

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10455**]
May 7, 1991]

REGULATION K
Amendments Expanding Scope of
U.S. Banks' International Activities

*To All Depository Institutions, and Others
Concerned, in the Second Federal Reserve District:*

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

The Federal Reserve Board has announced revisions to Regulation K, which governs international banking operations, that will permit U.S. banking organizations to expand the scope of their international activities.

Some of the revisions to the regulation will become effective immediately; others will become effective May 24, 1991.

The revisions will:

- expand the existing authority to engage in underwriting and dealing in equity securities outside the United States;
- increase the current dollar limits under which U.S. banking organizations may make investments abroad without prior notice to the Board;
- clarify the portfolio investment authority under which U.S. banking organizations may make limited equity investments in any type of company outside the United States;
- permit Edge corporations to provide domestic banking services, including loans, to foreign persons and governments;
- expand the range of permissible activities for U.S. banking organizations abroad to include futures commission merchant activities and life insurance underwriting;
- modify the authority for debt-for-equity investments, including permitting a cash component to such investments without prior notice to the Board and providing for retention of such investments in companies that engage in a small level of business activities in the United States;
- authorize case-by-case exemptions from the standard for qualifying foreign banking organizations;
- require Edge corporations to maintain a minimum risk-based capital level of 10 percent; and
- make certain other technical and clarifying amendments.

The International Banking Act requires the Board to review its regulations with respect to Edge corporations at least 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 Board included in this review all of the provisions of Regulation K.

The Board's notice is attached together with a Dissenting Statement of Governor Angell.

(OVER)

Enclosed — for depository institutions, bank holding companies, Edge corporations, U.S. branches and agencies of foreign banks, and others who maintain sets of the Board's regulations — are (a) the amendments to Regulation K, as printed in the *Federal Register* of April 29; (b) related amendments to the Rules Regarding Delegation of Authority, also as printed in the *Federal Register* of April 29; and (c) the dissenting statement of Governor Angell. Additional, single copies may be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling the Circulars Division (Tel. No. 212-720-5215 or 5216).

Questions on this matter may be directed to our Banking Applications Department (Tel. No. 212-720-5678).

E. GERALD CORRIGAN,
President.

DISSENTING STATEMENT OF GOVERNOR ANGELL

In my view the revisions to Regulation K should be a part of the more general effort to reform the banking system in the United States. That reform will be required to address the fundamental issues of bank structure, safety and soundness, and competitive equity. I recognize that a different statutory and regulatory framework governs the activities and investments of U.S. banking organizations abroad. Nevertheless, it is my view that now is not the time to expand activities covered by the safety net. Rather, I believe that comprehensive structural reform is an essential condition to any expansion of banking powers.

April 18, 1991

[Enc. Cir. No. 10455]

Board of Governors of the Federal Reserve System

AMENDMENTS TO
RULES REGARDING DELEGATION OF AUTHORITY

(Effective May 24, 1991)

**PART 265—RULES REGARDING
DELEGATION OF AUTHORITY**

1. The authority citation for part 265 continues to read as follows:

Authority: Sec. 11(k), 38 Stat. 261 and 80 Stat. 1314 (12 U.S.C. 248(k)).

2. In § 265.2, paragraph (c)(38) is added to read as follows:

§ 265.2 Specific functions delegated to Board employees and to Federal Reserve Banks.

(c) * * *

(38) Under § 211.5(d)(4) of this chapter (Regulation K):

(i) To approve requests for authority to engage in the activities of underwriting, distributing, and dealing in shares outside the United States, provided that the Staff Director has determined that the internal procedures and operations of the organization and the effect of the proposed activities on capital adequacy are consistent with

approval; and

(ii) To approve hedging methods authorized under § 211.5(d)(14)(iii)(A) of this chapter.

§ 265.2 [Amended]

3. In § 265.2, paragraphs (f)(46)(iii) and (46)(v) are removed; paragraphs (f)(46)(iv) and (46)(vi) are redesignated as (f)(46)(iii) and (46)(iv) respectively; and paragraph (f)(46)(ii) is revised, and paragraph (f)(53) is added, to read as follows:

* * * * *

(f) *Each Federal Reserve Bank* * * *

* * * * *

(46) * * *

(i) * * *

(ii) A bank holding company investor and its lead bank meet the minimum capital adequacy guidelines of the Board, the Comptroller of the Currency or the Federal Deposit Insurance Corporation or have enacted capital

enhancement plans that have been determined by the appropriate supervisory authority to be acceptable;

* * * * *

(53) Under § 211.5(d)(17) of this chapter (Regulation K) to approve applications to engage in futures commission merchant activities on an exchange that requires members to guarantee or otherwise contract to cover losses suffered by other members, provided that the Board has previously approved the exchange and the application is on the same terms and conditions on which the Board based its approval of the exchange.

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Board of Governors of the Federal Reserve System, April 18, 1991.

William W. Wiles,

Secretary of the Board.

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**AMENDMENTS TO
REGULATION K
International Banking Operations**

For this Regulation to be complete, retain:
1) Regulation K Pamphlet, effective October 24, 1985; and
2) This pamphlet.

[Enc. Cir. No. 10455]

12 CFR Parts 211 and 265

[Docket No. R-0703]

Regulation K—International Banking Operations; Rules Regarding Delegation of Authority**AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Final rule.

SUMMARY: The International Banking Act of 1978 (Pub. L. 95-369) requires the Board to review and revise its regulation governing the operation of Edge corporations every five years. In connection with this review, the Board has examined all of the provisions of Regulation K, 12 CFR part 211, which governs international banking operations, and has revised provisions of the regulation governing permissible activities of U.S. banking organizations abroad, including underwriting and dealing in equity securities; investments by U.S. banking organizations under the general consent procedures; portfolio investments; domestic powers of Edge corporations; capitalization and supervision of Edge corporations; debt-for-equity investments; qualifying foreign banking organizations; powers of foreign branches of member banks; and export trading companies. In addition, there are other and technical amendments to Regulation K and certain amendments to the Board's Rules Regarding Delegation of Authority, 12 CFR part 265.

EFFECTIVE DATE: Effective May 24, 1991, except in the case of § 211.5 (b)(1)(iii), (c)(1) and (f)(4)(i), which are effective immediately.

FOR FURTHER INFORMATION CONTACT:

Ricki Rhodarmer Tigert, Associate General Counsel (202/452-3428), Kathleen M. O'Day, Assistant General Counsel (202/452-3786), Kimberly A. Lynch, Attorney (202/452-3584), Deborah K. Burand, Attorney (202/452-3427), Legal Division; Michael G. Martinson, Assistant Director (202/452-3640), or Michael D. O'Connor, Senior Financial Analyst (202/452-3808), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION: The International Banking Act of 1978 ("IBA") requires the Board to review and revise its rules issued under section

25(a) of the Federal Reserve Act ("Edge Act") at least once every five years to ensure that the purposes of the Edge Act are being served in light of prevailing economic conditions and banking practices.

On August 1, 1990, following a comprehensive review of the regulation, the Board requested public comment on proposed revisions to Regulation K (55 FR 32424). The comment period, originally scheduled to expire September 30, 1990, was extended to October 14, 1990, with comments being received through January 17, 1991. The Board received 38 comments from outside the Federal Reserve System. Comments were received from 15 U.S. banks or bank holding companies; 4 Edge Act corporations; 5 foreign banking organizations; 5 law firms; and 7 trade associations. The Board also received comments from the United States Department of Commerce and the Commission of the European Communities.

The Board has considered the comments and, as a result of this further review, some of the revisions adopted differ from the amendments proposed. The Board has revised Regulation K in a number of areas, including: Equity securities activities abroad; the portfolio investment authority; the general consent provisions of the investment procedures; debt-for-equity investments; provisions related to Edge corporations, including domestic powers, capitalization, and the Board's supervisory authority; additions to the list of permissible activities abroad, including the authority to engage in certain swap transactions, to underwrite life and related insurance products, and to engage in futures commission merchant activities; qualifying foreign banking organizations; and standards for bank-affiliated export trading companies. Certain other amendments, including technical amendments, were also made to Regulation K.

Equity Securities Activities

The Board proposed the following revisions to the authority of U.S. banking organizations to underwrite equity securities abroad under Regulation K:

1. Raise the underwriting limit applicable to U.S. banking organizations, on a consolidated basis (excluding underwriting commitments by affiliated section 20 companies¹), to the

¹ A "section 20 company" is a company owned by a bank holding company that is authorized under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) to engage in underwriting and dealing in corporate and other non-governmental securities.

lesser of \$60 million or 25 percent of the investor's Tier 1 capital, and eliminate the per subsidiary limitation of \$2 million.

2. Permit banking organizations to underwrite 100 percent of the equity of any one issuer.

3. Permit banking organizations, on an organization-by-organization basis, to underwrite equity securities in excess of the \$60 million limit where the banking organization would remain strongly capitalized after the authorized excess amount is permanently deducted from its capital.

4. Require banking organizations not currently engaged in equity underwriting or dealing activities to obtain the Board's specific consent before commencement of equity underwriting activities.

Under the proposal, any shares held by the investor or its affiliates 30 days after the close of the underwriting period would be considered to be held in the dealing account and would be required to conform to the permissible limits for dealing in equity securities. In addition, with respect to the proposal to permit underwriting in excess of the \$60 million limit on an organization-by-organization basis, the Board requested comment on whether a parent bank holding company should be required to guarantee any losses that a bank may incur in connection with overline underwriting.

The Board also proposed the following revisions to the authority in Regulation K for dealing in equity securities abroad:

1. Raise the limit relating to equity securities of any one issuer held in trading or dealing accounts to the lesser of \$30 million or 10 percent of the investor's Tier 1 capital.

2. For bank holding companies, lower the aggregate dollar amount of equity securities of companies engaged in impermissible activities that can be held in trading or investment accounts to 25 percent of Tier 1 capital. The aggregate limit for Edge corporations would remain 100 percent, although the relevant measure of capital would be Tier 1 capital instead of capital and surplus. Underwriting commitments would continue to be included in the aggregate limit for both bank holding companies and Edge corporations.

3. Apply both of the above limitations on a net basis by permitting some level of offset for hedged positions.

4. Expressly limit the dealing authority to equity securities "of foreign issuers."

5. Require banking organizations not currently engaged in equity underwriting or dealing activities to obtain the Board's specific approval before commencement of equity dealing activities.

The Board specifically solicited comment on its proposal to apply the dealing limit on a net basis, and particularly on the amount of offset that should be permitted for hedged positions.

