organization held in trading or dealing accounts under § 211.10(a)(15) of this part with investments in the same organization.

(c) *Limited general consent*—(1) *Individual limit.* The Board grants its general consent for an investor that is not well capitalized and well managed to make an investment in a subsidiary or joint venture, or to make a portfolio investment, if the total amount invested directly or indirectly (in one transaction or in a series of transactions) does not exceed the lesser of $25 million or:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of any parent insured bank's tier 1 capital or 5 percent of the investor's tier 1 capital, for any other investor.

(2) *Aggregate limit.* The amount of general consent investments made by any investor directly or indirectly under authority of this paragraph (c) during the previous 12-month period, when aggregated with the proposed investment, shall not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 5 percent of the investor's tier 1 capital, where the investor is a member bank; and

(iii) The lesser of 5 percent of any parent insured bank's tier 1 capital or 25 percent of the investor's tier 1 capital, for any other investor.

(3) *Application of limits.* In calculating compliance with the limits of this paragraph (c), the rules set forth in paragraphs (b)(6)(ii) and (b)(7) of this section shall apply.

(d) *Other eligible investments under general consent.* In addition to the authority granted under paragraphs (b) and (c) of this section, the Board grants its general consent for any investor to make the following investments:

(1) *Investment in organization equal to cash dividends.* Any investment in an organization in an amount equal to cash dividends received from that organization during the preceding 12 calendar months; and

(2) *Investment acquired from affiliate.* Any investment that is acquired from an affiliate at net asset value or through a contribution of shares.

(e) *Investments ineligible for general consent.* An investment in a foreign bank may not be made under authority of paragraphs (b) or (c) of this section if:

(1) After the investment, the foreign bank would be an affiliate of a member bank; and

(2) The foreign bank is located in a country in which the member bank and its affiliates have no existing banking presence.

(f) *Prior notice.* An investment that does not qualify for general consent under paragraph (b), (c), or (d) of this section may be made after the investor has given the Board 30 days' prior written notice, such notice period to commence at the time the notice is received, provided that:

(1) The Board may waive the 30-day period if it finds the full period is not required for consideration of the proposed investment, or that immediate action is required by the circumstances presented; and

(2) The Board may suspend the 30-day period or act on the investment under the Board's specific consent procedures.

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

§ 211.10 Permissible activities abroad.

(a) *Activities usual in connection with banking.* 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 consistent with the provisions of Regulation Y (12 CFR part 225);

(4) Acting as fiduciary;

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

(6) Performing services for other direct or indirect operations of a U.S. 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 (12 U.S.C. 1843(a)(2)(A), (c)(1)(C));

(7) Holding the premises of a branch of an Edge or agreement 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) Organizing, sponsoring, and managing a mutual fund, if the fund's shares are not sold or distributed in the United States or to U.S. residents and the fund does not exercise managerial control over the firms in which it invests;

(12) Performing management consulting services, if such services, when rendered with respect to the U.S. 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 as follows:

(i) *Limits for well-capitalized and well-managed investor*—(A) *General.* After providing 30 days' prior written notice to the Board, an investor that is well capitalized and well managed may underwrite equity securities, provided that commitments by an investor and its subsidiaries for the shares of a single organization do not, in the aggregate, exceed:

(*1*) 15 percent of the bank holding company's tier 1 capital, where the investor is a bank holding company;

(*2*) 3 percent of the investor's tier 1 capital, where the investor is a member bank; or

(*3*) The lesser of 3 percent of any parent insured bank's tier 1 capital or 15 percent of the investor's tier 1 capital, for any other investor;

(B) *Qualifying criteria.* An investor will be considered well-capitalized and well-managed for purposes of paragraph (a)(14)(i) of this section only if each of the bank holding company, member bank, and Edge or agreement corporation qualify as well-capitalized and well-managed.

(ii) *Limits for investor that is not well capitalized and well managed.* After providing 30 days' prior written notice to the Board, an investor that is not well capitalized and well managed may underwrite equity securities, provided that commitments by the investor and its subsidiaries for the shares of an organization do not, in the aggregate, exceed $60 million; and

(iii) *Application of limits.* For purposes of determining compliance with the limitations of this paragraph (a)(14), the investor may subtract portions of an underwriting that are covered by binding commitments obtained by the investor or its affiliates from sub-underwriters or other purchasers;

(15) Dealing in equity securities outside the United States as follows:

(i) *Grandfathered authority.* By an investor, or an affiliate, that had commenced such activities prior to March 27, 1991, and subject to the limitations in effect at that time (See 12 CFR part 211, revised January 1, 1991); or

(ii) *Limit on shares of a single issuer.* After providing 30 days' prior written notice to the Board, an investor may deal in the shares of an organization where the shares held in the trading or dealing accounts of an investor and its affiliates under authority of this paragraph (a)(15) do not in the aggregate exceed the lesser of:

(A) $40 million; or

(B) 10 percent of the investor's tier 1 capital;

(iii) *Aggregate equity limit.* The total shares held directly and indirectly by the investor and its affiliates under authority of this paragraph (a)(15) and § 211.8(c)(3) of this part in organizations engaged in activities that are not permissible for joint ventures do not exceed:

(A) 25 percent of the bank holding company's tier 1 capital, where the investor is a bank holding company;

(B) 20 percent of the investor's tier 1 capital, where the investor is a member bank;[6] and

(C) The lesser of 20 percent of any parent insured bank's tier 1 capital or 100 percent of the investor's tier 1 capital, for any other investor;

(iv) *Determining compliance with limits*—(A) *General.* For purposes of determining compliance with all limits set out in this paragraph (a)(15):

(*1*) Long and short positions in the same security may be netted; and

(*2*) Except as provided in paragraph (a)(15)(iv)(B)(*4*) of this section, equity securities held in order to hedge bank permissible equity derivatives contracts shall not be included.

(B) *Use of internal hedging models.* After providing 30 days' prior written notice to the Board the investor may use an internal hedging model that:

(*1*) Nets long and short positions in the same security and offsets positions in a security by futures, forwards, options, and other similar instruments referenced to the same security, for purposes of determining compliance with the single issuer limits of paragraph (a)(15)(ii) of this section;[7] and

(*2*) Offsets its long positions in equity securities by futures, forwards, options, and similar instruments, on a portfolio basis, and for purposes of determining compliance with the aggregate equity limits of paragraph (a)(15)(iii) of this section.

(*3*) With respect to all equity securities held under authority of paragraph (a)(15) of this section, no net long position in a security shall be deemed to have been reduced by more than 75 percent through use of internal hedging models under this paragraph (a)(15)(iv)(B); and

(*4*) With respect to equity securities acquired to hedge bank permissible equity derivatives contracts under authority of paragraph (a)(1) of this section, any residual position that remains in the securities of a single issuer after netting and offsetting of positions relating to the security under the investor's internal hedging models shall be included in calculating compliance with the limits of this paragraph (a)(15)(ii) and (iii).

(C) *Underwriting commitments.* Any shares acquired pursuant to an underwriting commitment that are held for longer than 90 days after the payment date for such underwriting shall be subject to the limits set out in

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

[7] A basket of stocks, specifically segregated as an offset to a position in a stock index derivative product, as computed by the investor's internal model, may be offset against the stock index.

paragraph (a)(15) of this section and the investment provisions of §§ 211.8 and 211.9 of this part.

(v) *Authority to deal in shares of U.S. organization.* The authority to deal in shares under paragraph (a)(15) of this section includes the authority to deal in the shares of a U.S. organization:

(A) With respect to foreign persons only; and

(B) Subject to the limitations on owning or controlling shares of a company in section 4(c)(6) of the BHC Act (12 U.S.C. 1843(c)(6)) and Regulation Y (12 CFR part 225).

