FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9929
October 8, 1985]

ACTIVITIES OF EDGE CORPORATIONS

Revision of Regulation K

To All Member Banks, Edge and Agreement Corporations, and Bank Holding Companies in the Second Federal Reserve District, and Others Concerned:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has published revisions to its Regulation K — International Banking Operations — that will permit Edge corporations to enlarge the scope of their activities.

The revisions become effective October 24, 1985 with one exception. The provisions that pertain to investment procedures are effective immediately.

The International Banking Act requires the Board to review and to revise Regulation K every five years to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions and banking practices. Edge corporations are corporations chartered to engage in international or foreign banking or other international or foreign operations.

The major revisions to the regulation pertain to: activities of Edge corporations in the United States; changes in control of Edge corporations; and investment procedures. Certain other technical and clarifying revisions have been made to Regulation K as well. The Board has deferred making any changes in the capital requirements for banking Edge corporations.

The revised regulation will allow Edge corporations to provide full banking services to a limited class of companies, such as foreign airlines and shipping companies, that are restricted by their charters or licenses to international business. The Board may consider whether procedures can be developed to identify other companies engaged in international business that could qualify for full banking services from Edge corporations.

The Board adopted changes to the regulation that would require any party purchasing 25 percent or more of the voting shares of an Edge corporation to give the Board 60 days notice prior to acquisition.

The Board revised the investment procedures applicable to Edge corporations. The regulation has permitted Edge corporations to invest the lesser of $2 million or five percent of their capital and surplus without prior notice or approval by the Federal Reserve. The Board increased the dollar investment amount to $15 million.

The Board also granted a certain amount of leeway in the permissible activities of subsidiaries. In order to provide some flexibility to U.S. banking organizations in acquiring controlling interests in existing companies engaged in impermissible activities, the Board has liberalized its standards to allow such companies to derive up to five percent of assets and revenues from impermissible activities.

In addition, the Board took action on some technical provisions of the regulation regarding U.S. nonbanking activities of foreign banks.

Enclosed is a copy of the text of the amendments to Regulation K, "International Banking Operations," and supplementary information, reprinted from the *Federal Register* of October 1, 1985. Questions regarding the regulation may be directed to our Foreign Banking Applications Department (Tel. No. 212-791-5878).

E. Gerald Corrigan,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTERNATIONAL BANKING OPERATIONS

AMENDMENTS TO REGULATION K

(effective October 24, 1985)

FEDERAL RESERVE SYSTEM

12 CFR Part 211

[Docket No. R-0520]

Regulation K; International Banking Operations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has reviewed and revised its regulations governing the operations of Edge corporations. The revisions concern certain U.S. activities of Edge corporations, lending limits and investment and change in control procedures applicable to Edge corporations. Some proposals dealing with foreign banking organizations operating in the United States have also been adopted.

EFFECTIVE DATE: October 24, 1985, except in the use of the provisions in section 211.5(c), which are effective immediately.

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SUPPLEMENTARY INFORMATION: In June 1984, the Board published for comment proposed revisions to Regulation K. The proposals were made pursuant to the directive in the International Banking Act of 1978 ("IBA") that the Board review and revise its regulations governing Edge corporations every five years in order to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions.

The Board proposed major revisions in four areas: (1) Activities of Edge corporations in the United States; (2) capitalization requirements and lending limits of Edge corporations; (3) procedures to permit Board review of a proposed change in control of Edge corporations, and (4) limits on investments in other organizations. In addition, various changes were proposed to other parts of the regulation.

The Board received 56 public comments on the proposal. The final revisions to the regulation and the reasons for the Board's action are outlined below. Some of the proposed revisions did not receive substantial comment and were adopted as proposed. In addition to the revisions described below, a number of technical and clarifying changes were also made.

Activities of Edge Corporations in the United States

Edge corporations are international banking and financial vehicles through which U.S. banking organizations can offer international banking services and through which they may compete with similar foreign-owned institutions in the United States and abroad. An Edge corporation is limited by statute to engaging only in activities in the United States that are "incidental" to international or foreign business. The Board, however, has broad discretionary authority to determine what U.S. activities are incidental to international or foreign business of an Edge corporation. The Board has interpreted this provision to require that all deposits accepted by Edge corporations from domestic residents must be related to or for the purpose of carrying out international transactions, and that all credit and other transactions with domestic residents must be related to identifiable international transactions. This approach, designed to assure the international character of Edge corporations and prevent their use to circumvent limitations on interstate banking, imposes fairly stringent constraints on the operations of Edge corporations in the United States.

In its 1984 proposal for comment, the Board suggested several possible modifications to this transaction-by-transaction approach. The Board requested comment on the feasibility of these proposals and whether they would maintain the necessary linkage with international or foreign business required by statute. The proposals were as follows:

1. Allow Edge corporations to provide full banking services (deposits, loans and other services) to a limited class of companies that are restricted charters or

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For this regulation to be complete, retain:

1) *Pamphlet effective July 8, 1983.*
2) Amendments December 20, 1983, February 13, 1984, March 29, 1984, and June 30, 1984 (*included in slip sheet dated April 1984*).
3) This slip sheet.

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licenses to an exclusively international business.

2. Allow Edge corporations to engage in domestic lending activities to the extent they were funded with overseas deposits from nonbank sources (the "limited branch" concept).

3. Allow Edge corporations to lend for domestic purposes to U.S. resident customers so long as at least 75 percent of the credits extended to that customer were for international purposes and met the traditional transactions test (a "transactional leeway" approach).

4. Allow Edge corporations to lend for domestic purposes to certain qualifying customers (U.S. residents engaged principally in international business) so long as 75 percent of a corporation's business meets the transactions test (a modified transactional leeway approach).

The comments on the proposals were mixed. Twenty commenters opposed any expansion at all of the powers of Edge corporations. These commenters, primarily smaller and regional banking organizations and associations representing such organizations, stated that any intrusion of Edge corporations into domestic business is contrary to the intent of the Edge Act, would constitute impermissible interstate banking, and would benefit only large institutions to the detriment of smaller organizations. On the other hand, four commenters supported all the proposals to expand Edge powers. The remainder of the comments supported some expansion of powers of Edge corporations but there was considerable diversity in the recommended approaches.

Restricted Charter

Under this proposal, an Edge corporation could provide full banking services (deposit-taking, lending and other services) to any entity that engages only in international business by virtue of its charter or license or by government regulation. These establishments would include such entities as international airlines or shipping lines and export trading companies that engage exclusively in international activities. This proposal is viewed as easier to administer than the qualified business entity ("QBE") concept that was proposed but not adopted in 1979, which required that the QBE meet a quantitative test based on export-import transactions.

The Board has determined to adopt this test as proposed. There is a clear international connection in the operations of these entities and any transaction by an Edge corporation with one of these entities would be incidental to international or foreign business. Some commenters suggested expanding the list of eligible organizations to include embassies, consulates, agencies of foreign governments, international commodities brokerage firms, international organizations such as the World Bank, and Foreign Sales Corporations ("FSCs"). The Board has included FSCs on the list in the regulation because they meet the test of being exclusively engaged in international transactions. The other entities suggested by the comments all transact substantial domestic business and therefore would not qualify under the test. It should be noted, however, that Edge corporations are currently permitted to maintain official embassy and consular accounts, although they may not offer accounts to embassy personnel. The Board is continuing to consider standards and procedures for determining whether other entities or businesses may be considered truly international and therefore eligible for full banking services from Edge corporations.