Fourteen of the seventeen comments that addressed this topic supported liberalization of foreign securities powers. The liberalization was opposed by three comments. The comments that opposed liberalization stated that no expansion of foreign powers should be allowed because it would increase risk to the federal safety net. After review of all the comments the Board has adopted the proposed revisions with some modifications as described below.

Dollar Limitations on Underwriting and Dealing Authority

Many of the comments that favored expanded underwriting and dealing authority opposed the proposed dollar limitations on the underwriting and dealing authority. The comments maintained that dollar limitations, which were designed chiefly to regulate the investments of banking organizations in other companies, should not be applied to dealing and underwriting activities. The comments opposing expansion rejected any increase in current limits.

The comments supporting expansion particularly objected to the \$30 million restriction on dealing in the shares of a single issuer, noting that there is a relationship between underwriting and dealing activities, especially in the extent to which dealing activities in the secondary market are necessary to support an underwriting. The comments maintained that inflexible dollar limits on dealing activities could interfere with their ability to use the expanded underwriting authority. A number of comments favored a limitation based solely upon a percentage of the investor's capital (e.g., the capital of the Edge corporation or bank holding company parent of the underwriting subsidiary). The comments argued that limitations based on a percentage of the investor's capital more accurately represent the risk of a single issuer to an underwriter or dealer. Four comments requested case-by-case authority to exceed the dealing limits, similar to the proposed underwriting authority.

Although the dollar limitations in Regulation K were originally designed to deal primarily with long-term investments, they have also served the function of placing some limitation on total exposure arising from the securities business conducted in subsidiaries of U.S. banks. Moreover, because there are not the same firewalls for foreign securities affiliates of U.S. banks as apply to domestic section 20 companies, the dollar limitations operate as an additional restriction on the risks

associated with the combination of banking and securities operations in a single organization, complementing other supervisory and operational safeguards.

In adopting its proposal, the Board considered whether it would be appropriate to liberalize the authority to conduct securities activities abroad through subsidiaries of banks or whether to require any expanded securities activities to be conducted in the domestic structure through specially-regulated subsidiaries of bank holding companies. The Board's proposal was a compromise that involved some expansion of current limits, in the interests of furthering the international competitiveness of U.S. banks, without imposing a changing domestic structure abroad. Under the Board's proposal, activities of a broader nature than those permitted by Regulation K could still be conducted through the section 20 format.

The quantitative limits proposed by the Board represented a careful balancing of the Board's competing interests—the overseas competitiveness of U.S. banking organizations, concerns for the safety net with respect to activities conducted through a subsidiary of a U.S. bank, and recognition that decisions on the appropriate structure for broader powers for U.S. banking organizations should properly be made in a wider context. The expansion is relatively modest and should not present material risk to the safety net.

The Board has adopted the quantitative limitations on underwriting and dealing authority as proposed. Subject to the requirement of supervisory review that is discussed below, U.S. banking organizations may (1) underwrite, on a consolidated basis, the lesser of \$60 million or 25 percent of the investor's Tier 1 capital, and (2) hold equity securities of any one issuer in trading or dealing accounts equivalent to the lesser of \$30 million or 10 percent of the investor's Tier 1 capital. Incidental to the authority to engage in equity securities activities, foreign subsidiaries may issue equity derivatives products and engage in related equity derivatives activities, including swap transactions.

Requirement of Supervisory Review Before Commencement of Expanded Securities Activities

The proposal would have required only banking organizations not currently engaged in underwriting or dealing in equity securities to obtain the Board's specific consent before commencement of such activities. The comments were

generally concerned about the purpose of the review, whether the requirement would be applied on an organization-by-organization basis or on a subsidiary-by-subsidary basis, and the type of approval that would be required—prior notice or specific consent.

Under the proposal, any banking organization currently engaged in equity securities activities abroad would have automatically been able to take advantage of the expanded authority. After further review of this issue, the Board determined that while the new limits for underwriting and dealing in equity securities do not themselves raise significant supervisory concerns where proper operational and managerial controls are in place, the proposed authority could lead to an expansion in the volume of overseas securities activities. The Board recognized that such expansion could affect the adequacy of internal controls with respect to an existing foreign securities business and could also require that additional capital be allocated to those operations.

Accordingly, the Board has revised the regulation to require each banking organization that wishes to use the new underwriting and dealing limits in Regulation K to submit to a review by the Board of its foreign securities operations. Such a review will focus on the adequacy of internal controls and procedures for dealing with the new limits. The review will also evaluate whether the capital of existing foreign securities operations would be adequate to support any expansion of activity contemplated under the new limits. Banking organizations currently engaged in equity securities activities are authorized to continue such activities under the existing limitations. However, under Regulation K, significant investments in new or existing foreign securities affiliates require prior notice to the Board, and any investors would be expected to be in strong financial condition in order to make such investments.

Dealing in Securities of U.S. Issuers

The proposal would have continued to implement the current limitation that U.S. banking organizations may deal abroad only in equity securities "of foreign issuers." Comments strongly opposed this limitation, arguing that it inhibits the ability of U.S. banking organizations to underwrite equity securities of U.S. issuers because an underwriter needs to be able to support an underwriting through dealing or market-making activities in the secondary market. The Board has

reviewed the statutory basis for this interpretation and has revised the proposal in this area.

The limitation reflected an interpretation of paragraph 8(c) of the Edge Act (12 U.S.C. 615), which prohibits an Edge corporation from purchasing and holding stock of any company that engages in business in the United States other than business incidental to its foreign business. Under that interpretation, dealing authority excluded dealing in shares of U.S. companies because the organization could be viewed as "holding" the shares in its dealing account in violation of the statute. Many of the comments noted that this limitation is not required by the Edge Act because dealers do not "hold" securities within the meaning of this provision.

The legislative history of the Edge Act demonstrates that the Congress was concerned that the ownership of U.S. equity securities by Edge corporations could permit Edge corporations to monopolize the businesses that they were intended to finance, primarily producers of agricultural products and raw materials for export. In light of the evolving nature of the business of dealing in equity securities, the growing internationalization of securities markets that has led to increased issuance of securities outside home markets, and the legislative history of the Edge Act, the Board is of the view that "holding" stock in a dealing account is not the kind of purchasing or controlling of securities at which the limitation in the Edge Act was aimed. Therefore, the Board has determined that subsidiaries of Edge corporations and bank holding companies may deal in equity securities of U.S. corporations abroad; however, U.S. banking organizations may only sell securities of U.S. issuers to, or buy such securities from, foreign persons, as that term is defined in the revised regulation. In addition, this authority may not be used to evade the restrictions applicable to the domestic securities activities of U.S. banking organizations.

This determination is in keeping with the requirements in the IBA, establishing the five-year review of Regulation K, that the Board consider ways of enhancing the ability of U.S. banking organizations to compete effectively with foreign-owned institutions. This determination with respect to the shares of U.S. issuers must, however, take account of the provisions of the Bank Holding Company Act ("BHC Act"), under which a U.S. banking organization may not generally acquire more than 5 percent of the voting shares and 24.9

percent of the total equity of a U.S. company. Therefore, a bank holding company may not exceed these limits on an aggregate basis, even where such shares are held in a foreign securities subsidiary and regardless of whether the ownership of the subsidiary is through a bank holding company or an Edge corporation that is a subsidiary of a bank. Banking organizations engaged in securities activities domestically through the section 20 structure are subject to these same limitations.

Applying the Dealing Limits on a Net Basis

The Board proposed to apply both the dollar limit on holding individual shares and the aggregate dollar portfolio investment limit, which is discussed below, on a net basis by permitting some offset for long and short positions in the same security and for positions hedged with derivative instruments. Nine comments responded to the Board's request for comment on the level of offset that would be permissible for positions hedged with various instruments. The comments generally urged the Board to permit flexibility in any formula used for determining permissible offsets and recommended against the implementation of any such formulation by regulation, because of the frequently changing nature of the market in equity securities and their derivatives. There were various suggestions: that the Board could permit any hedging technique approved by Board interpretation or staff opinion; that it could permit the Reserve Banks to approve netting techniques under delegated authority; or that it could allow netting issues to be handled through examination guidelines.

One comment expressed concern about the proposal to impose a percentage limit on hedging through options or futures contracts in the underlying security. Comments also expressed concern about the Board's failure to include in its proposal a variety of equity derivatives, such as options on stock indices and over-the-counter derivatives, as permissible offsetting instruments.

The Board is of the view that permitting an organization to establish individual netting techniques, subject to organization-by-organization approval, would give banking organizations the flexibility they desire while limiting the level of exposure to risks presented by dealing in equity securities and providing for regulatory review of hedging techniques. The Board has concluded that a limit, or "haircut," on the use of such techniques is necessary

both to account for risk and to impose a ceiling on the dollar amount of equity securities that may be held by a U.S. banking organization.

Accordingly, the Board has adopted the following amendments:

(1) Regulation K has been revised to permit a banking organization to use netting techniques to hedge risks from positions in equity securities within certain limitations: long and short positions in the same security may be netted, and positions in equity securities may also be offset through the use of derivative instruments, such as futures, forwards, options, and similar instruments referenced to the same equity security (including matched indices), subject to the requirement that, for the purposes of the limits in Regulation K, the risk exposure associated with the holding of a position in a given equity will in no event be viewed as having been reduced by more than 75 percent through hedging;³

(2) Regulation K has further been revised to state that an organization's proposed specific hedging method for netting is subject to the Board's prior approval; and

(3) The Board's Rules Regarding Delegation of Authority (12 CFR part 265) have been revised to delegate to the Staff Director of Banking Supervision and Regulation the authority to approve specific hedging methods.

Including Underwriting Commitments and Shares Held in Dealing Accounts in the Aggregate Limits on Impermissible Investments

Both the current regulation and the proposal include underwriting commitments and shares held in dealing accounts in the aggregate limit on ownership of "impermissible" equity securities — generally, equity securities of a company engaged in nonfinancial activities. The aggregate limit is currently 100 percent of the investor's capital and surplus. As noted above and discussed in greater detail below, the Board proposed to lower the aggregate limit to 25 percent of the investor's Tier 1 capital when the investor is a bank holding company.⁴

A number of comments objected to including underwriting commitments and equity securities held in dealing accounts in this aggregate limit. The comments noted that there is a significant difference between, on the one hand, underwriting and dealing in shares that are generally held for a short period and marked-to-market daily, and,

on the other hand, portfolio investments that are held for a longer period and recorded at historic cost.

