

AT 89 89  
December 22, 1980

REGULATIONS K AND Y

To the Addressee:

As indicated in Circular No. 8974, dated December 15, 1980, enclosed are copies of the text of amendments to Regulation K, "International Banking Operations," and Regulation Y, "Bank Holding Companies and Change in Bank Control," effective January 3, 1981.

The amendments deal with the nonbanking activities of foreign bank holding companies and foreign banks that have banking offices in the United States.

Questions regarding the amendments may be directed to the Domestic Banking Applications Department of this Bank (Tel. No. 212-791-5865).

Circulars Division  
FEDERAL RESERVE BANK OF NEW YORK

Board of Governors of the Federal Reserve System  
BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

AMENDMENT TO REGULATION Y

*(effective January 3, 1981)*

Section 225.4(g) is amended to read as follows:

SECTION 225.4—NONBANKING  
ACTIVITIES

\* \* \*

(g) **Foreign banking organizations.** In addition to the exemptions afforded by this Part, a foreign banking organization (as defined in 12 CFR 211.23) may engage in activities and make investments under Part 211 (Regulation K).

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For this Regulation to be complete, retain:

- 1) Regulation Y pamphlet, as amended effective April 5, 1978.
- 2) Amendments effective January 1, 1979, March 10, 1979, April 2, 1979, October 24, 1979, December 5, 1979, and December 31, 1980.
- 3) This slip sheet.

Board of Governors of the Federal Reserve System

INTERNATIONAL BANKING OPERATIONS

AMENDMENTS TO REGULATION K

(Effective January 3, 1981)

12 CFR Part 211

[Reg. K; Docket No. R-0291]

Nonbanking Activities of Foreign Banking Organizations

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** Foreign banks that have branches, agencies, or commercial lending company subsidiaries in the U.S., companies controlling such foreign banks, and foreign companies that have bank subsidiaries in the U.S. are subject to the nonbanking prohibitions of the Bank Holding Company Act (12 U.S.C. 1841 et seq.). That Act also affords exemptions from the nonbanking prohibitions for qualifying foreign organizations. The Board has adopted amendments to Regulation K (International Banking Operations) to implement and interpret these exemptions.

**DATE:** January 3, 1981. In view of the modifications made to the proposal, comments will be accepted on the amendments until January 30, 1981.

**ADDRESS:** Comments, which should refer to Docket No. R-0291, may be mailed to Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, D.C. 20551; or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

**FOR FURTHER INFORMATION CONTACT:** C. Keefe Hurley, Jr., Senior Counsel (202/452-3269), Kathleen M. O'Day, Attorney (202/452-3786), Legal Division; or Michael G. Martinson, Senior Financial Analyst, Division of Banking Supervision and Regulation (202/452-3621), Board of Governors of the Federal Reserve System.

**SUPPLEMENTARY INFORMATION:** Section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3101 et seq.) ("IBA") provides that a foreign bank that does business in the United States through a branch, agency or commercial lending company shall be subject to the provisions of the Bank Holding Company Act ("BHCA") in the same manner and to the same extent as a bank holding company. Companies that own such foreign banks are also subject to the provisions of the BHCA. Foreign banks and companies that control U.S. banks are "bank holding companies" and, therefore, subject to the nonbanking prohibitions of the BHCA.

In order to limit its extraterritorial effect on foreign organizations, the BHCA affords these organizations two exemptions from the nonbanking prohibitions. Section 4(c)(9) grants the Board discretion to permit a foreign company to engage in any activity or make any investment that the Board determines is in the public interest and not substantially at variance with the purposes of the BHCA. This exemption is currently implemented by § 225.4(g) of the Board's Regulation Y (12 CFR 225.4(g)). Section 2(h) permits a foreign institution principally engaged in the banking business outside the United States to hold shares of foreign nonbanking companies that engage in business in the United States.

On May 1, 1980, the Board requested public comment on proposed amendments to Regulation K to implement and interpret these provisions of the BHCA (45 FR 30082). The period for public comment expired on July 31, 1980. After consideration of the 29 comments received, including some representing a number of banks, the Board adopted the amendments with some modifications to the rules as proposed. These modifications relate to the definition of "qualifying foreign banking organization," the test for determining eligibility for qualified status, and the types of activities that may be engaged in in the United States.

The Board will accept public comment on these modifications to the regulation until January 30, 1981. In addition to the changes referred to above, technical modifications were also made to the proposal.