(vi) *Report to senior management.* Any shares held in trading or dealing accounts for longer than 90 days shall be reported to the senior management of the investor;

(16) Operating a travel agency, but only in connection with financial services offered abroad by the investor or others;

(17) Underwriting life, annuity, pension fund-related, and other types of insurance, where the associated risks have been previously determined by the Board to be actuarially predictable; provided that:

(i) Investments in, and loans and extensions of credit (other than loans and extensions of credit fully secured in accordance with the requirements of section 23A of the FRA (12 U.S.C. 371c), or with such other standards as the Board may require) to, the company by the investor or its affiliates are deducted from the capital of the investor (with 50 percent of such capital deduction to be taken from tier 1 capital); and

(ii) Activities conducted directly or indirectly by a subsidiary of a U.S. insured bank are excluded from the authority of this paragraph (a)(17), unless authorized by the Board;

(18) Providing futures commission merchant services (including clearing without executing and executing without clearing) for nonaffiliated persons with respect to futures and options on futures contracts for financial and nonfinancial commodities; provided that prior notice under § 211.9(f) of this part shall be provided to the Board before any subsidiaries of a member bank operating pursuant to this subpart may join a mutual exchange or clearinghouse, unless the potential liability of the investor to the exchange, clearinghouse, or other members of the exchange, as the case may be, is legally limited by the rules of the exchange or clearinghouse to an amount that does not exceed applicable general consent limits under § 211.9 of this part;

(19) Acting as principal or agent in commodity-swap transactions in relation to:

(i) Swaps on a cash-settled basis for any commodity, provided that the investor's portfolio of swaps contracts is hedged in a manner consistent with safe and sound banking practices; and

(ii) Contracts that require physical delivery of a commodity, provided that:

(A) Such contracts are entered into solely for the purpose of hedging the investor's positions in the underlying commodity or derivative contracts based on the commodity;

(B) The contract allows for assignment, termination or offset prior to expiration; and

(C) Reasonable efforts are made to avoid delivery.

(b) *Regulation Y activities.* An investor may engage in activities that the Board has determined in § 225.28(b) of Regulation Y (12 CFR 225.28(b)) are closely related to banking under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)).

(c) *Specific approval.* With the Board's specific approval, an investor may engage 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.

§ 211.11 Advisory opinions under Regulation K.

(a) *Request for advisory opinion.* Any person may submit a request to the Board for an advisory opinion regarding the scope of activities permissible under any subpart of this part.

(b) *Form and content of the request.* Any request for an advisory opinion under this section shall be:

(1) Submitted in writing to the Board;

(2) Contain a clear description of the proposed parameters of the activity, or the service or product, at issue; and

(3) Contain a concise explanation of the grounds on which the submitter contends the activity is or should be considered by the Board to be permissible under this part.

(c) *Response to request.* In response to a request received under this section, the Board shall:

(1) Direct the submitter to provide such additional information as the Board may deem necessary to complete the record for a full consideration of the issue presented; and

(2) Provide an advisory opinion within 45 days after the record on the request has been determined to be complete.

§ 211.12 Lending limits and capital requirements.

(a) *Acceptances of Edge corporations.* (1) Limitations. An Edge corporation shall be and remain fully secured for acceptances of the types described in section 13(7) of the FRA (12 U.S.C. 372), as follows:

(i) All acceptances outstanding in excess of 200 percent of its tier 1 capital; and

(ii) All acceptances outstanding for any one person in excess of 10 percent of its tier 1 capital.

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

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

(ii) Covered by participation agreements from other banks, as described in 12 CFR 250.165.

(b) *Loans and extensions of credit to one person*—(1) *Loans and extensions of credit defined. Loans and extensions of credit* has the meaning set forth in § 211.2(q) of this part [8] and, for purposes of this paragraph (b), also include:

(i) Acceptances outstanding that are not of the types described in section 13(7) of the FRA (12 U.S.C. 372);

(ii) 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 agreements;

(iii) Investments in the securities of another organization other than a subsidiary; and

(iv) Any underwriting commitments to an issuer of securities, where no binding commitments have been secured from subunderwriters or other purchasers.

(2) *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;[9] 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

[8] In the case of a foreign government, these includes 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.

[9] For purposes of this pargraph (b), *subsidiaries* includes subsidiaries controlled by the Edge corporation, but does not include companies otherwise controlled by affiliates of the Edge corporation.

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.

(3) *Exceptions.* The limitations of paragraph (b)(2) 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 banker's acceptance, of the kind described in section 13(7) of the FRA (12 U.S.C. 372), 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; and

(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, the Asian Development Bank, or the European Bank for Reconstruction and Development;

(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 would necessarily include default to that entity. The total loans and extensions of credit under this paragraph (b)(3)(vi)(B) to any person shall at no time exceed 100 percent of the tier 1 capital of the Edge corporation.

(c) *Capitalization.* (1) 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.

(2) In the case of an Edge corporation engaged in banking, the minimum ratio of qualifying total capital to risk-weighted assets, as determined under the Capital Adequacy Guidelines, shall not be less than 10 percent, of which at least 50 percent shall consist of tier 1 capital.

(3) For purposes of this paragraph (c), no limitation shall apply on the inclusion of subordinated debt that qualifies as tier 2 capital under the Capital Adequacy Guidelines.

§ 211.13 Supervision and reporting.

(a) *Supervision.* (1) *Foreign branches and subsidiaries.* U.S. banking organizations conducting international 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.

(i) Effective systems of records, controls, and reports shall be maintained to keep management informed of their activities and condition.

(ii) Such systems shall provide, in particular, information on risk assets, exposure to market risk, liquidity management, operations, internal controls, legal and operational risk, and conformance to management policies.

(iii) Reports on risk assets shall 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.

(iv) Reports on operations and controls shall 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.

(i) Such information shall include audits and other reports on financial performance, risk exposure, management policies, operations, and controls.

(ii) Complete information shall be maintained on all transactions with the joint venture by the investor and its affiliates.

(3) *Availability of reports and information to examiners.* The reports specified in paragraphs (a)(1) and (2) of this section and any other information deemed necessary to determine compliance with U.S. banking law 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 or agreement corporation shall make available to examiners information sufficient 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 or agreement 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 or disposition of shares.* Member banks, Edge and agreement corporations, and bank holding companies shall report, in a manner prescribed by the Board, any acquisition or disposition of shares.

(d) *Filing and processing procedures*—(1) *Place of filing.* Unless otherwise directed by the Board, applications, notices, and reports required by this part shall be filed with the Federal Reserve Bank of the District in which the parent bank or bank holding company is located or, if none, the Reserve Bank of the District in which the applying or reporting institution is located. Instructions and forms for applications, notices, and reports are available from the Reserve Banks.

(2) *Timing.* The Board shall act on an application under this subpart within 60 calendar days after the Reserve Bank has received the application, 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

§ 211.20 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 (BHC Act) (12 U.S.C. 1841 *et seq.*) and the International Banking Act of 1978 (IBA) (12 U.S.C. 3101 *et seq.*).

(b) *Purpose and scope.* This subpart is in furtherance of the purposes of the BHC Act and the IBA. It applies to foreign banks and foreign banking organizations with respect to:

(1) The limitations on interstate banking under section 5 of the IBA (12 U.S.C. 3103);

(2) The exemptions from the nonbanking prohibitions of the BHC Act and the IBA afforded by sections 2(h) and 4(c)(9) of the BHC Act (12 U.S.C. 1841(h), 1843(c)(9));

(3) Board approval of the establishment of an office of a foreign bank in the United States under sections 7(d) and 10(a) of the IBA (12 U.S.C. 3105(d), 3107(a));

(4) The termination by the Board of a foreign bank's representative office, state branch, state agency, or commercial lending company subsidiary under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(e), 3107(b)), and the transmission of a recommendation to the Comptroller to terminate a federal branch or federal agency under section 7(e)(5) of the IBA (12 U.S.C. 3105(e)(5));

(5) The examination of an office or affiliate of a foreign bank in the United States as provided in sections 7(c) and 10(c) of the IBA (12 U.S.C. 3105(c), 3107(c));

(6) The disclosure of supervisory information to a foreign supervisor under section 15 of the IBA (12 U.S.C. 3109);

(7) The limitations on loans to one borrower by state branches and state agencies of a foreign bank under section 7(h)(2) of the IBA (12 U.S.C. 3105(h)(2));

(8) The limitation of a state branch and a state agency to conducting only activities that are permissible for a federal branch under section (7)(h)(1) of the IBA (12 U.S.C. 3105(h)(1)); and

(9) The deposit insurance requirement for retail deposit taking by a foreign bank under section 6 of the IBA (12 U.S.C. 3104).

(10) The management of shell branches (12 U.S.C. 3105(k)).

(c) *Additional requirements.* Compliance by a foreign bank with the requirements of this subpart and the laws administered and enforced by the Board does not relieve the foreign bank of responsibility to comply with the laws and regulations administered by the licensing authority.

§ 211.21 Definitions.

The definitions contained in §§ 211.1 and 211.2 apply to this subpart, except as a term is otherwise defined in this section:

(a) *Affiliate* of a foreign bank or of a parent of a foreign bank means any company that controls, is controlled by, or is under common control with, the foreign bank or the parent of the foreign bank.