"Limited Branch" Concept

Under this approach, the international link that is required between an Edge corporation's domestic and international business would have been supplied by the funding sources of the Edge. The proposal would have permitted an Edge corporation to lend for any purpose in the United States up to the amount of the deposits it derived from foreign nonbank sources. This proposal drew the most support of any of the proposals from money center banks, some regional companies active in international lending, and trade associations of the larger institutions. These commenters stated that this proposal could be the single most important regulatory measure that would enable Edges to compete more effectively with U.S. branches and agencies of foreign banks. They also stated that the Board has broad discretionary power under the Edge Act to determine what is "incidental" and that the tie between nonqualifying loans and foreign deposit-taking may provide a sufficient international nexus. They went on to state that the effectiveness of the approach would be seriously compromised by not including all foreign source deposits, including those from foreign banks.

The opponents of this approach stated that a funding link is insufficient to make domestic loans "incidental" to international business. They asserted that the Board would be assisting in the creation of a loophole that would permit evasion of the restrictions on interstate banking, including by nonbank banks. Opponents also contended that Edges remain an attractive vehicle despite limitations on powers, as evidenced by their proliferation since 1979 (from about 70 offices to about 320 offices).

After consideration of the comments received, the Board was not convinced that adoption of this proposal would be consistent with the requirements of the Edge Act that an Edge corporation's business in the United States must be incidental to foreign business. It was also not clear that the proposal would further the purpose of the Act to finance international trade since the thrust of the proposal would be toward transactions of a purely domestic nature. For these reasons the Board determined not to adopt the proposal in the final revision.

Transactional Leeway Proposals

The two other proposals put forth for comment attracted little support. In the transactional leeway proposal, an Edge corporation would be permitted to lend to a customer for any purpose up to 25 percent of the Edge's total lending to that customer. Thus, 75 percent of the business of an Edge corporation with that customer would have to meet the transaction-by-transaction test but the Edge would also be able to service the needs of the customer better by lending a limited amount for purposes that could not meet this strict transaction test. There would be no expansion of deposit-taking activities.

Some commenters were opposed to this approach as an unwarranted expansion of Edge powers in the domestic area. Others did not support it because the proposal would be too difficult to implement. These commenters stated that the recordkeeping would be burdensome and that compliance could fluctuate according to when a customer repaid loans.

In a similar vein, it was also proposed that an Edge corporation be permitted to lend to "qualified customers" for domestic purposes up to 25 percent of the Edge's total lending. No expansion of deposit-taking would be permitted. The Board requested specific comment on the feasibility of the approach and on the measures that should be employed in determining qualified customers. The Board requested actual data that could be used in establishing the test.

As with the previous approach, few commenters supported this proposal. Most objections focused on the difficulties in establishing a rational test for measuring international business and on the recordkeeping burden that would be required. Others objected on

the grounds that the benefits received would be far outweighed by the burdensome requirements of the proposal. Many other commenters, mainly smaller and regional banking organizations, objected because, in their view, it would exceed the scope of the Edge Act and would permit Edge participation in domestic banking.

In proposing these for comment, the Board had intended to reduce the burden of maintaining records on a transaction-by-transaction basis. Many of the comments indicate that these proposals would be more burdensome than the current requirements. Moreover, little useful data that would help establish a qualified customer test in the modified transactional leeway proposal was supplied by the comments. In light of this and the admittedly difficult administrative problems associated with the proposals, the Board has determined not to adopt these proposals.

One commenter did submit data on the number of companies that engage in export sales and recommended adoption of a test that establishes a very low threshold of international sales—10 percent—in order to qualify. In support of this very low test, the comment states that it is those companies with low exports sales that could best use the services of Edge corporations. The Board is of the view that this does not meet the intent of the proposal, which was to establish a test of whether a customer is primarily engaged in international business such that all of an Edge's dealings with that customer could reasonably be deemed to be internationally related. This particular proposal would permit Edges to act as full service lenders to companies that have negligible connections to international business transactions and, for this reason, the Board did not adopt it.

In sum, the Board has revised Regulation K to permit Edge corporations to engage in a fuller range of transaction with identifiable international businesses. The Board has not adopted provisions that would allow a substantial expansion of an Edge corporation's domestic powers because of the difficulty in devising standards that would meet the incidental test, would be easily administered, and would not involve potential evasion of statutory restrictions against interstate banking.

Although the Board has adopted only one of the proposals liberalizing Edge lending powers, the Board also believes that the purposes of the revision of Regulation K, which are to make Edge corporations more competitive and to provide U.S. businesses with a source of international credit and other services, are met through other revisions of the regulation adopted by the Board. These include a significant increase in the lending limit of Edge corporations and the liberalization of investment limits. With respect to activities in the United States, the revised regulation clarifies that an Edge corporation may offer merger and acquisition advice to foreign persons and to U.S. persons with respect to foreign assets. This would include providing advice to a U.S. company on a proposed merger with or acquisition by a foreign company. This activity has been previously determined to be permissible for Edge corporations subject to the conditions that a foreign company to which it provides advice is a company more than half of the assets and revenues of which, on a consolidated basis at the ultimate parent level, are located and derived outside the United States. Advice on transactions in the United States is available only to foreign persons and a U.S. subsidiary of a foreign company would not be considered "foreign" for this purpose.

Similarily, the provision dealing with an Edge corporation acting as a agent for the purchase of securities at the order and for the account of a customer has been adopted as proposed. The provision was clarified to require that, with respect to U.S. securities, the customer for whom the Edge corporation is acting must be a foreign person. In this regard, an Edge corporation would be permitted to purchase and sell, for the account of any customer, securities that are registered in the United States for the sole purpose of serving as a substitute for foreign securities issued abroad. These kinds of securities, so-called American depository receipts ("ADRs"), have substance only with respect to the underlying foreign securities and therefore would be considered foreign securities for purposes of Regulation K.

The revised regulation also would permit Edge corporations to engage in a wider range of foreign exchange activity than is currently permitted. As new contracts in foreign exchange are developed, an Edge corporation would be permitted to enter these contracts without receiving prior Board approval. Several commenters stated that futures, options and options on futures contracts on foreign exchange are useful hedging tools that enhance the ability of an Edge corporation to minimize risk associated with transactions related to foreign currencies. An Edge corporation is expected to conduct these operations in a prudent manner and in accordance with the policies governing the foreign exchange activities of its parent U.S. banking organization. For an Edge corporation that is not owned by a U.S. banking organization, the Edge corporation should conduct its foreign exchange activities in accordance with Board policies. This authority would not permit an Edge corporation to become a member of an exchange or to act generally as a broker or futures commission merchant with respect to contracts on foreign exchange. Such activity would require an application to the Board for prior approval.

Prudential limitations on Edge corporations

The Board proposed a number of changes to § 211.6 of Regulation K, dealing with limits on acceptances, lending limits, and capital requirements. The technical changes on bankers' acceptances—one clarifying that a separate lending limit applies to acceptances of the kind described in section 13 of the Federal Reserve Act and the other clarifying the treatment of participation agreements with respect to acceptances—drew little comment and are adopted as proposed.