The Board has determined that it is appropriate to continue to include underwriting commitments and equity securities held in dealing accounts in the aggregate limit on impermissible investments. The limit is intended to restrict the total exposure of U.S. banking organizations to the risks presented by equity holdings in nonfinancial companies. Underwriting commitments and equity securities held in dealing accounts are, in particular, subject to the risk of rapid changes in market values. For these reasons, underwriting commitments for equity shares and shares held in dealing accounts are included in the aggregate limit.

One comment requested that, at a minimum, underwriting commitments in excess of \$60 million, as may be authorized on an organization-by-organization basis, should not be included in the aggregate amount limitations because such commitments would already have been counted against capital specifically earmarked for that purpose. The Board agrees that because the risk of such commitments would be addressed by the capital deduction, underwriting commitments in excess of \$60 million are excluded from the aggregate dollar limits on impermissible investments. Given this exclusion and the authority for shares held in dealing accounts to be netted for purposes of determining compliance with this limit, which is discussed above, the Board does not believe that the inclusion of underwriting commitments and shares held in dealing accounts in the aggregate limitation on impermissible investments will be unduly burdensome with respect to equity underwriting and dealing activities.

Limiting Voting Shares of a Single Issuer Held in Dealing Accounts to 19.9 Percent

As discussed below with respect to portfolio investments, Regulation K prohibits an investor or its affiliates from holding 20 percent or more of the voting shares of a company engaged in impermissible activities. In the past this limitation has included underwriting commitments and shares held in dealing accounts, as well as shares held in investment accounts. The Board proposed to exclude underwriting commitments for securities from the 20 percent limit in order to permit U.S. banking organizations to compete more

³ Thus, the maximum fully-hedged long position in a single stock could be \$120 million — the \$30 million dealing limit divided by the 25 percent haircut. Stated otherwise, if 25 percent of the risk is always retained then the maximum fully-hedged position is four times the \$30 million dealing limit.

⁴ The investor can be a bank holding company, Edge corporation, or foreign bank subsidiary of a member bank.

effectively, especially in underwriting initial public offerings, and has adopted this amendment as proposed.

The comments supported the proposal to exclude underwriting commitments from the 20 percent limit but opposed the continuing inclusion of shares held in dealing accounts in the limitation. The Board has, however, determined that it is appropriate to continue to include shares held in dealing accounts in the limitation on equity ownership of a company engaged in impermissible activities. Limiting the total percentage of an issuer's shares that may be held by a U.S. banking organization in both dealing and investment accounts assures that a U.S. banking organization's interest in a nonfinancial company remains at a level commensurate with a passive investment.⁴ Without such limitation, there is a potential for evasion of the prohibition on exercising control over nonfinancial companies, through holding substantial blocks of equity in both an investment and dealing account. The 19.9 percent limitation should not inhibit underwriting activities because, as discussed below, a banking organization would have 90 days after the payment date for an underwriting to sell down any excess position obtained in connection with an underwriting to a position that meets the proposed limit or to seek the Board's approval to retain the shares.

To address concerns that dealing accounts should not be used to disguise securities held as investments, one comment proposed that the Board require that any securities held in a dealing account for more than a certain period of time, such as 90 days, be reported to the appropriate Federal Reserve Bank with an explanation of the dealer's strategy for disposing of the securities. The comment suggested that this procedure would be a preferable alternative to limiting the percentage of shares of an individual company that may be held in dealing and portfolio investment accounts. The Board does not consider this proposal an adequate substitute for the percentage limits on ownership of shares of a nonfinancial company. Moreover, the Board generally would not expect shares to be held in a dealing account longer than 90 days. In the event shares are held longer than 90 days in a dealing account, Regulation K is amended to require such holdings to

⁴ As noted below in the discussion on portfolio investments, Regulation K has been amended to specify explicitly that total equity ownership in a foreign company is limited to 40 percent. Nonvoting shares of a nonfinancial company held in a dealing account are included in this limitation.

be reported to senior management of the banking organization.

Underwriting Period

Under the Board's proposal, a banking organization would be permitted to underwrite 100 percent of the equity securities of an issuer, provided that 30 days after the close of the underwriting period the underwriter and its affiliates together do not hold in their dealing and investment accounts more than the permissible percentage and dollar amounts of an issuer's shares.

Most comments opposed the 30-day limitation, contending that it takes significantly longer than 30 days to distribute an equity issue outside the United States, where markets are not as developed, and thus not as deep or broad, as the market in this country. A number of the comments noted that a short underwriting period after which positions must be sold down to the dealing limits could require U.S. banking organizations to dispose of securities at firesale prices. Accordingly, many of the comments requested an underwriting period of at least 90 days, with some asking for up to six months. Comments also requested that the Board clarify what would constitute the end of the underwriting period.

To address the concerns expressed in the comments, the Board has revised Regulation K to require underwriting positions to be sold-down to the dealing limits within 90 days after the payment date for the underwritten securities. Market participants have stated that the term "payment date" is clearly understood to mean the date on which the issuer receives the net proceeds of the underwriting from the underwriters. Thus, the use of the term "payment date" will provide clarity in the regulation. The Board has adopted a 90-day period instead of a 30-day period to reflect the fact that foreign markets may not be as liquid as U.S. markets and typically have longer underwriting periods.

Underwriting in Excess of \$60 Million

The Board proposed to permit banking organizations on an organization-by-organization basis to underwrite issues in excess of the \$60 million consolidated limitation, provided that the banking organization remains strongly capitalized after a deduction from its regulatory capital of the amount by which its underwriting limit exceeds \$60 million. The Board specifically requested comment on whether to require a guarantee from the bank holding company parent for losses to a subsidiary bank when underwriting

activities are conducted under the bank ownership chain.

The comments generally favored the proposal because it would provide U.S. banking organizations with greater flexibility in their foreign underwriting business. The comments generally objected, however, to the requirement of a permanent deduction of the entire overline amount from the banking organization's regulatory capital. A number of comments noted that to require a deduction of the overline amount on a permanent basis would be inefficient because an organization's use of the full overline amount would be sporadic.

The Board has adopted the proposed authority for underwriting in excess of \$60 million, including the requirement of a capital deduction for the entire stand-by capability. The \$60 million limit establishes a ceiling on potential loss from a particular underwriting, and the requirement of a capital deduction for amounts above \$60 million helps ensure that the safety net is not unduly exposed to the additional risks of equity securities activities beyond that amount. The alternative to a permanent deduction from regulatory capital of the maximum overline amount would be to deduct the amount on a transaction-by-transaction basis. A number of comments dismissed the approach of authority on a transaction-by-transaction basis as unworkable and as likely to interfere too much with the daily operations of an underwriting subsidiary.

Several comments noted that the "strongly capitalized" requirement was vague. In the Board's view, "strongly-capitalized" means a risk-based capital level well in excess of the Basle standards after the overline amount is deducted. As in the case of domestic section 20 subsidiaries, the capital deduction is required to be evenly distributed with 50 percent from Tier 1 capital and 50 percent from Tier 2 capital. Approval will be granted on an organizational basis to ensure that, when the overline activity is conducted by a subsidiary of a bank, the bank as well as the bank holding company remain "strongly-capitalized." Thus, the deduction from capital will be made on a consolidated basis, including from the bank's capital, when the underwriting subsidiary is held under a bank, as well as from the parent bank holding company's capital. Moreover, excess capital in other parts of the banking organization cannot substitute for capital in the bank for purposes of this requirement.

Four comments responded to the Board's request for comment on whether a bank holding company parent should be required to guarantee a bank subsidiary against losses resulting from securities activities conducted indirectly by the bank. All four comments opposed the requirement of a parent guarantee as unnecessary. One of these comments also stated, however, that a requirement for a parent guarantee was preferable to the requirement of a capital deduction.

As noted above, the deduction from regulatory capital will be made from the capital of both the parent bank, where relevant, and the parent bank holding company. Further, overline authority will be granted only on an organization-by-organization basis in order to ensure that the banking organization, including a parent bank of an underwriting subsidiary, is sufficiently strong to conduct expanded underwriting activities in an indirect subsidiary. Given these safeguards, the Board believes that a bank will be adequately shielded from losses that might result from indirect equity underwriting activities based on the overline authority and that the holding company guarantee is therefore unnecessary. Accordingly, Regulation K does not include the requirement of a separate guarantee by the parent for use of overline authority.

Other Equity Securities Issues

Under the Board's proposal, underwriting commitments of affiliated section 20 companies would be excluded from the consolidated limit of the lesser of \$60 million or 25 percent of Tier 1 capital. Two comments noted their support for this proposal but recommended that the Board similarly exempt equity shares held by affiliated section 20 subsidiaries from the other limitations in Regulation K, such as the dollar limitations on dealing authority and other limits applicable to dealing accounts. The Board has adopted both its proposal and clarifications that exclude shares held by affiliated section 20 subsidiaries from the dollar amount limitations on dealing authority and the aggregate limit on impermissible investments applicable to dealing accounts. However, shares held in dealing accounts of affiliated section 20 subsidiaries must be included in determining compliance with the percentage limitations under Regulation K on voting and total equity ownership of companies engaged in impermissible activities.

In addition, one comment requested that the Board modify the restriction on purchases and sales of assets applicable

to section 20 companies to clarify that a foreign securities subsidiary may subunderwrite a portion of its underwriting liability to its section 20 affiliate and transfer securities to the latter in connection with the underwriting. The Board does not believe that the revision of Regulation K is the appropriate context in which to amend the restrictions applicable to section 20 companies.

Portfolio Investment Authority

Regulation K currently permits U.S. banking organizations to make a passive portfolio investment in less than 20 percent of the voting shares of a foreign company without regard to the nature of its non-U.S. activities.⁵ The regulation does not currently expressly limit total equity ownership — that is, ownership of voting and non-voting equity shares — although there is a requirement that the investment be non-controlling. The regulation also currently imposes an aggregate limit on all investments in companies engaged in impermissible activities (including securities held in trading or dealing accounts and underwriting commitments for shares) of 100 percent of the investor's capital and surplus. An investor is either a bank holding company, Edge corporation, or foreign bank subsidiary of a member bank, depending upon which entity holds the investment. The Board proposed a number of amendments to this authority.