(b) *Agency* means any place of business of a foreign bank, located in any state, at which credit balances are maintained, checks are paid, money is lent, or, to the extent not prohibited by state or federal law, deposits are accepted from a person or entity that is not a citizen or resident of the United States. Obligations shall not be considered credit balances unless they are:

(1) Incidental to, or arise out of the exercise of, other lawful banking powers;

(2) To serve a specific purpose;

(3) Not solicited from the general public;

(4) Not used to pay routine operating expenses in the United States such as salaries, rent, or taxes;

(5) Withdrawn within a reasonable period of time after the specific purpose for which they were placed has been accomplished; and

(6) Drawn upon in a manner reasonable in relation to the size and nature of the account.

(c)(1) *Appropriate Federal Reserve Bank* means, unless the Board designates a different Federal Reserve Bank:

(i) For a foreign banking organization, the Reserve Bank assigned to the foreign banking organization in § 225.3(b)(2) of Regulation Y (12 CFR 225.3(b)(2));

(ii) For a foreign bank that is not a foreign banking organization and proposes to establish an office, an Edge corporation, or an agreement corporation, the Reserve Bank of the Federal Reserve District in which the foreign bank proposes to establish such office or corporation; and

(iii) In all other cases, the Reserve Bank designated by the Board.

(2) The appropriate Federal Reserve Bank need not be the Reserve Bank of the Federal Reserve District in which the foreign bank's home state is located.

(d) *Banking subsidiary,* with respect to a specified foreign bank, means a bank that is a subsidiary as the terms *bank* and *subsidiary* are defined in section 2 of the BHC Act (12 U.S.C. 1841).

(e) *Branch* means any place of business of a foreign bank, located in any state, at which deposits are received, and that is not an agency, as that term is defined in paragraph (b) of this section.

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

(g) *Commercial lending company* means any organization, other than a bank or an organization operating under section 25 of the Federal Reserve Act (FRA) (12 U.S.C. 601–604a), organized under the laws of any state, that maintains credit balances permissible for an agency, and engages in the business of making commercial loans. *Commercial lending company* includes any company chartered under article XII of the banking law of the State of New York.

(h) *Comptroller* means the Office of the Comptroller of the Currency.

(i) *Control* has the same meaning as in section 2(a) of the BHC Act (12 U.S.C. 1841(a)), and the terms *controlled* and *controlling* shall be construed consistently with the term *control.*

(j) *Domestic branch* means any place of business of a foreign bank, located in any state, that may accept domestic deposits and deposits that are incidental to or for the purpose of carrying out transactions in foreign countries.

(k) A foreign bank *engages directly in the business of banking outside the United States* if the foreign bank engages directly in banking activities usual in connection with the business of banking in the countries where it is organized or operating.

(l) To *establish* means:

(1) To open and conduct business through an office;

(2) To acquire directly, through merger, consolidation, or similar transaction with another foreign bank, the operations of an office that is open and conducting business;

(3) To acquire an office through the acquisition of a foreign bank subsidiary that will cease to operate in the same corporate form following the acquisition;

(4) To change the status of an office; or

(5) To relocate an office from one state to another.

(m) *Federal agency, federal branch, state agency,* and *state branch* have the same meanings as in section 1 of the IBA (12 U.S.C. 3101).

(n) *Foreign bank* means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States. The term *foreign bank* does not include a central bank of a foreign country that does not engage or seek to engage in a commercial banking business in the United States through an office.

(o) *Foreign banking organization* means:

(1) A foreign bank, as defined in section 1(b)(7) of the IBA (12 U.S.C. 3101(7)), that:

(i) Operates a branch, agency, or commercial lending company subsidiary in the United States;

(ii) Controls a bank in the United States; or

(iii) Controls an Edge corporation acquired after March 5, 1987; and

(2) Any company of which the foreign bank is a subsidiary.

(p) *Home country,* with respect to a foreign bank, means the country in which the foreign bank is chartered or incorporated.

(q) *Home country supervisor,* with respect to a foreign bank, means the governmental entity or entities in the foreign bank's home country with responsibility for the supervision and regulation of the foreign bank.

(r) *Licensing authority* means:

(1) The relevant state supervisor, with respect to an application to establish a state branch, state agency, commercial lending company, or representative office of a foreign bank; or

(2) The Comptroller, with respect to an application to establish a federal branch or federal agency.

(s) *Limited branch* means a branch of a foreign bank that receives only such deposits as would be permitted for a corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611–631).

(t) *Office* or *office of a foreign bank* means any branch, agency, representative office, or commercial lending company subsidiary of a foreign bank in the United States.

(u) A *parent* of a foreign bank means a company of which the foreign bank is a subsidiary. An *immediate parent* of a foreign bank is a company of which the foreign bank is a direct subsidiary. An *ultimate parent* of a foreign bank is a parent of the foreign bank that is not the subsidiary of any other company.

(v) *Regional administrative office* means a representative office that:

(1) Is established by a foreign bank that operates two or more branches, agencies, commercial lending companies, or banks in the United States;

(2) Is located in the same city as one or more of the foreign bank's branches, agencies, commercial lending companies, or banks in the United States;

(3) Manages, supervises, or coordinates the operations of the foreign bank or its affiliates, if any, in a particular geographic area that includes the United States or a region thereof, including by exercising credit approval authority in that area pursuant to written standards, credit policies, and procedures established by the foreign bank; and

(4) Does not solicit business from actual or potential customers of the foreign bank or its affiliates.

(w) *Relevant state supervisor* means the state entity that is authorized to supervise and regulate a state branch, state agency, commercial lending company, or representative office.

(x) *Representative office* means any office of a foreign bank which is located in any state and is not a Federal branch, Federal agency, State branch, State agency, or commercial lending company subsidiary.

(y) *State* means any state of the United States or the District of Columbia.

(z) *Subsidiary* means any organization that:

(1) Has 25 percent or more of its voting shares directly or indirectly owned, controlled, or held with the power to vote by a company, including a foreign bank or foreign banking organization; or

(2) Is otherwise controlled, or capable of being controlled, by a foreign bank or foreign banking organization.

§ 211.22 Interstate banking operations of foreign banking organizations.

(a) *Determination of home state.* (1) A foreign bank that, as of December 10, 1997, had declared a home state or had a home state determined pursuant to the law and regulations in effect prior to that date shall have that state as its home state.

(2) A foreign bank that has any branches, agencies, commercial lending company subsidiaries, or subsidiary banks in one state, and has no such offices or subsidiaries in any other states, shall have as its home state the state in which such offices or subsidiaries are located.

(b) *Change of home state*—(1) *Prior notice.* A foreign bank may change its home state once, if it files 30 days' prior notice of the proposed change with the Board.

(2) *Application to change home state.* (i) A foreign bank, in addition to changing its home state by filing prior notice under paragraph (b)(1) of this section, may apply to the Board to change its home state, upon showing that a national bank or state-chartered bank with the same home state as the foreign bank would be permitted to change its home state to the new home state proposed by the foreign bank.

(ii) A foreign bank may apply to the Board for such permission one or more times.

(iii) In determining whether to grant the request of a foreign bank to change its home state, the Board shall consider whether the proposed change is consistent with competitive equity between foreign and domestic banks.

(3) *Effect of change in home state.* The home state of a foreign bank and any change in its home state by a foreign bank shall not affect which Federal Reserve Bank or Reserve Banks supervise the operations of the foreign bank, and shall not affect the obligation of the foreign bank to file required reports and applications with the appropriate Federal Reserve Bank.

(4) *Conforming branches to new home state.* Upon any change in home state by a foreign bank under paragraph (b)(1) or (b)(2) of this section, the domestic branches of the foreign bank established in reliance on any previous home state of the foreign bank shall be conformed to those which a foreign bank with the new home state could permissibly establish or operate as of the date of such change.

(c) *Prohibition against interstate deposit production offices.* A covered interstate branch of a foreign bank may not be used as a deposit production office in accordance with the provisions in § 208.7 of Regulation H (12 CFR 208.7).

§ 211.23 Nonbanking activities of foreign banking organizations.