The Board has also proposed raising the customer lending limit for Edge corporation from 10 percent to 15 percent of the Edge Corporation's capital and surplus. Some commenters stated that an Edge corporation does not need a separate lending limit and that an Edge's lending should merely be aggregated into the parent bank's customer lending limit. The Board, however, continues to believe that Edge corporations, as separate corporate banking vehicles, should be operated in accordance with prudent standards, which would include diversification. Therefore, the separate lending limit for Edge corporation is maintained. The Board adopted the proposed increase in the per-customer lending limit of 15 percent of the Edge corporation's capital and surplus.

With respect to lending limits generally, Regulation K also requires aggregation of the loans made to a customer by an Edge corporation with the loans to the same customer by the parent bank. The total amount may not exceed the parent bank's lending limit. The provision has been the source of some confusion because Regulation K includes within the lending limit certain kinds of obligations that may not be included in the parent bank lending limit. For example, Regulation K includes within the lending limit investments in unaffiliated organizations. The National Bank Act,

however, permits a national bank to invest up to 10 percent of its capital and surplus in debt securities of other organizations. These investment securities are not included in the National Bank Act's lending limit.

The purpose of the aggregation requirement is to prevent the parent bank from using the Edge corporation to evade the parent bank's lending limits. For purposes of determining compliance with the aggregation provision of Regulation K's lending limit, a parent bank may exclude from the Edge corporation's loans and extensions of credit any obligations, such as investment securities, that are not included in the parent bank's lending limit. Where such obligations, however, are subject to separate limitations in the law or regulations governing the parent bank, the Edge corporation's holdings of such obligations may not be used to evade these separate limitations on the parent bank.

With respect to capitalization requirements, under the current regulation the capital requirement for banking Edge corporations is set at 7 percent of "risk" assets with risk assets being defined as total assets less cash, amounts due from domestic banking organizations, U.S. government securities, and federal funds sold. It was proposed to change this standard to accord with the standards applied to commercial banks under the Board's capital adequacy guidelines. The Board did not adopt this proposal.

The principal objection to the proposal in comments submitted to the Board was similar to that voiced with respect to lending limits, namely, that no separate capital requirement should be applied to Edge corporations because they are generally parts of larger banking organizations to which a capital requirement is applied on a consolidated basis. However, as already noted, an Edge corporation is a separately chartered company engaged in the conduct of a banking business and should therefore maintain an individual capital position to support its own operations. Moreover, not all banking Edge corporations are part of larger banking organizations to which U.S. capital requirements apply. In addition to Edge corporations owned by foregin banks, several Edge corporations have recently been acquired by nonbanking organizations.

A number of comments objected to abandoning the "risk asset" capital requirement, asserting that it would have a negative impact on some Edge corporations because of clearing activities and the large amounts of funds in the category of "due from banks." At the time the change was proposed, available data indicated that, while a few banking Edge corporations would have to strengthen their capital positions, changes in clearing procedures had greatly reduced the amount of float, and thus the amount of interbank claims booked in Edge corporations. Thus, the original justification for the risk asset standard for capital requirements appeared inapplicable. More recent data still seem to confirm that conclusion. The data show that 12 out of 94 banking Edge corporations would have to obtain additional capital or reduce assets if the capital standard were changed. Of those 12 Edge corporations, many are either placing large amounts of surplus funds with their parent banks or are very active in interbank money market transactions. For example, in several of these cases, claims on other banks amount to a majority of total assets. Most of the affected corporations have capital ratios that range from three to five percent of total assets and are still capitalized well above the 7 percent of risk assets standards. The remaining 82 banking Edge corporations, in addition to meeting the risk-asset ratio requirement, also have capital ratios well in excess of the minimum standards under the capital guidelines.

In light of the generally satisfactory capital positions on Edge corporations, the Board has decided to defer action on this proposal pending futher experience with the capital guidelines for banks and bank holding companies. Those guidelines are being reevaluated in the light of recent developments in banking markets and for their adequacy in relation to current banking practices. The Board believed that a change in the method of calculating the capital requirements of Edge Corporations should await that reevaluation. As already noted, the great bulk of existing banking Edge corporations now meet the commercial bank capital standards. Because the Board has deferred action on the proposal to adopt the capital adequacy standards applicable to banks for Edge corporations, Regulation K has not been revised to conform the definition of capital and surplus to the components of primary capital in the Board's capital adequacy guidelines. Capital and surplus therefore will continue to be defined in § 211.2(b) to include paid-in and unimpaired capital and surplus, which would include reserves for loan losses, and undivided profits, but not capital notes or debentures.

Change in control of Edge corporations

The Board in 1984 proposed for comment a procedure that would require a person to give the Board prior notice of acquisition of control of an Edge corporation. In its proposal, the Board noted the substantial growth in the number and the asset size of Edge corporations since 1979, and their increased participation in the economy and the interbank market. The prior review procedure was intended to allow the Board to assess the financial strength of the acquiror and whether adverse effects might result from the acquisition.

Under the proposed procedure any person would be required to give 60 days' notice before acquiring 25 percent or more of the voting shares of an Edge corporation. The Board could disapprove an investment or impose conditions necessary to prevent adverse effects such as conflicts of interest, undue concentration of resources or unsound banking practices. The proposal was generally supported in the comments received. However, three commenters objected on the grounds that the Board lacked specific statutory authority for the requirement.

The Board has exclusive jurisdiction over chartering, supervising and examining Edge corporations. The governing statute and the Board's regulations establish a comprehensive scheme requiring the prior approval of the Board for the formation and establishment of Edge corporations, extensions of their corporate existence, change to their articles of association, their investments in other organizations and any new activities in which they may seek to engage. Moreover, paragraph 4 of the Edge Act provides that an Edge corporation may prescribe "by-laws not inconsistent with law or with the regulations of the Board . . . regulating the manner in which its stock shall be transferred . . . ." This framework commits responsibility to the Board to maintain the sound operation of Edge corporations and clearly authorizes the Board to adopt a procedure for review of the transfer of ownership of an Edge corporation. Therefore, the Board adopted the proposal. The language of the proposal was revised to reflect some technical clarifications and to make clear that the prior notice requirements applies to foreign banks acquiring between 25 and 50 percent of the shares of an Edge corporation.

Investment procedures

Under Regulation K, U.S. banking organizations may invest in international subsidiaries that confine their activities to those specified by the Board as permissible, and may acquire 20 to 50 percent interests in foreign joint ventures that are predominantly engaged in premissible activities. They may also make international portfolio investment by acquiring up to 20 percent of the shares of companies regardless of the nature of their activities. These investments must be made in accordance with procedures set forth in the regulation.

Three changes were proposed in those procedures.

1. Under the General Consent, to raise the amount for initial investments that may be made without prior notice or approval from $2 million to $15 million.

2. Under the General Consent, to alter from historical cost to book value the basis on which additional investments in a single organization may be made without prior notice or approval.

3. In the acquistion of going concerns, to permit some leeway in the requirement that subsidiaries confine their activities exclusively to those listed in the regulation.