*Qualifying foreign organizations.* The Board proposed that a foreign organization would qualify for the exemption if more than 50 per cent of its worldwide consolidated business were banking and more than 50 per cent of its banking business were outside the United States. The Board was of the opinion that this interpretation of "principally engaged in the banking business outside the U.S." served the Board's supervisory purposes in ensuring that an organization that qualified for the exemptions was principally foreign and would serve as a source of strength to its U.S. banking operations.

Some comments stated that the Board should not impose the "engaged in banking" test, which is derived from section 2(h), in order for an organization to qualify for exemptions granted under section 4(c)(9) since there is no statutory requirement for so doing. However, since the purposes of the two sections are the same and the Board has the same supervisory objectives in interpreting the exceptions, the Board has adopted the proposal to require the same test for eligibility for both exemptive provisions.

One comment strongly objected to the inclusion of U.S. banking operations in determining whether an organization is principally engaged in banking. This comment stated that an otherwise ineligible institution could "bootstrap" itself into qualification for the exemptions by acquisition of a U.S. subsidiary bank. Although the Board believes that this particular situation could be scrutinized in connection with the approval procedure under the BHCA, the Board also is of the view that the comment has merit from a supervisory standpoint. There may be circumstances in which an organization that must rely on its U.S. banking

For this Regulation to be complete retain:

- 1) Printed regulation pamphlet dated June 14, 1979.
- 2) Amendments dated November 28, 1979, October 2, 1980, and November 13, 1980.
- 3) This slip sheet.

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[Ref. Cir. No. 8974]

(OVER)

business to qualify under the "principally engaged in banking" test should not be entitled to the use of the exemptions without closer scrutiny by the Board. Therefore, the Board has adopted the proposal that, in order to be considered principally engaged in the banking business outside the United States, more than half of an organization's worldwide business, exclusive of its U.S. banking business, must derive from banking outside the United States. Those organizations that fail to qualify under this standard may apply for a specific determination of eligibility, described below. The Board also will accept comment on this amendment from interested parties.

*Definition of "banking business".* Under the IBA, a foreign bank with a U.S. branch or agency is subject to the nonbanking prohibitions of the BHCA. "Foreign bank" is defined in section 1(b)(7) of the IBA as including, in addition to companies that engage in the business of banking, "foreign commercial banks, foreign merchant banks and other foreign institutions that engage in banking activities usual in connection with the business of banking in the countries where such foreign institutions are organized." (Emphasis added). Because this definition includes organizations considered "banks" by virtue of activities conducted that are usual in connection with banking activities in their home countries, the board proposed to treat as "banking" the activities in § 211.5(d) of Regulation K (12 CFR 211.5(d)) that have been determined to be usual in connection with banking or financial operations abroad. This provision occasioned little comment and therefore is adopted as proposed.

*Measurement of banking business.* Under the proposed amendments, a foreign institution would have had to meet two tests in order to qualify for the nonbanking exemptions; first, more than half of its worldwide business must be banking; and second, more than half of its banking business must be outside the U.S. The first test involved a measurement of banking versus nonbanking business; the second, foreign banking versus U.S. banking. Under both tests, the foreign banking organization could choose as its measurement either total assets or total revenues.

The Board recognized that the use of solely assets or solely revenues provides an imperfect measure for comparing banking and nonbanking activities, and therefore adopted a revised test of measuring relative sizes of an organization's banking and nonbanking business. On the basis of at least two of three criteria, i.e., assets, revenues, and net income, an organization must derive more than half of its business, excluding U.S. banking business, from banking outside the United States. No assets,

revenues or net income of a U.S. bank, branch, agency, commercial lending company, or other company engaged in the business of banking in the U.S. shall be considered as held or derived from outside the United States. This approach would avoid the bias in favor of one type of organization over another that using assets or revenues would produce. The amendment also retains the requirement that more than half of an organization's worldwide banking business must be derived from outside the United States. The same criteria described above will be used to measure foreign and U.S. banking business. Comment will also be accepted on the criteria used for measuring "banking business."

Measurement of banking and nonbanking business poses problems primarily because under most accounting conventions the financial statements of the two types of organizations are not ordinarily consolidated; moreover, consolidation occurs at ownership levels above 50 per cent, while control is assumed at 25 per cent levels of ownership under the BHCA. The proposed regulation provided that assets and revenues could be determined on a consolidated or combined basis. The proposal as adopted leaves it to the foreign organization to choose the level of ownership (25 or 50 per cent) at which consolidation or combining will take place.