(a) *Qualifying foreign banking organizations.* Unless specifically made eligible for the exemptions by the Board, a foreign banking organization shall qualify for the exemptions afforded by this section only if, disregarding its United States banking, more than half of its worldwide business is banking; and more than half of its banking business is outside the United States.[10] In order to qualify, a foreign banking organization shall:

(1) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed total worldwide nonbanking assets;

(ii) Revenues derived from the business of banking outside the United States exceed total revenues derived from its worldwide nonbanking business; or

(iii) Net income derived from the business of banking outside the United States exceeds total net income derived from its worldwide nonbanking business; and

(2) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed banking assets held in the United States;

(ii) Revenues derived from the business of banking outside the United States exceed revenues derived from the business of banking in the United States; or

[10] None of the assets, revenues, or net income, whether held or derived directly or indirectly, of a subsidiary bank, branch, agency, commercial lending company, or other company engaged in the business of banking in the United States (including any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands) shall be considered held or derived from the business of banking ''outside the United States''.

(iii) Net income derived from the business of banking outside the United States exceeds net income derived from the business of banking in the United States.

(b) *Determining assets, revenues, and net income.* (1)(i) For purposes of paragraph (a) of this section, the total assets, revenues, and net income of an organization may be determined on a consolidated or combined basis.

(ii) The foreign banking organization shall include assets, revenues, and net income of companies in which it owns 50 percent or more of the voting shares when determining total assets, revenues, and net income.

(iii) The foreign banking organization may include assets, revenues, and net income of companies in which it owns 25 percent or more of the voting shares, if all such companies within the organization are included.

(2) Assets devoted to, or revenues or net income derived from, activities listed in § 211.10(a) shall be considered banking assets, or revenues or net income derived from the banking business, when conducted within the foreign banking organization by a foreign bank or its subsidiaries.

(c) *Limited exemptions available to foreign banking organizations in certain circumstances.* The following shall apply where a foreign bank meets the requirements of paragraph (a) of this section but its ultimate parent does not:

(1) Such foreign bank shall be entitled to the exemptions available to a qualifying foreign banking organization if its ultimate parent meets the requirements set forth in paragraph (a)(2) of this section and could meet the requirements in paragraph (a)(1) of this section but for the requirement in paragraph (b)(2) of this section that activities must be conducted by the foreign bank or its subsidiaries in order to be considered derived from the banking business;

(2) An ultimate parent as described in paragraph (c)(1) of this section shall be eligible for the exemptions available to a qualifying foreign banking organization except for those provided in § 211.23(f)(5)(iii).

(d) *Loss of eligibility for exemptions*—(1) *Failure to meet qualifying test.* A foreign banking organization that qualified under paragraph (a) or (c) of this section shall cease to be eligible for the exemptions of this section if it fails to meet the requirements of paragraphs (a) or (c) of this section for two consecutive years, as reflected in its annual reports (FR Y–7) filed with the Board.

(2) *Continuing activities and investments.* (i) A foreign banking organization that ceases to be eligible for the exemptions of this section 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 (a) or (c) of this section.

(ii) *Termination or divestiture.* Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second annual report, or at such time as the Board may determine upon request by the foreign banking organization to extend the period, unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section.

(3) *Request for specific determination of eligibility.* (i) A foreign banking organization that ceases to qualify under paragraph (a) or (c) of this section, or an affiliate of such 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), (3), and (4) of this section.

(ii) The Board may grant consent for the foreign banking organization or its affiliate to make investments under paragraph (f)(5) of this section.

(e) *Specific determination of eligibility for organizations that do not qualify for the exemptions*—(1) *Application.* (i) A foreign organization that is not a foreign banking organization or a foreign banking organization that does not qualify under paragraph (a) or (c) of this section for some or all of 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 some or all of the exemptions.

(ii) 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.

(2) *Factors considered by Board.* In determining whether eligibility for the exemptions would be consistent with the purposes of the BHC Act and in the public interest, the Board shall consider:

(i) The history and the financial and managerial resources of the foreign organization or foreign banking organization;

(ii) The amount of its business in the United States;

(iii) The amount, type, and location of its nonbanking activities, including whether such activities may be conducted by U.S. banks or bank holding companies;

(iv) Whether eligibility of the foreign organization or foreign banking organization would result in undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices; and

(v) The extent to which the foreign banking organization is subject to comprehensive supervision or regulation on a consolidated basis or the foreign organization is subject to oversight by regulatory authorities in its home country.

(3) *Conditions and limitations.* The Board may impose any conditions and limitations on a determination of eligibility, including requirements to cease activities or dispose of investments.

(4) *Eligibility not granted.* Determinations of eligibility generally would not be granted where a majority of the business of the foreign organization or foreign banking organization derives from commercial or industrial activities.

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

(1) Engage in activities of any kind outside the United States;

(2) Engage directly in activities in the United States that are incidental to its activities outside the United States;

(3) Own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the United States, other than those that are incidental to the international or foreign business of such company;

(4) Own or control voting shares of any company in a fiduciary capacity under circumstances that would entitle such shareholding to an exemption under section 4(c)(4) of the BHC Act (12 U.S.C. 1843(c)(4)) if the shares were held or acquired by a bank;

(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; provided that, if the foreign company fails to meet the requirements of this paragraph (f)(5)(i) for two consecutive years (as reflected in annual reports (FR Y–7) filed with the Board by the foreign banking organization), the foreign company shall be divested or its activities terminated within one year of the filing of the second consecutive annual report that reflects nonconformance with the requirements of this paragraph (f)(5)(i), unless the Board grants consent to retain the investment under paragraph (g) of this section;

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 10 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 must 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 BHC Act (12 U.S.C. 1843(c)(8)), only under regulations of the Board or with the prior approval of the Board, subject to the following;

(*1*) 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); and

(*2*) 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).

(g) *Exemptions under section 4(c)(9) of the BHC Act.* A foreign banking organization that is of the opinion that other activities or investments may, in particular circumstances, meet the conditions for an exemption under section 4(c)(9) of the BHC Act (12 U.S.C. 1843(c)(9)) may apply to the Board for such a determination by submitting to the appropriate Federal Reserve Bank a letter setting forth the basis for that opinion.

(h) *Reports.* The foreign banking organization shall report in a manner prescribed by the Board any direct activities in the United States by a foreign subsidiary of the foreign banking organization and the acquisition of all shares of companies engaged, directly or indirectly, in activities in the United States that were acquired under the authority of this section.

(i) *Availability of information.* If any information required under this section is unknown and not reasonably available to the foreign banking organization (either because obtaining it would involve unreasonable effort or expense, or because it rests exclusively within the knowledge of a company that is not controlled by the organization) the organization shall:

(1) Give such information on the subject as it possesses or can reasonably acquire, together with the sources thereof; and

(2) Include a statement showing that unreasonable effort or expense would be involved, or indicating that the company whose shares were acquired is not controlled by the organization, and stating the result of a request for information.

§ 211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.

(a) *Board approval of offices of foreign banks*—(1) *Prior Board approval of branches, agencies, commercial lending companies, or representative offices of foreign banks.* (i) Except as otherwise provided in paragraphs (a)(2) and (a)(3) of this section, a foreign bank shall obtain the approval of the Board before it:

(A) Establishes a branch, agency, commercial lending company subsidiary, or representative office in the United States; or

(B) Acquires ownership or control of a commercial lending company subsidiary.

(2) *Prior notice for certain offices.* (i) After providing 45 days' prior written notice to the Board, a foreign bank may establish:

(A) An additional office (other than a domestic branch outside the home state of the foreign bank established pursuant to section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3))), provided that the Board has previously determined the foreign bank to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor (*comprehensive consolidated supervision* or *CCS*); or

(B) A representative office, if:

(*1*) The Board has not yet determined the foreign bank to be subject to consolidated comprehensive supervision, but the foreign bank is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a)); or

(*2*) The Board previously has approved an application by the foreign bank to establish a branch or agency pursuant to the standard set forth in paragraph (c)(1)(iii) of this section; or

(*3*) The Board previously has approved an application by the foreign bank to establish a representative office.

(ii) The Board may waive the 45-day notice period if it finds that immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is received by the appropriate Federal Reserve Bank. The Board may suspend the period or require Board approval prior to the establishment of such office if the notification raises significant policy or supervisory concerns.

(3) *General consent for certain representative offices.* (i) The Board grants its general consent for a foreign bank that is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a)), to establish:

(A) A representative office, but only if the Board has previously determined that the foreign bank proposing to establish a representative office is subject to consolidated comprehensive supervision;

(B) A regional administrative office; or

(C) An office that solely engages in limited administrative functions (such as separately maintaining back-office support systems) that:

(*1*) Are clearly defined;

(*2*) Are performed in connection with the U.S. banking activities of the foreign bank; and

(*3*) Do not involve contact or liaison with customers or potential customers, beyond incidental contact with existing customers relating to administrative matters (such as verification or correction of account information).