The General Consent now permits initial investments of lesser of $2 milion or five percent of the investor's capital and surplus to be made without prior notice or consent, provided, of course, that the investment raises no question regarding the permissiblity of the activities. The comment supported a liberalization of the General Consent, with some commenters proposing a higher dollar amount than that proposed, and others suggested elimination of the dollar amount with reliance exclusively on the five percent of capital limitation. After consideration of all comments, the Board adopted the proposal to raise the initial investment amount covered by general consent to $15 million. In reaching this determination, the Board noted that elimination of a dollar amount limit would allow the largest banks to make substantial individual investments without any prior review, in some cases of up to $300 million. Because this amount can be leveraged many times in the case of subsidiaries, thus increasing exposure beyond the investment amount, the Board decided to maintain a dollar limit set at a level that would allow routine initial investments to be made without regulatory scrutiny while at the same time permitting regulatory review of those investments that are likely to be more significant.

As to the second proposed change in investment procedures, additional investments beyond the initial investment (or series of investments up to $15 million) in an organization may now be made under the General Consent in any one year of up to 10 percent of the *historical cost* of the investment and these rights may be carried forward and accumulated for up to five years (*i.e.*, up to 50 percent). It was proposed that the basis for this calculation be changed from historical cost to book value. It was believed that the book value would be easier to account for over time and therefore that the change would represent a simplication. However, a number of strong objections were received to the proposed change, and these objections were registered mainly by organizations active in making additional investments.

The main arguments were that maintaining records of historical cost is not burdensome, that book values fluctuate, and that more often than not additional investments are likely to be needed where the book value has fallen below historical cost. Some commenters suggested that if a change were to be made it should permit the greater of historical cost or book value to be used as the basis. However, this could lead to difficult problems of regulatory administration and compliance. In light of all the comments, the Board decided to retain the historical cost criterion for calculating additional investments under the General Consent.

The third proposed change in investment procedures was to allow a certain amount of leeway in the permissible activities of subsidiaries when they are acquired as going concerns. Under the present regulatory requirements, a subsidiary must conform its activities exclusively to those listed in the regulation or otherwise permitted by the Board. By contrast, up to 10 percent of the assets or revenues of a joint venture may be attributable to impermissible activities.

When subsidiaries have been acquired as going concerns, there have often been parts of the organization engaged in impermissible activities. These sectors, either departments of the company or separate subsidiaries, have often been small in relation to the overall organization and sometimes have been historically associated with the firm acquired. In the circumstances, it has frequently been awkward to effect their discontinuance either prior to acquisition or even post-acquisition. The proposed change sought to avoid this kind of difficulty by setting a *de minimis* standard that would allow up to 2 percent of assets and revenues in such companies to be derived from impermissible activities.

While supporting the idea in principle, many commenters suggested a higher limit (*e.g.*, 5 percent) or applying the limit selected to all subsidiaries (going concerns and *de novo*). Because the proposal was intended to provide flexibility to banking organizations, the Board adopted a limit of 5 percent of assets and revenues that may be derived from impermissible activities in a subsidiary acquired as a going concern. The provision is intended primarily to permit acquisitions under the General Consent and should provide the intended flexibiity in that area. Where, however, an investor proposes to acquire a very large organization, which does not qualify for the General Consent, such that 5 percent of assets and revenues would be large in absolute dollar terms, the Board will take into account the size of the investment, the magnitude of impermissible activities, and the structure of the acquired organization in detemining whether the proposed investment should be approved or whether the impermissible activities could be retained. The Board also determined that *de novo* subsidiaries should continue to conform strictly to the activities standards set by the Board because the parent has control over the subsidiary's activities from the outset.

In addition to these revisions, the Board adopted as proposed the revision to § 211.5(d)(5) that would permit foreign subsidiaries to underwrite all forms of credit life, and credit accident and health insurance, eliminating the requirement that such insurance be underwritten only for credit extended by the investor and its affiliates. Section 211.5(d)(1) was revised to clarify that a U.S. banking organization may invest in foreign thrift institutions, such as savings banks and building and loan associations.

The Board also adopted as proposed the revision that eliminates from the list of activities in § 211.5(d) those activities that the Board has found to be closely related to banking *by order* under section 4(c)(8) of the Bank Holding Company Act. Investments made or activities commenced in reliance on this provision may continue to be held or conducted.

Securities Activities Abroad

The Board proposed no change to the provision permitting foreign subsidiaries to engage in certain securities activities. Comments were received on two aspects of securities activities abroad: limits on the underwriting of equities

and limits affecting dealing or trading in equities. Because of significant developments currently under way in this area, no changes were adopted in the rules governing the conduct of securities activities abroad pending further study and analysis.

U.S. nonbanking activities of foreign banks. One proposed change in the regulation dealt with exempt U.S. nonbanking activities of foreign banks. Section 2(h) of the BHC Act permits foreign banks to own foreign companies that engage in nonbanking activities in the United States if the U.S. activities are in the same general line of business as the company's foreign activities. The exemption is intended to prevent disruptions in the foreign activities and business of foreign banks that would occur if its nonbank affiliates were completely barred from U.S. markets. However, the exemption was intended to be available to commercial and industrial companies with which foreign banks were affiliated and not to companies that engage in financial or financially-related activities, or are primarily investment vehicles.

To clarify this point, an amendment to § 211.23(f)(5) was proposed which would require these foreign companies affiliated with foreign banks to conduct an actual operating business overseas in order to take advantage of the exemption. This would preclude a foreign company that engages only in acquiring noncontrolling interests in other companies from using the section 2(h) exemption to engage in the United States in activities of the kind conducted by such companies. An example would be a foreign bank that directly or indirectly acquires oil and gas properties abroad as investments and seeks to rely on the section 2(h) exemption to engage in the oil and gas business in the United States or to engage generally in investing in such properties in the United States.

Two commenters opposed adoption of this change. They argued that the Board should not seek to prevent foreign banking organizations from investing for their own account in real estate and oil, gas and other mineral properties in the United States because these are commercial properties entitled to the exemption. The Board is of the view that the exemption was intended to apply only to directly related U.S. activities of foreign affiliates engaged in commercial activities and was not intended to allow unrelated investments in commercial and industrial businesses in the U.S. simply because investments are held in the same kinds of businesses abroad.

Both commenters requested that the provision not be construed to exclude foreign shell holding companies that are set up for legitimate corporate tax purposes. The Board did not intend that the proposal interfere with or inhibit the legitimate structuring of foreign holdings by foreign banking organizations. The Board adopted the proposal with the clarification that the U.S. company may be held through a shell holding company so long as the foreign banking organization *controls* a foreign company actually engaged in the same kind of commercial business as the U.S. company.

The Board had also proposed a change to §211.23(b) of Regulation K concerning qualification of foreign banking organizations to take advantage of the exemptions for foreign banks in the Bank Holding Company Act. The proposal required that a foreign bank include in its calculation of the amount of its assets, revenues and net income attributable to U.S. banking, any assets, revenues or income derived from banking operations in U.S. territories and possessions and Puerto Rico. The Institute of Foreign Bankers objected to this proposal because such locations have generally been treated as foreign. However, the Board continues to be of the view that a foreign bank, should not be permitted to bootstrap itself into qualification for exemptions from nonbanking prohibitions by including banking assets that are subject to U.S. jurisdiction. Therefore, the Board adopted this revision as proposed.

Other Issues

The Board also adopted two liberalizing provisions that were not contained in the proposal for comment.

Additional investment authority for foreign branches. Section 25 of the Federal Reserve Act provides that a member bank may hold the shares of a foreign bank as a limited exception to the restrictions on member bank ownership of stock generally. The Board has not permitted member banks to hold directly the shares of any foreign organization other than a foreign bank. The Board has received requests to permit member banks to hold directly the shares of companies that engage only in activities permitted to the foreign branch or foreign bank subsidiary of the member bank where the conduct of the activity in a separate company is required or necessary under local law or regulation.