First, the Board proposed to limit the total equity investment a U.S. banking organization would be able to make under the portfolio investment authority to 24.9 percent, which was derived from the limit on total equity ownership for non-controlling investments under Regulation Y. Unlike domestic non-controlling investments, however, up to 19.9 percent of the equity could be in the form of voting shares as currently provided in Regulation K. In addition, the Board proposed an exception to the 24.9 percent total equity limit to permit banking organizations to make small portfolio investments in up to 40 percent of the total equity of a company, provided that the total amount of equity investments in, and loans to, the foreign company would not exceed the

⁵ As noted in the discussion on equity securities activities above, this limitation also previously included underwriting commitments for voting shares and voting shares held in dealing accounts. As Regulation K has been revised, underwriting commitments are excluded in determining compliance with the 19.9 percent limitation on voting shares and the 40 percent limitation on total equity of companies engaged in impermissible activities.

proposed general consent limit of \$25 million.

Second, the Board proposed to define "equity" to encompass various forms of instruments conferring rights of ownership, including loans that give rights to participate in the profits of an organization, and, as currently under Regulation K, subordinated debt when the investor also holds shares of the company. This approach recognizes that many types of hybrid instruments confer ownership interests that are equivalent to equity interests. The proposal also provided, however, that an investor could seek a specific determination from the Board that participating loans or subordinated debt would not be considered equity in the circumstances of a particular investment.

Third, the Board proposed to lower the aggregate portfolio investment authority for bank holding company investors to 25 percent of the investor's Tier 1 capital.

The Board received thirteen comments on the proposed revisions to the portfolio investment authority. Two comments opposed any authority for U.S. banking organizations to make investments in nonfinancial companies. The other eleven comments opposed various aspects of the proposal as too restrictive. In light of the comments, the Board has modified the original proposal and has revised the portfolio investment provisions as described below.

Total Equity Ownership

Eight comments opposed the proposed 25 percent total equity limitation on investments in a nonfinancial company when the organization's exposure to the company exceeds \$25 million. The comments generally disagreed with the Board's position that large equity interests may impair credit judgments, with several comments noting that the procedures and approvals required in most banks for investments and credit judgments are entirely separate and that credit judgments are required to stand on their own.

The Board has revised the portfolio investment provisions to limit total equity ownership of a nonfinancial company to 40 percent, regardless of the size of the investment. This approach is consistent with interpretations of the current provisions of Regulation K that limited total equity positions in portfolio investments to 40 percent, a number derived from the maximum limitation on debt-for-equity investments in private sector, nonfinancial companies. The Board has adopted a 40 percent limitation for foreign portfolio

investments, rather than the domestic 24.9 percent limitation, in recognition that U.S. banks compete abroad with foreign banks that have the authority to make these types of equity investments. Under current practice, a U.S. banking organization may invest in up to 19.9 percent of a foreign firm's voting shares, and may also invest in additional non-voting equity in the company as long as the investment does not exceed a total of 40 percent of the company's total equity.⁶

In connection with these revisions to Regulation K, the Board reiterates that U.S. banking organizations may not exert control over nonfinancial companies in which they invest through the portfolio investment authority. Accordingly, a U.S. banking organization may not be involved in the operations of a company in which it makes a portfolio investment except to the extent necessary to protect its investment. This stipulation generally means that the U.S. banking organization would be able to appoint one—but not more than one—director to the board of directors of the company, if the organization has sufficient share ownership to elect one director. No officer, director, or employee of a U.S. banking organization would be permitted to be an employee or officer of the company in which the investment is made. Management agreements that give a right to participate in the day-to-day operations of a company are also contrary to the requirement that a portfolio investment must be passive.

Definition of "Equity"

Nine comments opposed the proposed definition of "equity" on the ground that it was overly broad. The term "equity" for purposes of the 40 percent limit on total equity ownership has been defined to include voting and nonvoting shares; quasi-equity instruments, such as warrants and other convertible instruments; and loans that give rights to participate in the profits of a company. This is a less stringent standard than proposed by the Board in that it excludes subordinated debt when determining the percentage of equity ownership. The Board continues to believe that ownership of warrants, other convertible instruments, and profit participation loans provide the holder with an equity interest in, and the potential to exercise influence over, a

⁶ In determining the percentage of shares of a foreign company held by a U.S. banking organization, shares held under Regulation K or any other authority are aggregated. The definitions of "joint venture" and "subsidiary" in Regulation K have been clarified to this effect.

company and should therefore be included for purposes of the limits on equity holdings. The percentage of equity ownership in a company is to be determined on a fully diluted basis where there are unexercised rights to shares.⁷

Definition of "Investment"

The term "investment" for purposes of both the dollar limitations under the general consent provisions and the aggregate dollar limit on portfolio investments has been defined to include all instruments incorporated within the definition of "equity," and also to include subordinated debt when the investor or an affiliate also owns 5 percent or more of the company's shares as an investment or in a dealing account. The provision for subordinated debt represents a liberalization of both the proposal and the existing regulation in that both include subordinated debt if any shares are also owned by the investor or an affiliate. The *de minimis* 5 percent threshold is intended to permit a banking organization to hold a small investment or an inventory of a company's shares in a dealing account without being subject to the general consent dollar limitations when, for example, the banking organization makes a subordinated loan to the company.

Unlike the original proposal, senior loans would not be counted in the general consent dollar limitations. However, to address supervisory concerns about equity ownership affecting lending decisions, the regulation has been revised to require arms's-length lending decisions when the lender or an affiliate has an equity investment in the company. This requirement means, *inter alia*, that approvals of loans and equity investments are to be obtained by separate parts of a banking organization to ensure against conflicts of interest.

⁷ A number of comments raised concerns about the possible effect of incorporating the proposed definition of "equity" into the term "equity securities" as used in the underwriting and dealing authority, although this incorporation was not specifically proposed by the Board. The comments stated that such an incorporation would subject the underwriting and dealing of many kinds of debt instruments to the limitations on equity securities activities in Regulation K, even though as a general matter they are not currently subject to those limitations. The proposed definition of "equity" was not intended to carry over to "equity securities" for purposes of underwriting and dealing authority. Accordingly, the provisions of the regulation addressing the limitations on underwriting and dealing in equity securities use the term "shares" instead of "equity securities" in order to confirm that, consistent with current practice, debt instruments with limited equity characteristics do not come within the limitations on equity securities activities in Regulation K.

Aggregate Limitations on Portfolio Investments

The Board has adopted the proposal to lower the aggregate limit on portfolio investments in companies engaged in nonfinancial activities from 100 percent of capital and surplus to 25 percent of Tier 1 capital when the investor is a bank holding company. The limitations on aggregate holdings are designed to make certain that the overall capitalization of an investor is not impaired by market and other risks attendant to equity holdings in non-affiliated companies. The aggregate limit for portfolio investments by Edge corporations and foreign bank subsidiaries of member banks remains at 100 percent; however, consistent with the risk-based capital guidelines, the regulation has been revised to indicate that Tier 1 capital is the relevant standard rather than the current standard of capital and surplus.⁸

Six comments opposed the Board's proposal to decrease the aggregate portfolio investment authority for bank holding companies to 25 percent of Tier 1 capital. The comments were for the most part concerned with the inhibiting effect the proposal would have on their equity underwriting and dealing businesses. As noted above in the discussion on equity securities powers, equity shares of nonfinancial companies held in dealing and trading accounts and underwriting commitments for such shares are included in the aggregate limit on impermissible investments. The proposed 25 percent limitation for bank holding companies would not appear to constrain unduly the existing equity securities activities of such companies. In addition, as noted above, shares held in dealing accounts can be netted for purposes of determining compliance with this limit. The Board will, however, monitor future developments in this area to determine the continued appropriateness of the aggregate limitations.

Other Issues

One comment sought expanded authority to make portfolio investments in foreign companies that derive up to 10 percent of their consolidated assets and revenues from business in the United States. The Board has determined that such authority in the context of new investments in foreign companies would not be consistent with the requirement

⁸ Regulation K has been revised to state that Tier 1 capital is the relevant standard for all capital measures other than those implementing statutory restrictions based on capital and surplus.

in the Edge Act that investments in foreign companies be limited to those engaged only in U.S. business that is incidental to foreign business. Moreover, U.S. banking organizations already have the authority under Regulation K to invest in up to 5 percent of the voting shares of foreign companies engaged in business in the United States.

General Consent Procedures

The Board proposed to increase the dollar limitation on investments under the general consent provisions of Regulation K from \$15 million to \$25 million. Thus, a bank holding company, member bank, or an Edge corporation engaged in banking would be permitted to invest the lesser of \$25 million or 5 percent of its Tier 1 capital in activities and investments abroad permitted under Regulation K without providing the Board with prior notice of the investment.⁹ Permissible activities are those activities specifically listed in Regulation K that the Board has found to be usual in connection with the transaction of banking or other financial operations abroad. Under the general consent authority, U.S. banking organizations may also make portfolio investments in companies that engage in "impermissible," usually nonfinancial, activities, and in joint ventures and subsidiaries engaged largely in permissible activities abroad.

Dollar Limitations

The Board received eleven comments on the proposed liberalization of the general consent authority. One comment specifically opposed the proposal on the grounds that any expansion of foreign powers threatens the deposit insurance fund. Ten comments supported the liberalization although most of them would prefer more liberal authority in the form of either a larger dollar amount or a limitation based only upon a percentage of the investor's capital. The comments generally argued that a percentage of the investor's capital was a more accurate reflection of the exposure of a banking organization to a particular investment than an absolute dollar limitation.

Meaningful Board review of foreign investments has been a primary justification for giving U.S. banking organizations the authority to make investments in a wide range of activities through subsidiaries of U.S. banks abroad. The Board's proposal sought to balance the need for continuing

oversight — and to encourage more substantial internal review of such investments by banking organizations when a prior notice to the Board is required — against any inconvenience to the investors from Board review.

One of the factors that the Board considered in proposing this revision to the general consent limitations was that the existing limitations do not appear to be unduly burdensome. The general consent procedures — even with the \$15 million limitation — accommodated approximately 60 percent of the dollar amount of foreign investments and 80 to 90 percent of the total number of foreign investments by a sample group of eight multinational bank holding companies in 1988.

The Board proposed to increase the dollar limitation from \$15 million to \$25 million to reflect the average growth of the dollar amount of the Tier 1 capital of multinational banks since the last five-year review of Regulation K, which was slightly less than one-third, with a projection for the same amount of growth over the next five years. The Board does not believe that the comments provide any additional insights that have not already been considered by the Board. Moreover, there seems to have been no diminution of risk to the banking system over the past five years that would warrant more substantial liberalization at this time. Accordingly, the Board has adopted the general consent provisions as proposed.