(4) *Suspension of general consent or prior notice procedures.* The Board may, at any time, upon notice, modify or suspend the prior notice and general consent procedures in paragraphs (a)(2) and (3) of this section for any foreign bank with respect to the establishment by such foreign bank of any U.S. office of such foreign bank.

(5) *Temporary offices.* The Board may, in its discretion, determine that a foreign bank has not established an office if the foreign bank temporarily operates at one or more additional locations in the same city of an existing branch or agency due to renovations, an expansion of activities, a merger or consolidation of the operations of affiliated foreign banks or companies, or other similar circumstances. The foreign bank must provide reasonable advance notice of its intent temporarily to utilize additional locations, and the Board may impose such conditions in connection with its determination as it deems necessary.

(6) *After-the-fact Board approval.* Where a foreign bank proposes to establish an office in the United States through the acquisition of, or merger or consolidation with, another foreign bank with an office in the United States, the Board may, in its discretion, allow the acquisition, merger, or consolidation to proceed before an application to establish the office has been filed or acted upon under this section if:

(i) The foreign bank or banks resulting from the acquisition, merger, or consolidation, will not directly or indirectly own or control more than 5 percent of any class of the voting securities of, or control, a U.S. bank;

(ii) The Board is given reasonable advance notice of the proposed acquisition, merger, or consolidation; and

(iii) Prior to consummation of the acquisition, merger, or consolidation, each foreign bank, as appropriate, commits in writing either:

(A) To comply with the procedures for an application under this section within a reasonable period of time; to engage in no new lines of business, or otherwise to expand its U.S. activities until the disposition of the application; and to abide by the Board's decision on the application, including, if necessary, a decision to terminate the activities of any such U.S. office, as the Board or the Comptroller may require; or

(B) Promptly to wind-down and close any office, the establishment of which would have required an application under this section; and to engage in no new lines of business or otherwise to expand its U.S. activities prior to the closure of such office.

(7) *Notice of change in ownership or control or conversion of existing office or establishment of representative office under general-consent authority.* A foreign bank with a U.S. office shall notify the Board in writing within 10 days of the occurrence of any of the following events:

(i) A change in the foreign bank's ownership or control, where the foreign bank is acquired or controlled by another foreign bank or company and the acquired foreign bank with a U.S. office continues to operate in the same corporate form as prior to the change in ownership or control;

(ii) The conversion of a branch to an agency or representative office; an agency to a representative office; or a branch or agency from a federal to a state license, or a state to a federal license; or

(iii) The establishment of a representative office under general-consent authority.

(8) *Transactions subject to approval under Regulation Y.* Subpart B of Regulation Y (12 CFR 225.11–225.17) governs the acquisition by a foreign banking organization of direct or indirect ownership or control of any voting securities of a bank or bank holding company in the United States if the acquisition results in the foreign banking organization's ownership or control of more than 5 percent of any class of voting securities of a U.S. bank or bank holding company, including through acquisition of a foreign bank or foreign banking organization that owns or controls more than 5 percent of any class of the voting securities of a U.S. bank or bank holding company.

(b) *Procedures for application*—(1) *Filing application.* An application for the Board's approval pursuant to this section shall be filed in the manner prescribed by the Board.

(2) *Publication requirement*—(i) *Newspaper notice.* Except with respect to a proposed transaction where more extensive notice is required by statute or as otherwise provided in paragraphs (b)(2)(ii) and (iii) of this section, an applicant under this section shall publish a notice in a newspaper of general circulation in the community in which the applicant proposes to engage in business.

(ii) *Contents of notice.* The newspaper notice shall:

(A) State that an application is being filed as of the date of the newspaper notice; and

(B) Provide the name of the applicant, the subject matter of the application, the place where comments should be sent, and the date by which comments are due, pursuant to paragraph (b)(3) of this section.

(iii) *Copy of notice with application.* The applicant shall furnish with its application to the Board a copy of the newspaper notice, the date of its publication, and the name and address of the newspaper in which it was published.

(iv) *Exception.* The Board may modify the publication requirement of paragraphs (b)(2)(i) and (ii) of this section in appropriate circumstances.

(v) *Federal branch or federal agency.* In the case of an application to establish a federal branch or federal agency, compliance with the publication procedures of the Comptroller shall satisfy the publication requirement of this section. Comments regarding the application should be sent to the Board and the Comptroller.

(3) *Written comments.* (i) Within 30 days after publication, as required in paragraph (b)(2) of this section, any person may submit to the Board written comments and data on an application.

(ii) The Board may extend the 30-day comment period if the Board determines that additional relevant information is likely to be provided by interested persons, or if other extenuating circumstances exist.

(4) *Board action on application.* (i) *Time limits.* (A) The Board shall act on an application from a foreign bank to establish a branch, agency, or commercial lending company subsidiary within 180 calendar days after the receipt of the application.

(B) The Board may extend for an additional 180 calendar days the period within which to take final action, after providing notice of and reasons for the extension to the applicant and the licensing authority.

(C) The time periods set forth in this paragraph (b)(4)(i) may be waived by the applicant.

(ii) *Additional information.* The Board may request any information in addition to that supplied in the application when the Board believes that the information is necessary for its decision, and may deny an application if it does not receive the information requested from the applicant or its home country supervisor in sufficient time to permit adequate evaluation of the information within the time periods set forth in paragraph (b)(4)(i) of this section.

(5) *Coordination with other regulators.* Upon receipt of an application by a foreign bank under this section, the Board shall promptly notify, consult with, and consider the views of the licensing authority.

(c) *Standards for approval of U.S. offices of foreign banks*— (1) *Mandatory standards*—(i) *General.* As specified in section 7(d) of the IBA (12 U.S.C. 3105(d)), the Board may not approve an application to establish a branch or an agency, or to establish or acquire ownership or control of a commercial lending company, unless it determines that:

(A) Each of the foreign bank and any parent foreign bank engages directly in the business of banking outside the United States and, except as provided in paragraph (c)(1)(iii) of this section, is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor; and

(B) The foreign bank has furnished to the Board the information that the Board requires in order to assess the application adequately.

(ii) *Basis for determining comprehensive consolidated supervision.* In determining whether a foreign bank and any parent foreign bank is subject to comprehensive consolidated supervision, the Board shall determine whether the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. In making such a determination, the Board shall assess, among other factors, the extent to which the home country supervisor:

(A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;

(B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;

(C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;

(D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;

(E) Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

(iii) *Determination of comprehensive consolidated supervision not required in certain circumstances.* (A) If the Board is unable to find, under paragraph (c)(1)(i) of this section, that a foreign bank is subject to comprehensive consolidated supervision, the Board may, nevertheless, approve an application by the foreign bank if:

(*1*) The home country supervisor is actively working to establish arrangements for the consolidated supervision of such bank; and

(*2*) All other factors are consistent with approval.

(B) In deciding whether to use its discretion under this paragraph (c)(1)(iii), the Board also shall consider whether the foreign bank has adopted and implemented procedures to combat money laundering. The Board also may take into account whether the home country supervisor is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering. In approving an application under this paragraph (c)(1)(iii), the Board, after requesting and taking into consideration the views of the licensing authority, may impose any conditions or restrictions relating to the activities or business operations of the proposed branch, agency, or commercial lending company subsidiary, including restrictions on sources of funding. The Board shall coordinate with the licensing authority in the implementation of such conditions or restrictions.

(2) *Additional standards.* In acting on any application under this subpart, the Board may take into account:

(i) *Consent of home country supervisor.* Whether the home country supervisor of the foreign bank has consented to the proposed establishment of the branch, agency, or commercial lending company subsidiary;

(ii) *Financial resources.* The financial resources of the foreign bank (including the foreign bank's capital position, projected capital position, profitability, level of indebtedness, and future prospects) and the condition of any U.S. office of the foreign bank;

(iii) *Managerial resources.* The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors; the integrity of its principal shareholders; management's experience and capacity to engage in international banking; and the record of the foreign bank and its management of complying with laws and regulations, and of fulfilling any commitments to, and any conditions imposed by, the Board in connection with any prior application;

(iv) *Sharing information with supervisors.* 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;

(v) *Assurances to Board.* (A) Whether the foreign bank has provided the Board with adequate assurances that information will be made available to the Board on the operations or activities of the foreign bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the BHC Act, and other applicable federal banking statutes.