The Board has the authority under section 25 to grant additional powers to foreign branches of member banks where such powers are usual in connection with the banking business in the country in which the bank is located. The Board has used this authority where an additional power appeared necessary in order to allow foreign branches of member banks to compete with local banking organizations.

The Board has amended the regulations to permit a member bank, with the prior approval of the Board, to hold shares of subsidiaries that engage solely in activities permitted to a foreign branch where this structure is required by local law or regulation. Because the subsidiary would engage only in activities permitted to the branch, the shareholding would be permissible and consistent with the Board's longstanding position that a member bank may not directly hold the shares of a foreign company except as the Board may permit in accordance with section 25 of the Federal Reserve Act.

De minimis investments in shares. Regulation K requires divestiture of any investment if the organization invested in engages directly or indirectly in business in the United States that is not permitted to an Edge Corporation. This requirement applies no matter how small the ownership interest may be, and can have an adverse impact upon U.S. banking organizations that make small investments in foreign companies that thereafter engage directly or indirectly in activities in the United States.

Several commenters requested limited relief from this divestiture requirement. The Board believes that this requirement is unnecessarily stringent and has amend the regulation to permit U.S. banking organizations to invest in up to five percent of the shares of a foreign company that engages in business in the United States without being required to divest those shares. This five percent exemption would correspond to the exemption for bank holding companies under the Bank Holding Company Act for investments in up to five percent of the shares of any company without regard to the activities of the company and may fairly be regarded as incidental to the foreign business of the investor because it is a *de minimis* holding.

In light of the Board's adoption of this liberalization, other clarifying and conforming changes were made to § 211.5(b).

Pursuant to section 605(b) of the Regulatory flexibility Act (Pub. L. 96–354, 5 U.S.C. 601 *et seq.*), the Board certifies that the regulation will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 211

Banks, banking; Federal Reserve System; Foreign banking, Investments, Reporting and recordkeeping

requirements, Export trading companies, Allocated transfer risk reserve, reporting and disclosure of international assets, accounting for fees on international loans.

12 CFR Part 211 is amended as follows:

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

Authority: Federal Reserve Act (12 U.S.C. 211 *et seq.*); Bank Holding Company Act of 1956, as amended (12 U.S.C 1841 *et seq.*); the International Banking Act of 1978 (Pub. L. 95–369; 92 Stat. 607; 12 U.S.C. 3101 *et seq.*); the Bank Export Services Act (Title II, Pub. L. 97–290, 96 Stat. 1235); and the International Lending Supervision Act (Title IX, Pub. L. 98–181, 97 Stat. 1153).

Subpart A of 12 CFR Part 211 is revised to read as follows:

PART 211—INTERNATIONAL BANKING OPERATIONS

Subpart A—International Operations of United States Banking Organizations

Sec.

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SUBPART A—INTERNATIONAL OPERATIONS OF UNITED STATES BANKING ORGANIZATIONS

§ 211.1 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System ("Board") under the authority of the Federal Reserve Act ("FRA") (12 U.S.C. 221 et *seq.*); the Bank Holding Company Act of 1956 ("BHC Act") (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978 ("IBA") (92 Stat. 607; 12 U.S.C. 3101 *et seq.*). Requirements for the collection of information contained in this regulation have been approved by the Office of Management and Budget under the provision of 44 U.S.C. 3501, et seq. and have been assigned OMB Nos. 7100–0107; 7100–0109; 7100–0110; 7100–0069; 7100–0086, and 7100–0073.

(b) *Purpose.* This subpart sets out rules governing the international and foreign activities of U.S. banking organizations, including procedures for establishing foreign branches and Edge corporations to engage international banking and for investments in foreign organizations.

(c) *Scope.* This subpart applies to corporations organized under section 25(a) of the FRA (12 U.S.C. 611–631), "Edge corporations"; to corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601–604a), "Agreement corporations"; to member banks with respect to their foreign branches and investments in foreign banks under section 25 of the FRA (12 U.S.C. 601–604a);[1] and to bank holding companies with respect to the exemption from the nonbanking prohibitions of the BHC Act afforded by section 4(c)(13) of the BHC Act (12 U.S.C. 1843(c)(13)).

§ 211.2 Definitions.

Unless otherwise specified, for the purposes of this subpart:

(a) An "affiliate" of an organization means (1) any entity of which the organization is a direct or indirect subsidiary; or (2) any direct or indirect subsidiary of the organization or such entity.

(b) "Capital and surplus" means paid-in and unimpaired capital and surplus, and includes undivided profits but does not include the proceeds of capital notes or debentures.

(c) "Directly or indirectly" when used in reference to activities or investments of an organization means activities or investments of the organization or of any subsidiary of the organization.

(d) An Edge corporation is "engaged in banking" if it is ordinarily engaged in the business of accepting deposits in the United States from nonaffiliated persons.

(e) "Engaged in business" or "engaged in activities" in the United States means maintaining and operating an office (other than a representative office) or subsidiary in the United States.

(f) "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.

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

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

(i) "Investment" means the ownership or control of shares (including partnership interests and other interests evidencing ownership), binding commitments to acquire shares, contributions to the capital and surplus of an organization, and the holding of an organization's subordinated debt when shares of the organization are also held by the investor or the investor's affiliate.

(j) "Investor" means an Edge corporation, Agreement corporation, bank holding company, or member bank.

(k) "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, but which is not a subsidiary of the investor.

(l) "Organization" means a corporation, government, partnership, association, or any other entity.

(m) "Person" means an individual or an organization.

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

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

(p) "Subsidiary" means an organization more than 50 percent of the voting shares of which is held directly or indirectly by the investor, or which is otherwise controlled or capable of being controlled by the investor or an affiliate of the investor.

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

(a) *Establishment of foreign branches.*—(1) *Right to establish branches.* Foreign branches may be established by any member bank having capital and surplus of $1,000,000 or more, an Edge corporation, an Agreement corporation, or a subsidiary held pursuant to this Subpart. Unless otherwise provided in this section, the establishment of a foreign branch requires the specific prior approval of the Board.

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

[1] Section 25 of the FRA, which refers to national banking associations, also applies to state member banks of the Federal Reserve System by virtue of section 9 of the FRA (12 U.S.C. 321).

to establish additional branches in any foreign country where it operates one or more branches.[2]

(3) *Branching into additional foreign countries.* After giving the Board 45 days' prior written notice, an organization that operates branches in two or more foreign counties may establish a branch in an additional foreign country, unless notified otherwise by the Board.[2]

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

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

(b) *Further powers of foreign branches of member banks.* In addition to its general banking powers, and to the extent consistent with its charter, a foreign branch of a member bank may engage in the following activities so far as usual in connection with the business of banking in the country where it transacts business:

(1) *Guarantees.* Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events,[3] if the guarantee or agreement specifies a maximum monetary liability; but 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 paragraph (a)(1) of section 5200 of the Revised Statutes (12 U.S.C. 84) for loans and extensions of credit;

(2) *Investments.* Invest in: (i) The securities of the central bank, clearing houses, governmental entities, and government-sponsored development banks of the country in which the foreign branch is located; (ii) other debt securities eligible to meet local reserve or similar requirements; and (iii) shares of professional societies, schools, and the like necessary to the business of the branch; however, the total investments of the bank's branches in that country under this paragraph (exclusive of securities held as required by the law of that country or as authorized under section 5136 of the Revised Statutes (12 U.S.C. 24, Seventh)) may not exceed one percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or on the date of acquisition of the branch in the case of a branch that has not so reported);

(3) *Government obligations.* Underwrite, distribute, buy, and sell obligations of: (i) The national government of the country in which the branch is located; (ii) an agency or instrumentality of the national government; and (iii) a municipality or other local or regional governmental entity of the country; however, no member bank may hold, or be under commitment with respect to, such obligations for its own account in an aggregate amount exceeding 10 percent of its capital and surplus;

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

(5) *Real estate loans.* Take liens or other encumbrances on foreign real estate in connection with its extensions of credit, whether or not of first priority and whether or not the real estate has been improved.