Two comments proposed that the Board include subordinated debt in the definition of "historical cost" in Regulation K, because in certain cases Regulation K defines subordinated debt to be an investment in capital for purposes of the investment provisions. The historical cost of an investment is one of the factors used to determine the dollar amount of permissible additional investments that can be made in an organization each calendar year under the general consent provisions. The Board is of the view that, although it is appropriate to view subordinated debt as an investment in a company for regulatory purposes in certain circumstances where it functions much like preferred shares, subordinated debt should not be viewed as part of the historical cost of an investment because debt is contractually required to be repaid.

Exceptions for Joint Ventures and Subsidiaries Acquired as Going Concerns

Regulation K currently permits U.S. banking organizations to invest in (1) a joint venture that derives up to 10

percent of its assets and revenues from impermissible activities, that is, activities not on Regulation K's list of permissible activities, and (2) a subsidiary acquired as a going concern that derives up to 5 percent of its assets and revenues from impermissible activities. Three comments proposed that these allowances for impermissible activities be increased by various amounts, from 20 to 25 percent for joint ventures and 10 to 15 percent for subsidiaries. The Board is of the view that the existing standards already provide sufficient leeway for foreign investments in joint ventures and subsidiaries acquired as going concerns, while limiting the risks associated with impermissible investments, and that increases in the level of permissible activities such as those proposed would not be appropriate at this time.

Definition of Subsidiary

The Board proposed to clarify Regulation K by specifying that any company of which an investor or its affiliate is a general partner will be considered a subsidiary of the investor. This policy is consistent with definitions in Regulation Y and with existing interpretations under Regulation K. The rationale for this policy is that general partners usually have full management powers and full liability for partnership debt and commitments. Thus, general partners can be deemed to control the partnership. The comments did not object to this proposal and the definition of subsidiary has been revised to reflect this clarification.

Other Issues

The regulation has also been amended to clarify that, in computing the amounts that may be invested in a company under the general consent procedures of Regulation K, an investor must also include amounts that have been invested in the same company by the investor or its affiliates under any authority other than Regulation K. For example, if an investor proposes to make an investment in a company under Regulation K, an investment in the company held by a bank holding company under section 4(c)(6) of the BHC Act (12 U.S.C. 1843(c)(6)) must also be included for purposes of determining compliance with the general consent procedures.

Debt-for-Equity Investments

The Board amended Regulation K in 1987 and 1988 to permit specifically investments to be made by banking organizations for their own accounts

⁹ Edge corporations not engaged in banking would be able to invest the lesser of \$25 million or 25 percent of Tier 1 capital, without giving the Board prior notice.

through debt-for-equity swaps in heavily indebted countries, subject to certain limitations. As an analogy to the authority for banks to acquire investments to prevent a loss on debts previously contracted ("DPC"), the Board permitted a banking organization to acquire as a debt-for-equity investment as much as 100 percent of the shares of a foreign nonfinancial company being privatized by a heavily indebted foreign government. The Board also permitted a banking organization to acquire up to 40 percent of the equity of a private sector company in a heavily indebted country through a debt-for-equity swap, subject to certain limitations. Generally, a debt-for-equity investment in a nonfinancial company must be made through a bank holding company rather than a bank. However, Regulation K currently provides that in special circumstances, as permitted by the Board on a case-by-case basis, such debt-for-equity investments may be made by banks or their subsidiaries. Furthermore, Regulation K permits debt-for-equity investments to be made under special general consent procedures that require no prior notice to the Board unless the size of the investment exceeds the greater of U.S. \$15 million or one percent of the bank holding company's equity capital.

The Board proposed several technical modifications to the provisions of Regulation K governing debt-for-equity investments. First, the Board proposed to increase the general consent amount for debt-for-equity investments to the greater of \$25 million or 1 percent of Tier 1 capital (from the greater of \$15 million or 1 percent of equity capital). Second, the Board proposed to modify the reference to the procedures for exchanges of debt-for-equity to make clear that such procedures need not be pursuant to a formal government program as long as the procedures are otherwise permitted under applicable law or regulation. Along these lines, the Board proposed to adjust the divestiture requirement for debt-for-equity investments, which requires that investments be divested within two years after repatriation of the investment is permitted by the debtor country, with a maximum divestiture period of fifteen years. To take account of the fact that there may not be any restrictions on repatriation, the Board proposed the alternative of requiring divestiture within ten years of an acquisition, subject to extensions of time approved by the Board for up to an additional five years.

The Board received eight public comments on the debt-for-equity

investment proposal. The comments generally favored the technical modifications proposed by the Board, but recommended more substantive changes to the provisions of Regulation K governing debt-for-equity investments.

The Board has adopted the technical revisions discussed above. In connection with the divestiture requirement for debt-for-equity investments, the Board has also simplified the reporting requirements. In addition, in response to the requests for further revisions to the debt-for-equity procedures, the Board has adopted several substantive revisions to the regulation.

Cash Investment

The Board has revised the debt-for-equity investment provisions of Regulation K to allow U.S. banking organizations to make a relatively small new cash investment as part of a debt-for-equity investment in heavily indebted countries under the applicable general consent limit. Some heavily indebted countries that have sought to privatize government-owned companies in recent years have required that investors include a cash component in their bids to acquire such companies through debt-for-equity investments. The special provisions in Regulation K applicable to debt-for-equity investments do not generally permit additional cash investments without prior notice to, or approval from, the Board.

While this issue was not raised in written comments on the Board's proposal, discussions at various times between industry representatives and Board staff in connection with specific investments have indicated that U.S. banking organizations find the general consent provisions for debt-for-equity investments unduly limiting without the ability to include a cash component. Regulation K has been amended to permit a cash component for debt-for-equity investments under the special provisions of the regulation as long as the cash component does not exceed ten percent of the fair value of the debt being invested. As a condition of such investments, the Board expects that a reasonable judgment can be made that the likelihood of recovery from the investment would be greater than the potential risks of not collecting on the existing debt. In addition, if a larger cash component were required, the investor could request authority under other provisions of Regulation K.

Divestiture and Business in the United States

While the comments supported the Board's proposal to revise the divestiture requirement of Regulation K to take account of the fact that there is often no formal debt-for-equity program in eligible countries, five comments objected to the requirement that an investment in a foreign company be automatically divested if the company engages in business in the United States. The comments contended that the debt-for-equity investment itself is already subject to divestiture after a period of years and that foreign companies that engage in a limited U.S. business represent some of the best investment opportunities in heavily indebted countries. In response to these comments, the Board has eliminated the automatic divestiture requirement for debt-for-equity investments in companies that engage in a small level of business activities in the United States.

The Board has amended Regulation K to permit bank holding companies to retain, for the permitted holding period, debt-for-equity investments in companies that derive no more than 10 percent of their consolidated assets or revenues from activities conducted within the United States. To prevent any attempt to avoid the restrictions on the domestic activities of U.S. banking organizations, however, this authority excludes financial activities in the United States that otherwise require the Board's prior approval.

This revision will permit foreign companies in which U.S. banking organizations have invested through debt-for-equity swaps to engage in a greater amount of business in the United States than is currently permitted for other investments under Regulation K, where only U.S. activities otherwise incidental to the foreign business are permitted. The Board nevertheless believes that debt-for-equity investments can be distinguished from other types of investments with respect to their U.S. activities because, as noted by the comments, such investments are subject to a requirement of divestiture.¹⁰ In addition, the Board has determined that in the context of U.S. banking organizations seeking to manage their exposure to heavily indebted countries

¹⁰ There is some precedent for this type of distinction: when a foreign company in which a U.S. banking organization has invested subsequently commences activities in the United States, the U.S. banking organization is given a grace period before divestiture of the foreign company is required, albeit a much shorter period than the holding period permitted for debt-for-equity investments.

through investments in foreign companies with limited business in the United States, such U.S. business is incidental to foreign business as required by the Edge Act. Therefore, the Board has amended Regulation K to permit debt-for-equity investments in companies that derive no more than 10 percent of their consolidated assets or revenues from U.S. activities.

Dollar Limitations Under the Consent Procedures

As noted above, the Board has increased the maximum dollar amount limitations under the consent provisions for debt-for-equity investments from \$15 million to \$25 million. A number of comments suggested further increases in the maximum amount that could be invested under the special general consent provisions for debt-for-equity investments — from 1 to 2 percent of the Tier 1 capital of the investor. One comment also suggested a maximum general consent amount of 10 percent of the capital of the investor if the investor is an Edge corporation, while another suggested 3 percent. Two comments also urged that loans be excluded from the definition of "investment" for purposes of the provisions applicable to debt-for-equity investments.

In the Board's experience, few proposed debt-for-equity investments have exceeded the amount limitations of the general consent provisions for debt-for-equity investments and those that have were handled on an expedited basis, when requested by the banking organization. The Board has amended Regulation K, however, to provide additional leeway in the general consent procedures by excluding senior loans and extensions of credit from the definition of "investment" for purposes of the general consent procedures applicable to debt-for-equity investments.¹¹ Consistent with the definition of "investment" generally under Regulation K, which is discussed above, investments for purposes of the debt-for-equity provisions will continue to include subordinated debt and loans conferring rights to participate in profits of an organization when the banking organization also has an equity interest in the company. Thus, the same definition of "investment" will apply to both debt-for-equity investments and other investments under Regulation K.

¹¹ Bank holding companies making debt-for-equity in more than 25 percent of the voting shares of a private-sector company continue to be subject to the restriction in Regulation K that lending by the bank holding company and its affiliates to the foreign company may not exceed 50 percent of the total loans to the company.

Accordingly, the special definition of "investment" in the debt-for-equity provisions has been eliminated.¹²

Investment Vehicle

The proposed revisions to Regulation K discussed above will provide substantial additional authority for U.S. banking organizations to make debt-for-equity investments in heavily indebted countries; however, an issue addressed by several comments was the appropriate vehicle for such investments. Five comments recommended the elimination of the restriction requiring that debt-for-equity investments be held by or through the bank holding company unless the Board specifically approves an investment under the bank. One comment observed that requiring such investments to be held by the bank holding company or a subsidiary of a bank holding company may be inconsistent with the law of the country where the investment is taking place. Several of the comments stated that transferring debt from a bank to the bank holding company for purposes of making a debt-for-equity investment can raise tax and accounting issues. The comments advocated that the Board permit debt-for-equity investments to be made in nonfinancial companies through subsidiaries of the bank and not only subsidiaries of the bank holding company.