(B) These assurances shall include a statement from the foreign bank describing the laws that would restrict the foreign bank or any of its parents from providing information to the Board;

(vi) *Measures for prevention of money laundering.* Whether the foreign bank has adopted and implemented procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering;

(vii) *Compliance with U.S. law.* Whether the foreign bank and its U.S. affiliates are in compliance with applicable U.S. law, and whether the applicant has established adequate controls and procedures in each of its offices to ensure continuing compliance with U.S. law, including controls directed to detection of money laundering and other unsafe or unsound banking practices; and (viii) The needs of the community and the history of operation of the foreign bank and its relative size in its home country, provided that the size of the foreign bank is not the sole factor in determining whether an office of a foreign bank should be approved.

(3) *Additional standards for certain interstate applications.* (i) As specified in section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3)), the Board may not approve an application by a foreign bank to establish a branch, other than a limited branch, outside the home state of the foreign bank under section 5(a)(1) or (2) of the IBA (12 U.S.C. 3103(a)(1), (2)) unless the Board:

(A) Determines that the foreign bank's financial resources, including the capital level of the bank, are equivalent to those required for a domestic bank to be approved for branching under section 5155 of the Revised Statutes (12 U.S.C. 36) and section 44 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. 1831u);

(B) Consults with the Department of the Treasury regarding capital equivalency;

(C) Applies the standards specified in section 7(d) of the IBA (12 U.S.C. 3105(d)) and this paragraph (c); and

(D) Applies the same requirements and conditions to which an application by a domestic bank for an interstate merger is subject under section 44(b)(1), (3), and (4) of the FDIA (12 U.S.C. 1831u(b)(1), (3), (4)); and

(ii) As specified in section 5(a)(7) of the IBA (12 U.S.C. 3103(a)(7)), the Board may not approve an application to establish a branch through a change in status of an agency or limited branch outside the foreign bank's home state unless:

(A) The establishment and operation of such branch is permitted by such state; and

(B) Such agency or branch has been in operation in such state for a period of time that meets the state's minimum age requirement permitted under section 44(a)(5) of the Federal Deposit Insurance Act (12 U.S.C. 183u(a)(5)).

(4) *Board conditions on approval.* The Board may impose any conditions on its approval as it deems necessary, including a condition which may permit future termination by the Board of any activities or, in the case of a federal branch or a federal agency, by the Comptroller, based on the inability of the foreign bank to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

(d) *Representative offices*—(1) *Permissible activities.* A representative office may engage in:

(i) *Representational and administrative functions.* Representational and administrative functions in connection with the banking activities of the foreign bank, which may include soliciting new business for the foreign bank; conducting research; acting as liaison between the foreign bank's head office and customers in the United States; performing preliminary and servicing steps in connection with lending; [11] or performing back-office functions; but shall not include contracting for any deposit or deposit-like liability, lending money, or engaging in any other banking activity for the foreign bank;

(ii) *Credit approvals under certain circumstances.* Making credit decisions if the foreign bank also operates one or more branches or agencies in the United States, the loans approved at the representative office are made by a U.S. office of the bank, and the loan proceeds are not disbursed in the representative office; and

(iii) *Other functions.* Other functions for or on behalf of the foreign bank or its affiliates, such as operating as a regional administrative office of the foreign bank, but only to the extent that these other functions are not banking activities and are not prohibited by applicable federal or state law, or by ruling or order of the Board.

(2) *Standards for approval of representative offices.* As specified in section 10(a)(2) of the IBA (12 U.S.C. 3107(a)(2)), in acting on the application of a foreign bank to establish a representative office, the Board shall take into account, to the extent it deems appropriate, the standards for approval set out in paragraph (c) of this section. The standard regarding supervision by the foreign bank's home country supervisor (as set out in paragraph (c)(1)(i)(A) of this section) will be met, in the case of a representative office application, if the Board makes a finding that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities and the operating record of the applicant.

(3) *Special-purpose foreign government-owned banks.* A foreign government-owned organization engaged in banking activities in its home country that are not commercial in nature may apply to the Board for a determination that the organization is not a foreign bank for purposes of this section. A written request setting forth the basis for such a determination may be submitted to the Reserve Bank of the District in which the foreign organization's representative office is located in the United States, or to the Board, in the case of a proposed establishment of a representative office. The Board shall review and act upon each request on a case-by-case basis.

(4) *Additional requirements.* The Board may impose any additional requirements that it determines to be necessary to carry out the purposes of the IBA.

(e) *Preservation of existing authority.* Nothing in this subpart shall be construed to relieve any foreign bank or foreign banking organization from any otherwise applicable requirement of federal or state law, including any applicable licensing requirement.

(f) *Reports of crimes and suspected crimes.* Except for a federal branch or a federal agency or a state branch that is insured by the Federal Deposit Insurance Corporation (FDIC), a branch, agency, or representative office of a foreign bank operating in the United States shall file a suspicious activity report in accordance with the provisions of § 208.62 of Regulation H (12 CFR 208.62).

(g) *Management of shell branches.* (1) A state-licensed branch or agency shall not manage, through an office of the foreign bank which is located outside the United States and is managed or controlled by such state-licensed branch or agency, any type of activity that a bank organized under the laws of the United States or any state is not permitted to manage at any branch or subsidiary of such bank which is located outside the United States.

(2) For purposes of this paragraph (g), an office of a foreign bank located outside the United States is ''managed or controlled'' by a state-licensed branch or agency if a majority of the responsibility for business decisions, including but not limited to decisions with regard to lending or asset management or funding or liability management, or the responsibility for recordkeeping in respect of assets or liabilities for that non-U.S. office, resides at the state-licensed branch or agency.

(3) The types of activities that a state-licensed branch or agency may manage through an office located outside the United States that it manage or controls include the types of activities authorized to a U.S. bank by state or federal charters, regulations issued by chartering or regulatory authorities, and other U.S. banking laws, including the Federal Reserve Act, and the implementing regulations, but U.S. procedural or quantitative requirements that may be applicable to the conduct of such activities by U.S. banks shall not apply.

(h) *Government securities sales practices.* An uninsured state-licensed branch or agency of a foreign bank that is required to give notice to the Board under section 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5) and the Department of the Treasury rules under section 15C (17 CFR 400.1(d) and part 401) shall be subject to the provisions of 12 CFR 208.37 to the same extent as a state member bank that is required to give such notice.

(i) *Protection of customer information.* An uninsured state-licensed branch or

[11] *See* 12 CFR 250.141(h) for activities that constitute preliminary and servicing steps.

agency of a foreign bank shall comply with the Interagency Guidelines Establishing Standards for Safeguarding Customer Information prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805), set forth in appendix D–2 to part 208 of this chapter.

§ 211.25 Termination of offices of foreign banks.

(a) *Grounds for termination*—(1) *General.* Under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(d), 3107(b)), the Board may order a foreign bank to terminate the activities of its representative office, state branch, state agency, or commercial lending company subsidiary if the Board finds that:

(i) The foreign bank is not subject to comprehensive consolidated supervision in accordance with § 211.24(c)(1), and the home country supervisor is not making demonstrable progress in establishing arrangements for the consolidated supervision of the foreign bank; or

(ii) Both of the following criteria are met:

(A) There is reasonable cause to believe that the foreign bank, or any of its affiliates, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States; and

(B) As a result of such violation or practice, the continued operation of the foreign bank's representative office, state branch, state agency, or commercial lending company subsidiary would not be consistent with the public interest, or with the purposes of the IBA, the BHC Act, or the FDIA.

(2) *Additional ground.* The Board also may enforce any condition imposed in connection with an order issued under § 211.24.

(b) *Factor.* In making its findings under this section, the Board may take into account the needs of the community, the history of operation of the foreign bank, and its relative size in its home country, provided that the size of the foreign bank shall not be the sole determining factor in a decision to terminate an office.

(c) *Consultation with relevant state supervisor.* Except in the case of termination pursuant to the expedited procedure in paragraph (d)(3) of this section, the Board shall request and consider the views of the relevant state supervisor before issuing an order terminating the activities of a state branch, state agency, representative office, or commercial lending company subsidiary under this section.

(d) *Termination procedures*—(1) *Notice and hearing.* Except as otherwise provided in paragraph (d)(3) of this section, an order issued under paragraph (a)(1) of this section shall be issued only after notice to the relevant state supervisor and the foreign bank and after an opportunity for a hearing.

(2) *Procedures for hearing.* Hearings under this section shall be conducted pursuant to the Board's Rules of Practice for Hearings (12 CFR part 263).