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

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

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

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

(10) *Other activities.* With the Board's prior approval, engage in other activities that the Board determines are usual in connection with the transaction of the business of banking in the places where the member bank's branches transact business.

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

§ 211.4 Edge and Agreement corporations.

(a) *Organization.*—(1) *Permit.* A proposed Edge corporation shall become a body corporate when the Board issues a permit approving its proposed name, articles of association, and organization certificate.

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

(3) **Federal Register** *notice.* The Board will publish in the **Federal Register** notice of any proposal to organize an Edge corporation and will give interested persons an opportunity to express their views on the proposal.

(4) *Factors considered by the Board.* The factors considered by the Board in acting on a proposal to organize an Edge Corporation include:

(i) The financial condition and history of the applicant:

(ii) The general character of its management;

(iii) The convenience and needs of the community to be served with respect to international banking and financing services; and

(iv) The effects of the proposal on competition.

(5) *Authority to commence business.* After the Board issues a permit, the Edge corporation may elect officers and otherwise complete its organization, invest in obligations of the United States Government, and maintain deposits with depository institutions, but it may not exercise any other powers until at least 25 percent of the authorized capital stock specified in the articles of association has been paid in cash, and each shareholder has paid in cash at least 25 percent of that shareholder's stock subscription. Unexercised authority to commence business as an Edge corporation shall expire one year after issuance of the permit, unless the Board extends the period.

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

(b) *Nature and ownership of shares.*—(1) *Shares.* Shares of stock in an Edge corporation may not include no-par value shares and shall be issued and

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

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

transferred only on its books and in compliance with section 25(a) of the FRA and this subpart. The share certificates of an Edge corporation shall:

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

(ii) Conspicuously set forth the substance of:

(A) Limitations upon the rights of ownership and transfer of shares imposed by section 25(a) of the FRA; and

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

(2) *Ownership of Edge corporations by foreign institutions.*—(i) *Prior Board approval.* One or more foreign or foreign-controlled domestic institutions referred to in paragraph 13 of section 25(a) of the FRA (12 U.S.C. 619) may apply for the Board's prior approval to acquire directly or indirectly a majority of the shares of the capital stock of an Edge corporation.

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

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

(B) Ensure that any transaction by an Edge corporation with an affiliate [4] is on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions by the Edge corporation with nonaffiliated persons, and does not involve more than the normal risk of repayment or present other unfavorable features;

(C) Ensure that the Edge corporation will not provide funding on a continual or substantial basis to any affiliate or office of the foreign institution through transactions that would be inconsistent with the international and foreign business purposes for which Edge corporations are organized;

(D) In the case of a foreign institution not subject to section 4 of the BHC Act: (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 45 days' prior written notice, in a form to be prescribed by the Board, before engaging in any nonbanking activity in the United States, or making any initial or additional investments in another organization, that would require prior Board approval or notice by an organization subject to section 4 of the BHC Act; in connection with such notice, the Board may impose conditions necessary to prevent adverse effects that may result from such activity or investment; and

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

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

(ii) *Board review.* Interviewing a notice filed under this paragraph, the Board shall consider the factors set forth in paragraph (a)(4) of this section and may disapprove a notice or impose any conditions that it finds necessary to assure the safe and sound operation of the Edge corporation, to assure the international character of its operation, and to prevent adverse effects such as decreased or unfair competition, conflicts of interest, or undue concentration of resources.

(c) *Domestic branches.* An Edge corporation may establish branches in the United States 45 days after the Edge corporation has given notice to its Reserve Bank, unless the Edge corporation is notified to the contrary within that time. The notice to the Reserve Bank shall include a copy of the notice of the proposal published in a newspaper of general circulation in the communities to be served by the branch and may appear no earlier than 90 calendar days prior to submission of notice of the proposal to the Reserve Bank. The newspaper notice must provide an opportunity for the public to give written comment on the proposal to the appropriate Federal Reserve Bank for at least 30 days after the date of publication. The factors considered in acting upon a proposal to establish a branch are enumerated in paragraph (a)(4) of this section. Authority to open a branch under prior notice shall expire one year from the earliest date on which that authority could have been exercised, unless the Board extends the period.

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

(e) *Permissible activities in the United States.* An Edge corporation may engage directly or indirectly in activities in the United States that are permitted by the sixth paragraph of section 25(a) of the FRA and are incidental to international or foreign business, and in such other activities as the Board determines are incidental to international or foreign business. The following activities will ordinarily be considered incidental to an Edge corporation's international or foreign business:

(1) *Deposit activities.*—(i) *Deposits from foreign governments and foreign persons.* An Edge corporation may receive in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposits) from foreign governments and their agencies and instrumentalities; offices or establishments located, and individuals residing, outside the United States.

(ii) *Deposits from other persons.* An Edge corporation may receive from any other person in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposit) if such deposits:

(A) Are to be transmitted abroad;

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

(C) Consist of the proceeds of collections abroad that are to be used to pay for exported or imported goods or for other costs of exporting or importing or that are to be periodically transferred to the depositor's account at another financial institution;

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

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

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

(G) Are received from an organization that by its charter, license or enabling law is limited to business that is of an international character, including Foreign Sales Corporations (26 U.S.C. 921); transportation organizations

[4] For purposes of this paragraph, "affiliate" means any organization that would be an "affiliate" under section 23A of the FRA (12 U.S.C. 371c) if the Edge corporation were a member bank.

engaged exclusively in the international transportation of passengers or in the movement of goods, wares, commodities or merchandise in international or foreign commerce; and export trading companies that are exclusively engaged in activities related to international trade.

(2) *Liquid funds.* Funds of an Edge or Agreement corporation not currently employed in its international or foreign business, if held or invested in the United States, shall be in the form of cash, deposits with depository institutions, as described in Part 204 of this chapter (Regulation D), and other Edge and Agreement corporations, and money market instruments (including repurchase agreements with respect to such instruments) such as bankers' acceptances, obligations of or fully guaranteed by federal, state, and local governments and their instrumentalities, federal funds sold, and commercial paper.