It should be noted that Regulation K currently permits debt-for-equity investments by Edge corporation and foreign bank subsidiaries of a bank under the portfolio investment provisions of Regulation K, including investments involving amounts in excess of the general consent limits, although the portfolio investment provisions limit ownership of voting shares to 19.9 percent. In response to the concerns expressed in the comments, however, the Board will give substantial consideration on a case-by-case basis to permitting debt-for-equity investments under the special provisions of Regulation K through Edge corporation and foreign bank subsidiaries of a bank. Regulation K has therefore been amended to provide more flexibility for the Board to approve such investments. In making such judgments on applications in this area, the Board will look closely at, among other factors, the existing and contingent risks posed to the bank by the proposed investment. After experience is gained with these

¹² The definitions of "loans and extensions of credit" and "eligible country" have been moved from the special debt-for-equity investment provisions of Regulation K to the definitions applicable to the entire regulation.

types of investments, the Board will consider implementing appropriate general consent authority for debt-for-equity investments under the special provisions of Regulation K through an Edge corporation or foreign bank subsidiary of a bank.

40 Percent Limitation on Shares of Private Sector Companies

Bank holding companies are permitted to acquire up to 40 percent of the equity of a private sector company under the special debt-for-equity provisions of Regulation K, subject to certain restrictions. Six comments recommended the elimination of the 40 percent of equity limitation on the shares that can be held in private sector companies that are acquired through debt-for-equity investments. These comments noted that some of the best investment opportunities are in the private sector in heavily indebted countries and that it appears to be inconsistent to limit investments in these private sector companies while permitting the acquisition of 100 percent of the equity in public companies being privatized, when such companies may present greater investment risks. One of the comments also suggested that if the 40 percent limit is not increased, then the Board should clarify that investments made by two or more U.S. banking organizations in the same company would not be aggregated for purposes of the 40 percent of equity limitation.

The Board continues to believe that the 40 percent limitation serves a useful purpose, namely to permit U.S. banking organizations to have a significant stake in private sector companies, while assuring that there would be substantial participation by other investors in such companies. The limitation is intended to assure that a U.S. banking organization does not bear primary responsibility for the risks associated with running nonfinancial enterprises. Limiting a debt-for-equity swap participation in a private sector company to a substantial, but minority, position should help protect against the possibility that a U.S. banking organization would be so linked to its investment in the private sector company that it would make imprudent loans to an ailing enterprise or be held responsible for the liabilities incurred by such companies. Therefore, — and in keeping with the total equity limitation on portfolio investments — the Board has retained the 40 percent equity limit on debt-for-equity investments in nonfinancial private sector companies. Unless there are other indicia of control,

however, separate debt-for-equity investments by two or more U.S. banking organizations in the same private sector company will not be aggregated for purposes of calculating the 40 percent limitation.

Edge Corporations

Domestic Powers

The Edge Act limits the powers of lending and deposit-taking by Edge corporations in the United States to transactions that the Board has determined are incidental to the international or foreign business of the Edge corporation. Thus, an Edge corporation is generally required to verify that every deposit-taking or credit transaction it conducts is related to an international transaction. There are certain exceptions to this requirement. First, Edge corporations may take all types of deposits from foreign persons and governments. Second, Edge corporations are permitted to provide general banking services — including lending and deposit-taking — to so-called qualified business entities ("QBE"), companies that are listed in Regulation K that by charter or license are engaged in activities of an international character, without having to document the international character of each transaction. The Board requested comment on whether there are other entities for which Edge corporations could appropriately act as full service banks in the United States.

Most of the comments expressed the view that the U.S. activities of Edge corporations were too restrictive for Edge corporations to remain competitive and proposed numerous revisions, although one comment opposed any expansion of the domestic powers of Edge corporations other than adding to the list of QBEs, as currently defined. Comments proposed expansive liberalization of both QBE authority and the permissible U.S. activities of Edge corporations. Eight comments stated that the QBE list should be expanded to include foreign correspondent banks generally, or foreign organizations whose assets or revenues are predominantly foreign and predominantly derived from the business of banking, that is, foreign organizations that qualify as qualified foreign banking organizations.

Domestic Lending and Other Banking Services to Foreign Persons

In response to these comments, the Board has substantially liberalized the domestic powers of Edge corporations by revising the regulation to permit Edge

corporations to offer full banking services, including credit services for U.S. purposes, to foreign persons.¹³ The Board has previously determined that the foreign status of a person or company constitutes a sufficient "international" nexus to meet the requirement in the Edge Act that Edge corporations engage only in "international or foreign business." At present, Edge corporations may take deposits from, but generally cannot make loans to, foreign persons for domestic purposes. Thus, the revision to Regulation K with respect to credit extensions and other banking services parallels current authority for Edge corporations to accept domestic deposits from foreign governments and persons. Edge corporations also continue to be able to provide full banking services for U.S. entities that are QBEs under Regulation K.

This revision will enable Edge corporations to participate in the domestic activities of their foreign customers, as requested by a number of comments. It will, for example, enable Edge corporations to offer a full range of services to foreign correspondent banks and to foreign insurance and reinsurance companies, as requested by several comments. Nine comments requested authority to provide standby letters of credit to their customers, regardless of whether the specific transaction has an international origin. The Board's revision to Regulation K will enable an Edge corporation to provide a domestic standby letter of credit as long as the customer is a foreign person. Similarly, the revisions should satisfy the desire, reflected in four comments, for authority for Edge corporations to provide domestic as well as international wire transfers for foreign-based customers.

Overdrafts

The existing regulation permits Edge corporations to receive deposits from foreign governments and foreign persons. The Board proposed to add to this provision the limitation that overdrafts in a deposit account may not be frequent and should be restored within a short period of time because overdrafts are essentially extensions of credit that are not authorized by the regulation. One comment opposed this new limitation, indicating that overdraft financing had been a good source of revenue.

¹³ This includes foreign governments and their agencies and instrumentalities; and offices or establishments located, and individuals residing, outside the United States.

The purpose of the proposed limitation was to limit extensions of credit in the form of overdrafts to foreign customers so that they would be consistent with the deposit-taking and credit authority of Edge corporations. In light of the Board's amendment that permits Edge corporations to make loans to foreign persons for any purpose, as discussed above, the Board has decided that this amendment is unnecessary.

Other Comments

Five comments advocated permitting Edge corporations to provide a full range of services for their parent banks. Such services would include funds transfers, check collection, and processing of letters of credit. These services are currently permissible where the transaction is related to international or foreign business. If the transaction is not related to international or foreign business, the Board takes the view that the Edge Act was not intended to permit an Edge corporation effectively to act as a branch of the parent bank.

Capitalization of Edge Corporations

The Board proposed changing the capitalization requirement for Edge corporations engaged in banking from 7 percent of risk assets to 10 percent of risk-weighted assets as computed under the risk-based capital standards, with at least half of that amount consisting of Tier 1 capital. The 10 percent standard is higher than the 8 percent ratio required by the Board for state member banks and bank holding companies. As with the 8 percent ratio, the proposed 10 percent standard is considered a minimum standard. In both cases, the Board continues to have supervisory discretion to impose higher standards as appropriate on the basis of the nature of the activities and the condition of the organization as a whole.

Most of the comments received on this proposal were strongly opposed to a ratio higher than 8 percent, which they deemed unfair and anticompetitive. They argued that the activities of Edge corporations were no more inherently risky than the activities of their parent banks and that the various risks inherent in the activities of Edge corporations were adequately taken into account in the new, risk-based capital standards. Three comments stated that the imposition of a 10 percent standard would greatly reduce their ability to issue letters of credit and participate in clearing activities.

Despite the objections of the comments, nearly all of the Edge corporations engaged in banking appear

to meet the 10 percent minimum standard and most are at substantially higher capital levels. The Board believes that the higher risk-based standard for Edge corporations is justifiable in light of the fact that Edge corporations are specialized U.S. deposit-taking entities that have unique risk characteristics, as compared to insured banks. Due to their specialized nature, Edge corporations currently have different capital standards than banks, and it should be noted that the proposed changes do not subject Edge corporations to the additional requirement of a leverage limit.

Accordingly, the Board has adopted a minimum 10 percent risk-based capital standard, with at least half that amount consisting of Tier 1 capital, effective December 31, 1992. However, because of restraints on investments in Edge corporations and their limited access to the markets, the Board will permit all of the Tier 2 capital of an Edge corporation to be comprised of subordinated debt. At present, Edge corporations may not count subordinated debt as capital. Until the new capital standards become effective, Edge corporations are required to abide by the current capital standards.

Emergency Meeting of Shareholders of an Edge Corporation

The Board proposed to amend Regulation K to require that the bylaws of an Edge corporation contain a provision giving the Federal Reserve Board the authority to call an emergency meeting of shareholders to address pressing problems of the Edge corporation. The Board has adopted this proposal. The regulation requires any shareholder or group of shareholders that own or control 25 or more percent of the shares, or a representative of such shareholder or group of shareholders, to attend the meeting or risk being barred from further direct or indirect participation in the management and affairs of the Edge corporation. This provision is designed to give the Board an alternative supervisory tool to a more time-consuming enforcement proceeding.

Two comments were received on this proposal. One comment opposed the proposal and another comment suggested that the regulation be revised to limit expressly the purpose for which the Board could call such a meeting to the discussion of serious problems of the Edge corporation. The Board has nonetheless adopted the requirement because it provides necessary authority to deal quickly and efficiently with

serious developing problems in an Edge corporation.

Additions to the List of Permissible Activities Abroad

Swap Activities

The Board proposed to add acting as principal or agent in swap transactions relating to currency or interest rate obligations and their derivative products to Regulation K's list of permissible activities. The Board received ten comments on this proposal, all of which opposed the proposal. One comment opposed the proposal on the grounds that such swap transactions present risks that threaten the deposit insurance fund. Nine comments opposed the proposal on the theory that (1) the authority under Regulation K to engage in commercial and other banking activities already provides foreign subsidiaries with the authority to engage in swap transactions, and (2) the limitation in the proposal to currency and interest rate obligations and their derivative products suggests that other such products, such as commodity swaps, are not covered, and therefore the proposal narrows the existing authority.

In recognition of the fact that national and state banks are currently engaged in some commodity-linked transactions under permission granted by their chartering authorities, the Board has amended Regulation K to permit U.S. banking organizations to engage in swap activities abroad, including commodity swaps, to the same extent that state member banks are permitted to engage in such activities domestically. Therefore, such activities would be permitted unless the Board takes action to prohibit or limit state member banks from engaging in a particular swap activity domestically.¹⁴ The Board intends to review the parameters for permissible swap activities for state member banks.