(3) *Expedited procedure.* The Board may act without providing an opportunity for a hearing, if it determines that expeditious action is necessary in order to protect the public interest. When the Board finds that it is necessary to act without providing an opportunity for a hearing, the Board, solely in its discretion, may:

(i) Provide the foreign bank that is the subject of the termination order with notice of the intended termination order;

(ii) Grant the foreign bank an opportunity to present a written submission opposing issuance of the order; or

(iii) Take any other action designed to provide the foreign bank with notice and an opportunity to present its views concerning the order.

(e) *Termination of federal branch or federal agency.* The Board may transmit to the Comptroller a recommendation that the license of a federal branch or federal agency be terminated if the Board has reasonable cause to believe that the foreign bank or any affiliate of the foreign bank has engaged in conduct for which the activities of a state branch or state agency may be terminated pursuant to this section.

(f) *Voluntary termination.* A foreign bank shall notify the Board at least 30 days prior to terminating the activities of any office. Notice pursuant to this paragraph (f) is in addition to, and does not satisfy, any other federal or state requirements relating to the termination of an office or the requirement for prior notice of the closing of a branch, pursuant to section 39 of the FDIA (12 U.S.C. 1831p).

§ 211.26 Examination of offices and affiliates of foreign banks.

(a) *Conduct of examinations*—(1) *Examination of branches, agencies, commercial lending companies, and affiliates.* The Board may examine:

(i) Any branch or agency of a foreign bank;

(ii) Any commercial lending company or bank controlled by one or more foreign banks, or one or more foreign companies that control a foreign bank; and

(iii) Any other office or affiliate of a foreign bank conducting business in any state.

(2) *Examination of representative offices.* The Board may examine any representative office in the manner and with the frequency it deems appropriate.

(b) *Coordination of examinations.* To the extent possible, the Board shall coordinate its examinations of the U.S. offices and U.S. affiliates of a foreign bank with the licensing authority and, in the case of an insured branch, the Federal Deposit Insurance Corporation (FDIC), including through simultaneous examinations of the U.S. offices and U.S. affiliates of a foreign bank.

(c) *Frequency of on-site examination*—(1) *General.* Each branch or agency of a foreign bank shall be examined on-site at least once during each 12-month period (beginning on the date the most recent examination of the office ended) by—

(i) The Board;

(ii) The FDIC, if the branch of the foreign bank accepts or maintains insured deposits;

(iii) The Comptroller, if the branch or agency of the foreign bank is licensed by the Comptroller; or

(iv) The state supervisor, if the office of the foreign bank is licensed or chartered by the state.

(2) *18-month cycle for certain small institutions*—(i) *Mandatory standards.* The Board may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as required in paragraph (c)(1) of this section, if the branch or agency—

(A) Has total assets of $250 million or less;

(B) Has received a composite ROCA supervisory rating (which rates risk management, operational controls, compliance, and asset quality) of 1 or 2 at its most recent examination;

(C) Satisfies the requirement of either the following paragraph (c)(2)(i)(C)(*1*) or (*2*):

(*1*) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, tier 1 and total risk-based capital ratios of at least 6 percent and 10 percent, respectively, on a consolidated basis; or

(*2*) The branch or agency has maintained on a daily basis, over the past three quarters, eligible assets in an amount not less than 108 percent of the preceding quarter's average third-party liabilities (determined consistent with applicable federal and state law) and sufficient liquidity is currently available to meet its obligations to third parties;

(D) Is not subject to a formal enforcement action or order by the Board, FDIC, or OCC; and

(E) Has not experienced a change in control during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(ii) *Discretionary standards.* In determining whether a branch or agency of a foreign bank that meets the standards of paragraph (c)(2)(i) of this section should not be eligible for an 18-month examination cycle pursuant to this paragraph (c)(2), the Board may consider additional factors, including whether—

(A) Any of the individual components of the ROCA supervisory rating of a branch or agency of a foreign bank is rated ''3'' or worse;

(B) The results of any off-site surveillance indicate a deterioration in the condition of the office;

(C) The size, relative importance, and role of a particular office when reviewed in the context of the foreign bank's entire U.S. operations otherwise necessitate an annual examination; and

(D) The condition of the foreign bank gives rise to such a need.

(3) *Authority to conduct more frequent examinations.* Nothing in paragraphs (c)(1) and (2) of this section limits the authority of the Board to examine any U.S. branch or agency of a foreign bank as frequently as it deems necessary.

§ 211.27 Disclosure of supervisory information to foreign supervisors.

(a) *Disclosure by Board.* The Board may disclose information obtained in the course of exercising its supervisory or examination authority to a foreign bank regulatory or supervisory authority, if the Board determines that disclosure is appropriate for bank supervisory or regulatory purposes and will not prejudice the interests of the United States.

(b) *Confidentiality.* Before making any disclosure of information pursuant to paragraph (a) of this section, the Board shall obtain, to the extent necessary, the agreement of the foreign bank regulatory or supervisory authority to maintain the confidentiality of such information to the extent possible under applicable law.

§ 211.28 Provisions applicable to branches and agencies: limitation on loans to one borrower.

(a) *Limitation on loans to one borrower.* Except as provided in paragraph (b) of this section, the total loans and extensions of credit by all the state branches and state agencies of a foreign bank outstanding to a single borrower at one time shall be aggregated with the total loans and extensions of credit by all federal branches and federal agencies of the same foreign bank outstanding to such borrower at the time; and shall be subject to the limitations and other provisions of section 5200 of the Revised Statutes (12 U.S.C. 84), and the regulations promulgated thereunder, in the same manner that extensions of credit by a federal branch or federal agency are subject to section 4(b) of the IBA (12 U.S.C. 3102(b)) as if such state branches and state agencies were federal branches and federal agencies.

(b) *Preexisting loans and extensions of credit.* Any loans or extensions of credit to a single borrower that were originated prior to December 19, 1991, by a state branch or state agency of the same foreign bank and that, when aggregated with loans and extensions of credit by all other branches and agencies of the foreign bank, exceed the limits set forth in paragraph (a) of this section, may be brought into compliance with such limitations through routine repayment, provided that any new loans or extensions of credit (including renewals of existing unfunded credit lines, or extensions of the maturities of existing loans) to the same borrower shall comply with the limits set forth in paragraph (a) of this section.

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

(a) *Scope.* A state branch or state 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 Comptroller; 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 branch or state 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) through (c)(3)(ii)(A), not to present a significant risk to the affected deposit insurance fund;

(2) Is permissible for a federal branch, but the Comptroller 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 branch or state 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 branch insured by the FDIC, statements by the applicant:

(i) Of whether or not it is in compliance with 12 CFR 346.19 (Pledge of Assets) and 12 CFR 346.20 (Asset Maintenance);

(ii) That it has complied with all requirements of the FDIC 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

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

(5) 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 appropriate Federal Reserve 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) If an 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 appropriate Federal Reserve Bank within 60 days of the disapproval.

(i) 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.

(ii) Divestiture 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) If a foreign bank operating a state branch or state 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 the effective date of this part or of such change or decision.

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

(a) *Development and publication of criteria.* 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 consolidated supervision.

(b) *Criteria considered by Board.* Following a determination by the Board that, having taken into account the standards set forth in § 211.24(c)(1), a foreign bank is not subject to CCS, 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 home country supervisor of such foreign bank is actively working to establish arrangements for comprehensive consolidated supervision of the 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 anti-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 Comptroller or the relevant state supervisors 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 IBA, the BHC Act, and other U.S. 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 CCS 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 ensure 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:

(i) Enforcement action, in order to ensure safe and sound banking operations, under 12 U.S.C. 1818; or

(ii) Termination or a recommendation for termination of its U.S. operations, under § 211.25(a) and (e) and section (7)(e) of the IBA (12 U.S.C. 3105(e)).

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 (BHC Act) (12 U.S.C. 1841 *et seq.*), 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 eligible investors as defined in this subpart.

§ 211.32 Definitions.

The definitions in §§ 211.1 and 211.2 of subpart A apply to this subpart, subject to the following:

(a) *Appropriate Federal Reserve Bank* has the same meaning as in § 211.21(c).

(b) *Bank* has the same meaning as in section 2(c) of the BHC Act (12 U.S.C. 1841(c)).

(c) *Company* has the same meaning as in section 2(b) of the BHC Act (12 U.S.C. 1841(b)).

(d) *Eligible investors* means:

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

(2) Edge and agreement corporations that are subsidiaries of bank holding companies but are not subsidiaries of banks;

(3) Banker's 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 § 211.21(o).

(e) *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 (e)(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. The four-year period within which to calculate revenues derived from its activities under this section shall be deemed to have commenced with the first fiscal year after the respective export trading company has been in operation for two years.