*Change in status and specific determinations of eligibility.* The Board proposed that an organization that failed to qualify under the test for two consecutive years, as reflected in its annual report filed with the Board, would lose its eligibility for the exemptions. Such an organization could apply for a specific determination. Activities and investments undertaken while a foreign organization qualified for the exemptions could be retained after the loss of qualified status. However, activities or investments undertaken after the end of the first fiscal year in which the organization did not meet the criteria would not be grandfathered. Such an organization would, in effect, be on notice of the possible loss of qualified status.

Several comments stated that the uncertainties as to qualification under the test from year to year would make business planning difficult. These comments propose that an organization concerned about the possible future loss of qualification could apply for a specific determination of eligibility at any time. The Board found that this procedure would prove useful in administering the regulation and, with the addition of the procedure for applying for a specific determination prior to loss of eligibility, adopted the regulation as proposed. As proposed, other foreign organizations that do not qualify for automatic exemption may also apply to the Board for determinations on their eligibility.

The Board would exercise this authority under section 4(c)(9) where application of the qualifying tests would prevent sound and reputable foreign banks from doing business in the U.S. The Board will examine the particular facts and circumstances of each case to determine if granting the exemption is appropriate under section 4(c)(9), and if the Board determines that a potential for abuse exists, the Board will deny the exemption or approve the application conditioned in a manner to prevent the occurrence of such abuses.

*Nonbanking activities in the United States—Section 2(h)* permits a foreign organization to engage in activities in the U.S. through a foreign nonbanking company where the U.S. activities are in the same general line of business or in a business related to that of the foreign nonbanking company. The foreign company must be principally engaged in business outside the U.S. and the exemption may not be used to engage in the securities business in the U.S. Banking and financial activities and activities permissible under section 4(c)(8) of the BHCA may only be engaged in with the Board's approval.

It is clear from the legislative history of the IBA that Congress intended the Board to use the Standard Industrial Classification system for determining the comparability of U.S. and foreign nonbanking activities. The SIC system categories are not precise and the Board invited comments on the feasibility of using the SIC for determining whether U.S. and foreign nonbanking activities are in the same general lines of business.

The comments on the use of the SIC for determining whether U.S. activities of an exempt foreign company are in the same line of business alleged that the 4-digit establishment categories of the SIC were narrow and overly restrictive. Several suggested that the Board instead employ the Enterprise SIC which groups businesses together according to their ownership structure. An enterprise unit consists of all establishments under common ownership and it is the plurality contribution in terms of value added to goods and services, of an organization's component establishments that determines its Enterprise SIC designation. However, because Enterprise SIC units engage in a broader range of activities than SIC establishment units, use of this measure of "same general line of business" would similarly allow exempt foreign companies to engage in a broader range of nonbank activities in the U.S. In view of the explicit directive in the legislative history of the IBA and because the 4-digit classification appears to satisfactorily limit a company's U.S. nonbanking activities consistent with the purposes of the statute, the Board adopted this part of the regulation as proposed.

In keeping with the intent of section 2(h) to limit U.S. activities to those types that an exempt company engages in abroad, the Board proposed that an

organization give 60 days prior notification to the Board before engaging in an activity in the U.S. where the U.S. activity would exceed the foreign activity in the same 4-digit classification. The comments noted that this is not required by the statute and would be burdensome to the foreign banking organizations. It was suggested that the Board instead use the quarterly reports of U.S. acquisitions to monitor an organization's activities. If it became apparent that an organization is abusing the exemption, for example by undertaking a token activity abroad solely to engage in the same activity in the U.S., the Board could require cessation of the U.S. activity. The Board has deleted the requirement of prior notification and instead will rely on the quarterly reports submitted by the foreign organizations to monitor their U.S. activities.