With respect to commodity-linked swap transactions there is, however, another issue. The Edge Act generally prohibits an Edge corporation from trading in commodities (12 U.S.C. 617). This requirement was generally intended to safeguard against Edge corporations attempting to control the prices of commodities. Thus, to the extent that U.S. banks are authorized to engage in commodity swap transactions and such transactions are not prohibited or limited for state member banks, the authority for Edge corporations to

¹⁴ Swap transactions involving equity derivative products are separately authorized under Regulation K as incidental to equity securities powers.

engage in such activities abroad is limited to contracts with an option for cash settlement. This requirement is intended to prevent foreign subsidiaries of Edge corporations from taking delivery of commodities in settlement of swap contracts, thereby trading in the commodities themselves in violation of the statutory prohibition.

Life Insurance Underwriting

The Board proposed to add the underwriting of life insurance and other actuarially predictable risks to the list of permissible overseas activities, subject to the requirements that (1) the activity be conducted through a bank holding company subsidiary, and (2) capital investments in, and unsecured extensions of credit to, an insurance underwriting subsidiary be deducted from the regulatory capital of the bank holding company.

Ten comments supported the Board's proposal to add life insurance underwriting to the list. Six of the comments objected, however, to the requirement that the activity be conducted through a subsidiary of a bank holding company and not a subsidiary of a bank. Six comments also opposed the requirement of a capital deduction. Several of the comments maintained that such requirements should not be necessary given the Board's determination that underwriting actuarially predictable risks does not present undue risks to U.S. banking organizations.

The Board has added the underwriting of life insurance, insurance written in connection with pension funds and annuities, and the underwriting of other actuarially predictable risks to the list of permissible activities abroad under Regulation K, subject to the above-stated requirements. Unlike securities activities, insurance underwriting has not traditionally been conducted by banks through their Edge corporation and foreign bank subsidiaries. As a result, the Board believes it is appropriate to require life insurance underwriting abroad to be conducted generally through a subsidiary of a bank holding company and not a bank. Moreover, a deduction from regulatory capital is appropriate because, although banking and insurance may be complementary activities and may even at times offer functionally equivalent products, some of the risks are sufficiently different from banking that the most appropriate method for evaluating capital adequacy is on an unconsolidated basis. Such an approach is consistent with the Basle agreement.

The addition of annuity and pension fund-related insurance underwriting responds to the request of one comment for clarification as to the types of activities contemplated by the provision with respect to "other actuarially predictable risks." These types of activities have previously been approved by the Board on a case-by-case basis.¹⁵

FCM Activities

The Board proposed to add futures commission merchant ("FCM") activities on exchanges that the Board has previously approved to the list of permissible activities in Regulation K, subject to the requirement that any activities by foreign subsidiaries of U.S. banks on mutual exchanges or any activities involving nonfinancial instruments or their derivative products continue to require the Board's prior approval.

Three comments opposed the Board's proposal. Two comments objected on the basis that FCM activities are risky and threaten the deposit insurance fund. One comment generally objected to the proposal because it would require FCMs that are operating subsidiaries of national banks to obtain the approval of both the Board and the Comptroller of the Currency ("Comptroller") before becoming members of mutual exchanges abroad.

Seven comments generally supported the Board's proposal. Five of those comments recommended, however, that the Board also permit the brokerage of nonfinancial instruments without prior Board approval because, the comments maintained, the brokerage function and risk are no different for financial and nonfinancial futures. Three comments noted that the Comptroller permits the brokerage of nonfinancial futures.

The Board is of the view that the addition of FCM activities with respect to financial instruments is an appropriate addition to the list of permissible activities, particularly given that such activities are permissible domestically under Regulation Y. The Board, however, does not believe it is appropriate to add the brokerage of

nonfinancial instruments to Regulation K's list of permissible activities at this time because such "nonfinancial" activities present additional risks for banking organizations in nontraditional areas where they have little experience and expertise. Accordingly, as proposed, the Board has added FCM activities on exchanges that the Board has previously approved to the list of permissible activities in Regulation K.¹⁶ The Board has nevertheless limited such authority to financial instruments of the type it has previously approved under Regulation K. Basically, these include instruments with respect to which FCM activities have been authorized domestically under Regulation Y (12 CFR 225.25(b)(18)) and the foreign equivalents of such instruments, including futures and options on stock indices, bond indices, other interest rate contracts, and foreign exchange contracts. The Board would expect U.S. banking organizations to consult with Board staff when there is a question as to whether a product is a financial instrument of the type previously approved by the Board.

The Board also proposed to require prior approval for foreign subsidiaries of U.S. banks to engage in FCM activities on any mutual exchange. Two comments noted that this requirement would encompass mutual exchanges that the Board had previously approved and proposed that the Board require prior approval for bank subsidiaries to become members of mutual exchanges only when the Board has not previously approved the particular mutual exchange. One comment recommended that the prior approval requirement for mutual exchanges be eliminated when the exchange acknowledges that the parent bank is not liable for its subsidiary's obligations to the exchange.

Upon further review, because of the risks associated with mutual exchanges, the Board will require prior approval for foreign subsidiaries to engage in FCM activities on a mutual exchange, regardless of whether the parent of the foreign subsidiary is a bank or a bank

holding company. In response to the comments regarding mutual exchanges that the Board has previously approved, however, the Board has delegated to Reserve Banks the authority to approve applications to become members of mutual exchanges, provided that the mutual exchange has previously been approved by the Board and membership is on the same basis, and subject to the same terms and conditions, as that which the Board has previously approved. This requirement generally means that a Reserve Bank has the authority to approve such applications if the applicant has made the same commitments as the commitments on which the Board relied in previously authorizing membership on that mutual exchange. Approval for any new exchange, including any new mutual exchange, would continue to be granted by the Board.

Other Activities

Two comments recommend that the Board add Islamic banking products, such as purchase and repurchase arrangements involving goods and real property, which the comments maintained are the functional equivalent of extensions of credit, to the list of permissible activities. The Board recognizes that such activities may be usual in connection with the transaction of banking or other financial operations in certain foreign jurisdictions, and in that situation a banking organization may seek the Board's prior approval to engage in the activities in that jurisdiction. In the Board's view, however, such activities are not so prevalent or necessarily generically the same so as to warrant addition to the list of permissible activities in all foreign jurisdictions.

Another comment proposed that the current leasing authority in Regulation K, which is limited to leasing that is the functional equivalent of credit, be broadened to reflect recent changes domestically in leasing powers for banks and bank holding companies. For example, the Board has proposed to amend the list of permissible activities for bank holding companies in Regulation Y to include leasing transactions that rely upon an estimated residual value of up to 100 percent of the acquisition cost of the property leased (See 55 FR 22346 and 23446). Because the list of permissible activities in Regulation K incorporates activities permissible under Regulation Y, such leasing activities would be permissible under Regulation K if any revisions are made to Regulation Y. Accordingly, the

¹⁵ Specifically, the Board has approved: (1) underwriting life insurance in the United Kingdom, Federal Republic of Germany, and Australia; (2) underwriting credit insurance not directly related to extensions of credit by affiliates, savings completion insurance, and home loan life insurance and endowment life insurance related to mortgage lending activities of affiliates, in Belgium and Luxembourg; (3) underwriting pension fund-related insurance and disability insurance in connection with Chilean mandated worker pensions; (4) underwriting retirement-related life insurance in Argentina; and (5) underwriting permanent health insurance in the United Kingdom.

¹⁶ The Board, under Regulation K, has approved FCM activities for certain banking organizations on the London Gold Futures Market; the London International Financial Futures Exchange; the Singapore International Monetary Exchange; the Sydney Futures Exchange; the Tokyo Stock Exchange; the Marche a Terme d'Instruments Financiers, Paris; the Hong Kong Futures Exchange; the Bolsa Mercantil & de Futuros Exchange, Sao Paulo; the Bolsa de Mercadorias de Sao Paulo; the Bolsa Brasileira de Futuros, Rio de Janeiro; the Amsterdam Financial Futures Market; the Tokyo International Financial Futures Exchange; the DTB Deutsche Terminborse; the New Zealand Futures and Options Exchange Limited, Auckland; and the Osaka Securities Exchange.

Board does not believe it is necessary to expand the leasing authority in Regulation K at this time.

Finally, one comment requested that the Board add real estate brokerage and management, and pension fund administration to the list of permissible activities. The Board has approved these activities in a limited number of instances on a case-by-case basis. The Board continues to believe that such activities are best addressed in connection with a case-by-case review of the nature of each of the activities and the usualness of each activity in the proposed foreign jurisdiction, rather than by adding such activities to the list of permissible activities in Regulation K. More specifically, absent the Board's specific approval, U.S. banking organizations should not engage in real estate development through any combination of authorities for permissible activities.

Qualifying Foreign Banking Organizations

Regulation K implements statutory exemptions from the BHC Act for certain activities of foreign banks. These exemptions are granted to qualifying foreign banking organizations ("QFBOs"). In order to be deemed a QFBO, the foreign banking organization generally must derive more than half of its non-U.S. business from banking and more than half of its banking business from outside the United States. Banking business is defined to include any activity listed as permissible in Regulation K, if such activities are conducted in the bank ownership chain, that is, by the foreign bank or a subsidiary of the foreign bank.

The Board requested comments on several issues under Regulation K to address the increasing number of foreign affiliations between banks and other financial services companies, including insurance companies. In particular, the Board was concerned about foreign acquisitions that could prevent a previously qualifying foreign bank from satisfying the QFBO standard and the related extraterritorial effects of the Board's regulation. The proposals were to:

1. Add underwriting life and related insurance to the list of activities that are permissible for a U.S. banking organization abroad so that insurance activities conducted in the bank ownership chain would contribute toward a banking organization's qualification under the QFBO test.

2. Exercise the Board's discretion on a case-by-case basis to grant specific determinations of eligibility under the QFBO standard to prevent hardships to foreign financial

services companies that are engaged largely in activities permissible to U.S. bank holding companies abroad.

3. Amend Regulation K to state that specific determinations of eligibility would generally not be granted to a foreign industrial or commercial company that owns a foreign bank or to a company that derives less of its commercial banking business from outside the United States than it derives from inside the United States. In this context a commercial banking business means a banking business conducted through a regulated foreign commercial bank.

4. Modify Regulation K to permit a previously qualifying organization that falls out of compliance with the QFBO standard to continue to conduct activities and make acquisitions abroad without prior Board review until such time as the Board acts on a request for exemption from the QFBO standard.

The Board received twelve public comments on these issues. Most of the comments supported the Board's proposal, but some comments stated that the Board did not go far enough to avoid undue extraterritorial application of U.S. law to the activities of foreign banking organizations. Many of the comments provided extensive, detailed suggestions for liberalizing the QFBO standard, expanding the permissible activities of QFBOs, and clarifying means of compliance with the QFBO exemptions.