(f) *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.

(g) *Subsidiary* has the same meaning as in section 2(d) of the BHC Act (12 U.S.C. 1841(d)).

(h) *Well capitalized* has the same meaning as in § 225.2(r) of Regulation Y (12 CFR 225.2(r)).

(i) *Well managed* has the same meaning as in § 225.2(s) of Regulation Y (12 CFR 225.2(s)).

§ 211.33 Investments and extensions of credit.

(a) *Amount of investments.* In accordance with the procedures of § 211.34, an eligible investor may invest no more than 5 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 5 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.* (i) 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.

(ii) For the purposes of this section, 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) *General policy.* Direct and indirect investments by eligible investors in export trading companies shall be made in accordance with the general consent or prior notice procedures contained in this section. The Board may at any time, upon notice, modify or suspend the general-consent procedures with respect to any eligible investor.

(b) *General consent*—(1) *Eligibility for general consent.* Subject to the other limitations of this subpart, the Board grants its general consent for any investment an export trading company:

(i) If the eligible investor is well capitalized and well managed;

(ii) In an amount equal to cash dividends received from that export trading company during the preceding 12 calendar months; or

(iii) That is acquired from an affiliate at net asset value or through a contribution of shares.

(2) *Post-investment notice.* By the end of the month following the month in which the investment is made, the investor shall provide the Board with the following information:

(i) The amount of the investment and the source of the funds with which the investment was made; and

(ii) In the case of an initial investment, a description of the activities in which the export trading company proposes to engage and projections for the export trading company for the first year following the investment.

(c) *Filing notice*—(1) *Prior notice.* An eligible investor shall give the Board 60 days' prior written notice of any investment in an export trading company that does not qualify under the general consent procedure.

(2) *Notice of change of activities.* (i) 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:

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

(B) Product research and design;

(C) Product modification; or

(D) Activities not specifically covered by the list of activities contained in section 4(c)(14)(F)(ii) of the BHC Act (12 U.S.C. 1843(c)(14)(F)(ii)).

(ii) Such an expansion of activities shall be regarded as a proposed investment under this subpart.

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

(e) *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.

PART 265—RULES REGARDING DELEGATION OF AUTHORITY

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

Authority: 12 U.S.C. 248(i) and (k).

2. Section 265.5 is amended by adding a new paragraph (d)(3) to read as follows:

§ 265.5 Functions delegated to Secretary of the Board.

* * * * *

(d) * * *

(3) *Investments in Edge and Agreement Corporations.* To approve an application by a member bank to invest more than 10 percent of capital and surplus in Edge and agreement corporation subsidiaries.

* * * * *

3. Section 265.6 is amended by revising paragraph (f) to read as follows:

§ 265.6 Functions delegated to General Counsel.

* * * * *

(f) *International banking*—(1) *After-the-fact applications.* With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request by a foreign bank to establish a branch, agency, commercial lending company, or representative office through certain acquisitions, mergers, consolidations, or similar transactions, in conjunction with which:

(i) The foreign bank would be required to file an after-the-fact application for the Board's approval under § 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)); or

(ii) The General Counsel may waive the requirement for an after-the-fact application if:

(A) The surviving foreign bank commits to wind down the U.S. operations of the acquired foreign bank; and

(B) The merger or consolidation raises no significant policy or supervisory issues.

(2) To modify the requirement that a foreign bank that has submitted an application or notice to establish a branch, agency, commercial lending company, or representative office pursuant to § 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)) shall publish notice of the application or notice in a newspaper of general circulation in the community in which the applicant or notificant proposes to engage in business, as provided in § 211.24(b)(2) of Regulation K (12 CFR 211.24(b)(2)).

(3) With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request for an exemption under section 4(c)(9) of the Bank Holding Company Act (12 U.S.C. 1843(c)(9)), provided that the request raises no significant policy or supervisory issues that the Board has not already considered.

(4) To return applications and notices filed under the International Banking Act for informational deficits.

(5) To determine that an entity qualifies as a ''special-purpose foreign government-owned bank'' for purposes of § 211.24(d)(3) (12 CFR 211.24(d)(3)).

* * * * *

4. Section 265.7 is amended by:

a. Revising paragraph (d)(4); and

b. Adding new paragraphs (d)(9), (d)(10), (d)(11), (d)(12), (d)(13), and (d)(14).

The revision and additions read as follows:

§ 265.7 Functions delegated to Director of Division of Banking Supervision and Regulation.

* * * * *

(d) * * *

(4) *Authority under general-consent and prior-notice procedures.* (i) With regard to a prior notice to establish a branch in a foreign country under § 211.3 of Regulation K (12 CFR 211.3):

(A) To waive the notice period;

(B) To suspend the notice period;

(C) To determine not to object to the notice; or

(D) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice to make an investment under § 211.9(f) of Regulation K (12 CFR 211.9(f)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iv) To suspend the ability:

(A) Of a foreign banking organization to establish an office under the prior-notice procedures in § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)) or the general-consent procedures in § 211.24(a)(3) of Regulation K (12 CFR 211.24(a)(3));

(B) Of a U.S. banking organization to establish a foreign branch under the prior-notice or general-consent procedures in § 211.3(b) of Regulation K (12 CFR 211.3(b));

(C) Of an investor to make investments under the general-consent or prior-notice procedures in § 211.9 of Regulation K (12 CFR 211.9); and

(D) Of an eligible investor to make an investment in an export trading company under the general-consent procedures in § 211.34(b) of Regulation K (12 CFR 211.34(b)).

* * * * *

(9) *Allowing use of general-consent procedures.* To allow an investor that is not well-capitalized and well-managed to make investments under the general-consent procedures in § 211.9 or 211.34(b) of Regulation K (12 CFR 211.9 or 211.34(b)), provided that:

(i) The investor has implemented measures to become well-capitalized and well-managed;

(ii) Granting such authority raises no significant policy or supervisory concerns; and

(iii) Authority granted by the Director under this paragraph (d)(9) expires after one year, but may be renewed.

(10) *Exceeding general-consent investment limits.* To allow an investor to exceed the general-consent investment limits under § 211.9 of Regulation K (12 CFR 211.9), provided that:

(i) The investor demonstrates adequate financial and managerial strength;

(ii) The investor's investment strategy is not unsafe or unsound;

(iii) Granting such authority raises no significant policy or supervisory concerns; and

(iv) Authority granted by the Director under this paragraph (d)(10) expires after one year, but may be renewed.

(11) *Approval of temporary U.S. offices.* To allow a foreign bank to operate a temporary office in the United States, pursuant to § 211.24 of Regulation K (12 CFR 211.24), provided that:

(i) There is no direct public access to such office, with respect to any branch or agency function; and

(ii) The proposal raises no significant policy or supervisory issues.

(12) With the concurrence of the General Counsel, to approve applications, notices, exemption requests, waivers and suspensions, and other related matters under Regulation K (12 CFR part 211), where such matters do not raise any significant policy or supervisory issues.

(13) With the concurrence of the General Counsel, to approve:

(i) The establishment by a bank holding company or member bank of an agreement corporation under section 25 of the Federal Reserve Act; and

(ii) Any initial investment associated with the establishment of such agreement corporation.

(14) With the concurrence of the General Counsel, to determine that an election by a foreign bank to become or to be treated as a financial holding company is effective, provided that:

(i) The foreign bank meets the criteria for becoming or being treated as a financial holding company; and

(ii) The election raised no significant policy or supervisory issues.

* * * * *

5. Section 265.11 is amended by:

a. Revising paragraphs (d)(8) and (d)(11); and

b. Adding a new paragraph (d)(12).

The revisions and addition read as follows:

§ 265.11 Functions delegated to Federal Reserve Banks.

* * * * *

(d) * * *

(8) *Authority under prior-notice procedures.* (i) With regard to a prior notice to make an investment under § 211.9(f) of Regulation K (12 CFR 211.9(f)):

(A) To suspend the notice period; or

(B) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To suspend the notice period; or

(B) To require that the foreign bank file an application for the Board's specific consent.

* * * * *

(11) *Investments in Edge and agreement Corporation subsidiaries.* To approve an application by a member bank to invest more than 10 percent of capital and surplus in Edge and agreement corporation subsidiaries.

(12) *Amendments to Edge corporation charters.* To approve amendments to Edge corporation charters.

By order of the Board of Governors of the Federal Reserve System, October 16, 2001.

Robert deV. Frierson,

Deputy Secretary of the Board.

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