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

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

(ii) Incur indebtedness from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency or instrumentality thereof that the Edge corporation is obligated to repurchase;

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

(4) *Credit activities.* An Edge corporation may:

(i) Finance the following: (A) contracts, projects, or activities performed substantially abroad; (B) the importation into or exportation from the United States of goods, whether direct or through brokers or other intermediaries; (C) the domestic shipment or temporary storage of goods being imported or exported (or accumulated for export); and (D) the assembly or repackaging of goods imported or to be exported;

(ii) Finance the costs of production of goods and services for which export orders have been received or which are identifiable as being directly for export;

(iii) Assume or acquire participations in extensions of credit, or acquire obligations arising from transactions the Edge corporation could have financed;

(iv) Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events,[5] if the guarantee or agreement specifies the maximum monetary liability thereunder and is related to a type of transaction described in paragraphs (e)(4)(i) and (ii) of this section; and

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

(5) *Payments and collections.* An Edge corporation may receive checks, bills, drafts, acceptances, notes, bonds, coupons, and other instruments for collection abroad, and collect such instruments in the United States for a customer abroad; and may transmit and receive wire transfers of funds and securities for depositors.

(6) *Foreign exchange.* An Edge corporation may engage in foreign exchange activities.

(7) *Fiduciary and investment advisory activities.* An Edge corporation may:

(i) Hold securities in safekeeping for, or buy and sell securities upon the order and for the account and risk of, a person, provided such services for U.S. persons shall be with respect to foreign securities only;

(ii) Act as paying agent for securities issued by foreign governments or other entities organized under foreign law;

(iii) Act as trustee, registrar, conversion agent, or paying agent with respect to any class of securities issued to finance foreign activities and distributed solely outside the United States;

(iv) Make private placements of participations in its investments and extensions of credit; however, except to the extent permissible for member banks under section 5136 of the Revised Statutes (12 U.S.C. 24, Seventh), no Edge corporation may otherwise engage in the business of underwriting, distributing, or buying or selling securities in the United States;

(v) Act as investment or financial adviser by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real property interests and other investment assets,[6] and by providing advice on mergers and acquisitions, provided such services for U.S. persons shall be with respect to foreign assets only; and

(vi) Provide general economic information and advice, general economic statistical forecasting services and industry studies, provided such services for U.S. persons shall be with respect to foreign economies and industries only.

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

(9) *Other activities.* With the Board's prior approval, engage in other activities in the United States that the Board determines are incidental to the international or foreign business of Edge corporations.

(f) *Agreement corporations.* With the prior approval of the Board, a member bank or bank holding company may invest in a federally- or state-chartered corporation that has entered into an agreement or undertaking with the Board that it will not exercise any power that is impermissible for an Edge corporation under this subpart.

§ 211.5 Investments and activities abroad.

(a) *General policy.* Activities abroad, whether conducted directly or indirectly, shall be confined to those of a banking or financial nature and those that are necessary to carry on such activities. In doing so, investors shall at all times act in accordance with high standards of banking or financial prudence, having due regard for diversification of risks, suitable liquidity, and adequacy of capital. Subject to these considerations and the other provisions of this section, it is the Board's policy to allow activities abroad to be organized and operated as best meets corporate policies.

(b) *Investment requirements.*—(1) *Eligible investments.* (i) An investor may directly or indirectly:

(A) Invest in a subsidiary that engages solely in activities listed in paragraph (d) of this section or in such other activities as the Board has determined in the circumstances of a particular case are permissible except that, in the case of an acquisition of a going concern, existing activities that are not otherwise permissible for a subsidiary may account for not more than five percent of either the consolidated assets or revenues of the acquired organization;

(B) Invest in a joint venture provided that, unless otherwise permitted by the

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

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

Board, not more than 10 percent of the joint venture's consolidated assets or revenues shall be attributable to activities not listed in paragraph (d) of this section; and

(C) Make portfolio investments (including securities held in trading or dealing accounts) in an organization if the total direct and indirect portfolio investments in organizations engaged in activities that are not permissible for joint ventures does not at any time exceed 100 percent of the investor's capital and surplus.[7]

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

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

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

(i) The organization invested in—

(A) Engages in the general business of buying or selling goods, wares, merchandise, or commodities in the United States;

(B) Engages directly or indirectly in other business in the United States that is not permitted to an Edge corporation in the United States except that an investor may hold up to five percent of the shares of a foreign company that engages directly or indirectly in business in the United States that is not permitted to an Edge corporation; or

(C) Engages in impermissible activities to an extent not permitted under paragraph (b)(1) of this section; or

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

(c) *Investment procedures.*[8] Direct and indirect investments shall be made in accordance with the general consent, prior notice, or specific consent procedures contained in this paragraph. The Board may at any time, upon notice, suspend the general consent and prior notice procedures with respect to any investor or with respect to the acquisition of shares of organizations engaged in particular kinds of activities. An investor shall apply for and receive the prior specific consent of the Board for its initial investment in its first subsidiary or joint venture unless an affiliate has made such an investment. Authority to make investments under prior notice or specific consent shall expire one year from the earliest date on which the authority could have been exercised, unless the Board extends the period.

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

(i) Any investment in a joint venture or subsidiary, and any portfolio investment, if the total amount invested (in one transaction or in a series of transactions) does not exceed the lesser of:

(A) $15 million; or

(B) 5 percent of the investor's capital and surplus in the case of a member bank, bank holding company, or Edge corporation engaged in banking, or 25 percent of the investor's capital and surplus in the case of an Edge corporation not engaged in banking;

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

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

(B) The total amount invested under § 211.5 (including investments made pursuant to specific consent or prior notice) in that calendar year does not exceed cash dividends reinvested under paragraph (c)(1)(iii) of this section plus 10 percent of the investor's direct and indirect historical cost[9] in the organization, which investment authority, to the extent unexercised, may be carried forward and accumulated for up to five consecutive years;

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

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

(2) *Prior notice.* An investment that does not qualify under the general consent procedure may be made after the investor has given 45 days' prior written notice to the Board if the total amount to be invested does not exceed 10 percent of the investor's capital and surplus. The Board may waive the 45-day period if it finds immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is accepted. The Board may suspend the period or act on the investment under the Board's specific consent procedures.

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

(d) *Permissible activities.* The Board has determined that the following activities are usual in connection with the transaction of banking or other financial operations abroad:

(1) Commercial and other banking activities;

(2) Financing, including commercial financing, consumer financing, mortgage banking, and factoring;

(3) Leasing real or personal property, or acting as agent, broker, or advisor in leasing real or personal property, if the lease serves as the functional equivalent of an extension of credit to the lessee of the property;

(4) Acting as fiduciary;

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

(6) Performing services for other direct or indirect operations of a United States banking organization, including representative functions, sale of long-term debt, name saving, holding assets acquired to prevent loss on a debt previously contracted in good faith, and other activities that are permissible domestically for a bank holding company under sections 4(a)(2)(A) and 4(c)(1)(C) of the BHC Act;

(7) Holding the premises of a branch of an Edge corporation or member bank or the premises of a direct or indirect subsidiary, or holding or leasing the

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

[8] When necessary, the general consent and prior notice provisions of this section constitute the Board's approval under the eighth paragraph of section 25(a) of the FRA for investments in excess of the limitations therein based on capital and surplus.

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

residence of an officer or employee of a branch or subsidiary;

(8) Providing investment, financial, or economic advisory services;

(9) General insurance agency and brokerage;

(10) Data processing;

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

(12) Performing management consulting services provided that such services when rendered with respect to the United Sates market shall be restricted to the initial entry;

(13) Underwriting, distributing, and dealing in debt and equity securities outside the United States, provided that no underwriting commitment by a subsidiary of an investor for shares of an issuer may exceed $2 million or represent 20 percent of the capital and surplus or voting shares of an issuer unless the underwriter is covered by binding commitments from subunderwriters or other purchasers;

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

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

(16) With the Board's specific approval, engaging in other activities that the Board determines are usual in connection with the transaction of the business of banking or other financial operations abroad and are consistent with the FRA or the BHC Act.