Section 2(h) requires that a foreign banking organization must receive the prior approval of the Board before engaging in "banking or financial operations or types of activities permitted under section 4(c)(8)." The Board proposed that banking or financial operations in the U.S. would be permitted only where they are the type permitted under section 4(c)(8) or upon receipt of specific approval by the Board under section 4(c)(9). The Board also proposed that all activities encompassed by Division H (Finance, Insurance and Real Estate) of the SIC would be considered "banking or financial operations" for purposes of the regulation. Comments were highly critical of this approach. Most indicated that the better interpretation of section 2(h) is that it requires Board approval only for activities permitted by section 4(c)(8). In effect, the comments read the phrase "banking or financial operations or types of activities permitted under section 4(c)(8)" to refer only to section 4(c)(8) activities, and cite in support of this position the technical language of the statute and the lack of legislative history indicating that "banking or financial operations" has a meaning independent of section 4(c)(8) activities. The Board, however, continues to be of the view that this position conflicts with the legislative history of the IBA which shows a clear intent to establish competitive equality between foreign and domestic banking organizations, and would result in reading the words "banking or financial operations" out of the statute. In the absence of clear legislative intent to the contrary on this point, the Board, except as discussed below, has adopted the regulation as proposed.

With respect to the types of activities that the Board considers to be "banking or financial operations," the comments were equally critical of the use of Division H as a general definition. The comments found the coverage of Division H to be too broad. The Board reexamined the activities encompassed by Division H and concluded that not all of the activities included therein are

necessarily banking or financing in nature. At the same time, certain other activities outside the scope of Division H should be considered banking or financial operations. In other instances, these activities may be the same type of activity permitted under section 4(c)(8) and, in order to preserve competitive equality, should be conducted by foreign organizations only to the extent allowed domestic banking organizations. In view of these considerations the Board adopted the proposal to use Division H as a general category of impermissible (except with Board approval) banking or financial operations with the exception of certain real estate activities. The Board also amended the proposal to include within the scope of impermissible activities certain 4-digit activities found outside Division H of the SIC, including certain data processing, leasing and management consulting activities. The Board recognizes that some of the activities included within Division H may, depending on the circumstances in which the activities are performed, be primarily commercial as opposed to banking or financial. For example, the physical development of real estate would not appear to be a banking or financial activity. A different result would obtain, however, where that activity is joined with real estate leasing, financing, syndication, etc. Thus, the Board will consider applications to engage in activities that are contained in Division H, and may approve an application to engage in such activities where the facts and circumstances of the case indicate that the activity would not be banking or financial in nature.

In the proposal published for comment, the Board requested comment on any interpretive issues concerning the grandfather provisions of the IBA. Several comments were received and the matter will be addressed in the near future.

Pursuant to its authority under the International Banking Act of 1978 (12 U.S.C. 3101 *et seq.*) and the Bank Holding Company Act (12 U.S.C. 1841 *et seq.*), the Board has amended Regulation K (12 CFR Part 211) and Regulation Y (12 CFR Part 225) as follows:

2. Regulation K is amended by adding within Subpart B—Foreign Banking Organizations, new § 211.23, Nonbanking Activities of Foreign Banking Organizations. New § 211.23 is added as follows:

#### **Subpart B—Foreign Banking Organizations**

##### **§ 211.23 Nonbanking activities of foreign banking organizations.**

(a) *Definitions.* The definitions of § 211.2 in Subpart A apply to this section subject to the following:

(1) "Directly or indirectly" when used in reference to activities or investments of a foreign banking organization means activities or investments of the foreign banking organization or of any

subsidiary of the foreign banking organization.

(2) "Foreign banking organization" means a foreign bank (as defined in section 1 (b)(7) of the IBA) that operates a branch, agency, or commercial lending company subsidiary in the United States or that controls a bank in the United States; and a company of which such foreign bank is a subsidiary.

(3) "Subsidiary" means an organization more than 25 per cent of the voting stock of which is held directly or indirectly by a foreign banking organization or which is otherwise controlled or capable of being controlled by a foreign banking organization.

(b) *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. 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<sup>1</sup> 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;

(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;

(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.

(c) *Determining assets, revenues, and net income.* (1) For purposes of paragraph (b) of this section, the total assets, revenues, and net income of an organization may be determined on a consolidated or combined basis. Assets, revenues and net income of companies in which the foreign banking organization owns 50 per cent or more of the voting shares shall be included when determining total assets, revenues, and net income. The foreign banking organization may include assets, revenues, and net income of companies

<sup>1</sup> None of the direct or indirect assets, revenues, or net income of a United States subsidiary bank, branch, agency, commercial lending company, or other company engaged in the business of banking in the United States shall be considered held or derived from the business of banking "outside the United States."

in which it owns 25 per cent 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 § 211.5(d) 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.