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

§ 211.6 Lending limits and capital requirements.

(a) *Acceptances of Edge corporations.*—(1) *Limitations.* An Edge corporation shall be and remain fully secured for (i) all acceptance outstanding in excess of 200 percent of its capital and surplus; and (ii) all acceptances outstanding for any one person in excess of 10 percent of its capital and surplus. These limitations apply only to acceptances of the types described in paragraph 7 of section 13 of the FRA (12 U.S.C. 372).

(2) *Exceptions.* These limitations do not apply if the excess represents the international shipment of goods and the Edge corporations (i) is fully covered by primary obligations to reimburse it that are guaranteed by banks or bankers, or (ii) is covered by participation agreements from other banks, as such agreements are described in § 250.165 of this chapter.

(b) *Loans and extensions of credit to one person.*—(1) *Limitations.* Except as the Board may otherwise specify:

(i) The total loans and extensions of credit outstanding to any person by an Edge corporation engaged in banking and its direct or indirect subsidiaries may not exceed 15 percent of the Edge corporation's capital and surplus; [10] and

(ii) The total loans and extensions of credit to any person by a foreign bank or Edge corporation subsidiary of a member bank, and by majority-owned subsidiaries of a foreign bank or Edge corporation, when combined with the total loans and extensions of credit to the same person by the member bank and its majority-owned subsidiaries, may not exceed the member bank's limitation on loans and extensions of credit to one person.

(2) *"Loans and extensions of credit"* means all direct or indirect advances of funds to a person [11] made on the basis of any obligation of that person to repay the funds. These shall include acceptances outstanding not of the types described in paragraph 7 of section 13 of the FRA (12 U.S.C. 372); any liability of the lender to advance funds to or on behalf of a person pursuant to a guaranteed, standby letter of credit, or similar agreements; investments in the securities of another organization except where the organization is a subsidiary, and any underwriting commitments to an issuer of securities where no binding commitments have been secured from subunderwriters or other purchasers.

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

(i) Deposits with banks and federal funds sold;

(ii) Bills or drafts drawn in good faith against actual goods and on which two or more unrelated parties are liable;

(iii) Any bankers' acceptance of the kind described in paragraph 7 of section 13 of the FRA that is issued and outstanding;

(iv) Obligations to the extent secured by cash collateral or by bonds, notes, certificates of indebtedness, or Treasury bills of the United States;

(v) Loans and extensions of credit that are covered by bona fide participation agreements; or

(vi) Obligations to the extent supported by the full faith and credit of the following:

(A) The United States or any of its departments, agencies, establishments, or wholly-owned corporations (including obligations to the extent insured against foreign political and credit risks by the Export-Import Bank of the United States or the Foreign Credit Insurance Association), the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Inter-American Development Bank, the African Development Bank, or the Asian Development Bank;

(B) Any organization if at least 25 percent of such an obligation or of the total credit is also supported by the full faith and credit of, or participated in by, any institution designated in paragraph (b)(3)(v)(A) of this section in such manner that default to the lender will necessarily include default to that entity. The total loans and extensions of credit under this subparagraph to any person shall at not time exceed 100 percent of the capital and surplus of the Edge corporation.

(c) *Capitalization.* An Edge corporation shall at all times be capitalized in an amount that is adequate in relation to the scope and character of its activities. In the case of an Edge corporation engaged in banking, its capital and surplus shall be not less than 7 percent of risk assets. For this purpose, subordinated capital notes or debentures, in an amount not to exceed 50 percent of non-debt capital, may be included for determining capital adequacy in the same manner as for a member bank; risk assets shall be deemed to be all assets on a consolidated basis other than cash, amounts due from banking institutions in the United States, United States Government securities, and Federal funds sold.

§ 211.7 Supervision and reporting.

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

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

[11] In the case of a foreign government, these include loans and extensions of credit to the foreign government's departments or agencies deriving their current funds principally from general tax revenues. In the case of a partnership or firm, these include loans and extensions of credit to its members and, in the case of a corporation, these include loans and extensions of credit to the corporation's affiliates where the affiliate incurs the liability for the benefit of the corporation.

conducting international banking operations under this Subpart shall supervise and administer their foreign branches and subsidiaries in such a manner as to ensure that their operations conform to high standards of banking and financial prudence. Effective systems of records, controls, and reports shall be maintained to keep management informed of their activities and condition. Such systems should provide, in particular, information on risk assets, liquidity management, and operations of controls and conformance to management policies. Reports on risk assets should be sufficient to permit an appraisal of credit quality and assessment of exposure to loss, and for this purpose provide full information on the condition of material borrowers. Reports on the operations of controls should include internal and external audits of the branch or subsidiary.

(2) *Joint ventures.* Investors shall maintain sufficient information with respect to joint ventures to keep informed of their activities and condition. Such information shall include audits and other reports on financial performance, risk exposure, management policies, and operations of controls. Complete information shall be maintained on all transactions with the joint venture by the investor and its affiliates.

(3) *Availability of reports to examiners.* The reports and information specified in paragraph (a) (1) and (2) of this section shall be made available to examiners of the appropriate bank supervisory agencies.

(b) *Examinations.* Examiners appointed by the Board shall examine each Edge corporation once a year. An Edge corporation shall make available to examiners sufficient information to assess its condition and operations and the condition and activities of any organization whose shares it holds.

(c) *Reports.*—(1) *Reports of condition.* Each Edge corporation shall make reports of condition to the Board at such times and in such form as the Board may prescribe. The Board may require that statements of condition or other reports be published or made available for public inspection.

(2) *Foreign operations.* Edge and Agreement corporations, member banks, and bank holding companies shall file such reports on their foreign operations as the Board may require.

(3) *Acquisition or disposition of shares.* A member bank, Edge or Agreement corporation or a bank holding company shall report in a manner prescribed by the Board any acquisition or disposition of shares.

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

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

3. Subpart B of 12 CFR Part 211 is amended by revising § 211.23 (b) and (f) introductory text and (f)(5) to read as follows:

Subpart B—Foreign Banking Organizations

* * * * *

§ 211.23 Nonbanking Activities of Foreign Banking Organizations.

* * * * *

(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.[1] 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 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 businesses; 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

(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.

* * * * *

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

* * * * *

(5) Own or control voting shares of a foreign company that is engaged directly or indirectly in business in the United States other than that which is incidental to its international or foreign business, subject to the following limitations:

(i) More than 50 percent of the foreign company's consolidated assets shall be located, and consolidated revenues derived from, outside the United States;

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 5 percent of the voting shares of a company that underwrites, sells, or distributes securities in the United States except to the extent permitted bank holding companies;

(iii) If the foreign company is a subsidiary of the foreign banking organization, the foreign company must be, or control, an operating company and its direct or indirect activities in the United States shall be subject to the following limitations:

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Board of Governors of the Federal Reserve System, September 25, 1985.

William W. Wiles,

Secretary of the Board.

[FR Doc. 85–23339 Filed 9–30–85; 8:45 am]

[1] 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."