(d) *Loss of eligibility for exemptions.* A foreign banking organization that qualified under paragraph (b) of this section or an organization that qualified as a "foreign bank holding company" under § 225.4(g) of Regulation Y (12 CFR 225.4(g) (1980))<sup>2</sup> shall cease to be eligible for the exemptions of this section if it fails to meet the requirements of paragraph (b) for two consecutive years as reflected in its Annual Reports (F.R. Y-7) filed with the Board. A foreign banking organization that ceases to be eligible for the exemptions may continue to engage in activities or retain investments commenced or acquired prior to the end of the first fiscal year for which its Annual Report reflects nonconformance with paragraph (b) of this section. Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second Annual Report unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section.

(e) *Specific determination of eligibility for nonqualifying foreign banking organizations.* A foreign banking organization that does not qualify under paragraph (b) of this section for the exemptions afforded by this section, or that has lost its eligibility for the exemptions under paragraph (d) of this section, may apply to the Board for a specific determination of eligibility for the exemptions. A foreign banking organization may apply for a specific determination prior to the time it ceases to be eligible for the exemptions afforded by this section. In determining whether eligibility for the exemptions would be consistent with the purposes of the BHCA and in the public interest, the Board shall consider the history and the financial and managerial resources of the organization; the amount of its business in the United States; the amount, type and location of its nonbanking activities; and whether eligibility of the foreign banking organization would result in undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. Such determination shall be subject to any conditions and limitations imposed by the Board.

(f) *Permissible activities and investments.* A foreign banking

organization that qualifies under paragraph (b) 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 BHCA 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 per cent of the foreign company's consolidated assets shall be located, and consolidated revenues derived from, outside the United States;

(ii) The foreign company shall not engage directly, nor own or control more than 5 per cent of the voting shares of a company that engages, in the business of underwriting, selling, or distributing 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, 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 or financial operations, or types of activities permitted by regulation or order under section 4(c)(8) of the BHCA, only with the prior approval of the Board. Activities within Division H (Finance, Insurance, and Real Estate) of the SIC shall be considered banking or financial operations for this purpose, with the exception of acting as operators of nonresidential buildings (SIC 6512), operators of apartment buildings (SIC 6513), operators of dwellings other than apartment buildings (SIC 6514), and operators of residential mobile home sites (SIC 6515); and operating title abstract offices (SIC 6541). In addition, the following activities shall be considered banking or financial operations and may be engaged in only

with the approval of the Board under subsection (g); computer and data processing services (SIC 7372, 7374 and 7379); management consulting (SIC 7392); certain rental and leasing activities (SIC 7394, 7512, 7513 and 7519); accounting, auditing and bookkeeping services (SIC 8931); and arrangement of passenger transportation (SIC 4722).

(g) *Exemptions under section 4(c)(9) of the BHCA.* A foreign 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 BHCA may apply to the Board for such a determination by submitting to the Reserve Bank of the district in which its banking operations in the United States are principally conducting a letter setting forth the basis for that opinion.

(h) *Reports.* (1) The foreign banking organization shall inform the Board through the organization's Reserve Bank within 30 days after the close of each quarter of all shares of companies engaged, directly or indirectly, in activities in the United States that were acquired during such quarter under the authority of this section. The foreign banking organization shall also report any direct activities in the United States commenced during such quarter by a foreign subsidiary of the foreign banking organization. This information shall (unless previously furnished) include a brief description of the nature and scope of each company's business in the United States, including the 4-digit SIC numbers of the activities in which the company engages. Such information shall also include the 4-digit SIC numbers of the direct parent of any U.S. company acquired, together with a statement of total assets and revenues of the direct parent.

(2) If any required information 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 peculiarly within the knowledge of a company that is not controlled by the organizations, the organization shall (i) give such information on the subject as it possesses or can reasonably acquire together with the sources thereof; and (ii) include a statement either 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.

(3) A request for information required by this paragraph need not be made of any foreign government, or an agency or instrumentality thereof, if, in the opinion of the organization, such request would be harmful to existing relationships.

Board of Governors of the Federal Reserve System, December 4, 1980.

Theodore E. Allison,  
Secretary of the Board.

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<sup>2</sup> "[F]oreign bank holding company" means a bank holding company organized under the laws of a foreign country, more than half of whose consolidated assets are located or consolidated revenues derived, outside the United States." (12 CFR 225.4(g)(iii) (1980)).