Definition of Banking under the QFBO Test

The comments supported the Board's decision to expand the kinds of activities that U.S. banks may conduct abroad to include life insurance, recognizing that this proposed change will help international banks that acquire insurance companies to meet the QFBO standard. A number of comments, however, proposed further expansion of the definition of "banking assets" for purposes of determining compliance with the QFBO standard. The proposals varied widely, including a proposal that the Board consider any activity permitted by the home regulator as "banking" and several proposals that the Board eliminate the requirement that banking activities be conducted in the bank ownership chain for purposes of determining compliance with the QFBO standard. These comments argued that the current rules do not accommodate a bank holding company structure because the activities conducted by the subsidiaries held outside of the bank ownership chain do not count towards qualifying status.

These issues were considered in connection with the proposed revisions to Regulation K. The Board determined

that, because of the many unknown varieties of corporate combinations that may exist outside the United States, it is preferable at this time to retain the existing standard and to permit case-by-case exemptions rather than to create a new standard. In addition, a new standard could be considered after more experience is gained with respect to the ongoing consolidations in Europe and elsewhere. A number of comments expressly noted their support for the case-by-case exemptive procedure proposed by the Board to grant interim authority to non-qualifying foreign banking organizations to continue their activities outside the United States while their request for exemption is under consideration. Accordingly, the Board has adopted the four proposals listed above. It should be noted, however, that the temporary authority to engage in activities abroad prior to the Board's determination of an exemption from the QFBO standard would be provided only to foreign organizations that previously satisfied the QFBO standard and to affiliates of such organizations, but not to organizations that have never satisfied, and are not affiliated with organizations that previously satisfied, the QFBO test.

A number of comments also suggested that the Board provide certain grandfather rights to QFBOs, including QFBOs that have fallen out of compliance. One comment suggested grandfather rights for a QFBO that falls out of compliance because the growth of its U.S. banking operations exceeds that of its worldwide banking business. Two comments suggested that the Board grandfather U.S. insurance and banking operations that pre-date an affiliation outside the United States.

The Board has not adopted any provisions that provide grandfather rights for QFBOs. The first suggestion is in part dealt with by the Board's decision to treat certain foreign insurance activities conducted in the bank ownership chain, or otherwise permitted by the Board on an exemptive basis, as foreign "banking" activities. Where such grandfather rights would permit a foreign organization to develop substantial U.S. banking operations without the support of a foreign bank parent of nearly equivalent size, broader issues of supervisory and regulatory policy are raised. The second suggestion, if permitted on a permanent basis, would give foreign banks a significant competitive advantage over U.S. banking organizations.

Exemptions for Nonbanking Activities of QFBOs

QFBOs are granted authority in two respects under Regulation K to engage in certain nonfinancial activities within the United States that are impermissible for domestic bank holding companies. First, Regulation K implements section 2(h)(2) of the BHC Act (12 U.S.C. 1841(h)(2)) by authorizing a QFBO to control a foreign company that is engaged directly or indirectly in nonfinancial activities in the United States, provided that (1) more than 50 percent of the foreign company's assets and revenues derive from outside the United States, and (2) the U.S. activities of the foreign company are in the same line of business as its foreign activities. Second, Regulation K implements section 4(c)(9) of the BHC Act (12 U.S.C. 1843(c)(9)) by permitting a QFBO to engage directly in the United States in activities incidental to its activities outside the United States and to own or control the voting shares of a company engaged in U.S. activities that are incidental to the international or foreign business of such company.

Comments proposed introducing into Regulation K a basket exemption for small foreign venture capital investments, without regard to the U.S. activities of such companies. Section 2(h)(2) of the BHC Act authorizes foreign banking organizations to invest in foreign companies that are "principally engaged in business outside the United States." Under the proposed basket exemption there would be no way to ensure compliance with the statutory requirement, and such an exemption would provide a foreign banking organization with business opportunities unavailable to U.S. banking organizations.

One comment suggested that the Board should establish a "safe harbor" presumption of non-control for investments in a foreign company by a QFBO. The comment further suggested that the standard for control in Regulation K should not be as stringent as that in Regulation Y because of the extraterritorial consequences. The Board has not adopted these suggestions because they would allow foreign banking organizations to make significant equity investments in foreign companies conducting business in the United States that would be impermissible for U.S. bank holding companies.

A comment also asked that the Board make it clear that the Board will not apply its policy guidelines limiting nonvoting equity investments by bank holding companies (See 12 CFR 225.143) to foreign venture capital investments

that may engage in impermissible activities in the United States. For purposes of foreign banking organizations, Regulation K assumes control to exist at any level of share ownership in excess of 24.9 percent of voting shares. Whether ownership of voting shares below that level could constitute control is a question of fact and depends upon whether there are other indicia of control.

Compliance Issues Related to QFBOs

The proposal and comments also raised a number of issues concerning the method of determining compliance with certain exemptions from the BHC Act available to QFBOs. As noted above, in implementing the exemption in section 2(h)(2) of the BHC Act for investments in foreign companies with U.S. business, Regulation K requires that (1) 50 percent of the foreign company's consolidated assets and revenues derive from outside the United States, and (2) the U.S. activities of the foreign company be in the same line of business as the activities of the foreign company abroad. In computing the amount of business of a foreign company that is conducted outside the United States, assets and revenues are considered to be derived from outside the United States unless the assets are located in, or revenues generated by, the U.S. offices of the foreign company. Thus, the test is based on the location of the offices conducting the business and not the residency of the customers of the foreign company.

50 Percent Requirement

The requirement that 50 percent of the foreign company's consolidated assets and revenues derive from outside the United States is designed to implement the statutory requirement that the foreign company be "principally engaged in business outside of the United States." One comment stated that the Board has not made clear the dates or periods of time that are to be used in determining compliance with the consolidated assets and revenues tests. Although the Board does not believe that this has been an area of confusion, it should be noted that financial information as of the previous fiscal year should be used unless there is more recent information readily available.

The comment also suggested that Regulation K could be amended to clarify that where a foreign bank does not actually control a company, the foreign bank should be entitled to rely on information that is "reasonably available" to it for purposes of the

Board's regulation. The regulation currently includes a provision permitting reliance on reasonably available information; however, to remedy possible confusion as to the types of reports to which the provision is applicable, the Board has made certain technical amendments to the regulation to the effect that this provision applies to all reports on minority investments by foreign banks required under Regulation K.

This comment also proposed grandfathering investments that satisfy the 50 percent test at the time of investment but, because of changes beyond the control of the investor, subsequently cease to satisfy the 50 percent test. The Board has rejected this suggestion because it is inconsistent with the statutory requirement that foreign companies be "principally engaged in business outside the United States."

Noting the hardship imposed by a divestiture requirement for nonqualifying investments, the comment also proposed that if a company falls out of compliance with the assets or revenues test, the foreign bank should generally be given two years from that date to sell the investment. The Board has revised Regulation K to provide that if the investment fails to satisfy the 50 percent test for two consecutive years, the QFBO may either divest the investment within one year or seek the Board's specific approval to retain the investment for a longer period.

Same Line of Business Requirement

Regulation K looks to the Standard Industrial Classification (the "SIC") to determine whether activities are in the same line of business for purposes of the section 2(h)(2) exemption. The SIC was modified in 1987. The Board proposed to revise the references to the SIC in Regulation K to reflect the new SIC categories. No public comments were received on the issue. Thus, the Board has revised the references to the SIC in Regulation K as proposed.

Lending by Foreign Bank Subsidiaries of U.S. Banking Organizations to U.S. Residents

Although the Board did not solicit comments on this topic, three comments recommended that the Board rescind its policy which prohibits foreign bank subsidiaries of U.S. banking organizations from making loans to U.S. residents except for international purposes.¹⁷ The comments contended

¹⁷ Letter, dated November 13, 1970, from Kenneth A. Kenyon to American International Bank ("AIB").

Continued

that U.S. banking organizations are competitively disadvantaged by this requirement because foreign banks are permitted to make loans to U.S. residents.

The Board's decision to impose this restriction in 1970 was based in large part upon concern that permitting foreign subsidiaries of U.S. banking organizations to make loans to U.S. residents would permit avoidance of reserve requirements, as loans by foreign subsidiaries to U.S. residents would not be subject to the reserve requirements that would apply to such loans if made by the parent bank or its foreign branches. In light of the Board's recent decision to reduce to a rate of zero the reserve requirements on nonpersonal time and net Eurocurrency transactions, the incentive for banks to encourage foreign subsidiaries to make domestic loans in order to avoid reserve requirements no longer exists. Accordingly, the Board has suspended the prohibition against lending by foreign bank subsidiaries of U.S. banking organizations to U.S. residents for domestic purposes, as long as reserve requirements on nonpersonal time and Eurocurrency transactions are set at zero.

Powers of Foreign Branches of Member Banks

Investing, Underwriting, and Dealing in Government Obligations

Foreign branches of member banks are permitted to (1) invest in the securities of "governmental entities" of the country in which the foreign branch is located, and (2) to underwrite, distribute, buy, and sell obligations of "an agency or instrumentality of the national government of the country in which the branch is located." The former authority is limited to 1 percent of the total deposits of the bank's branches in that country and the latter authority is limited to 10 percent of the bank's capital and surplus. The Board proposed to limit both authorities to obligations or securities that are supported by the taxing authority or the full faith and credit of the national government.

Four comments opposed the proposed limitation to "full faith and credit" obligations of the national government as too restrictive. The Board proposed this amendment because the question of what constitutes the security of a governmental entity or the obligation of an instrumentality of a national

government has been raised in connection with several proposed foreign investments. The Board has adopted its proposal to define obligations of an agency or instrumentality as those supported by the taxing authority or full faith and credit of the national government to provide clarity as to what is intended by the regulation. The Board has, however, defined the authority to invest in securities of governmental entities to include securities of governmental entities not supported by the taxing authority or full faith and credit of the national government. The Board has clarified that the authority to underwrite, distribute, buy, and sell obligations, includes the authority to hold such obligations; thus the authority to invest in securities of governmental entities under this provision is authority in addition to the authority for investments in obligations of an agency or instrumentality.

Several comments requested that the Board increase the additional authority to invest in securities of governmental entities from 1 percent to 5 or 10 percent of the deposits of a bank's branches in that country. Because this authority includes securities that are not supported by the full faith and credit of the national government, the Board has not expanded the authority. However, the Board has revised the authority to underwrite, distribute, buy, sell, and hold governmental obligations supported by the full faith and credit of the national government from 10 percent of a member bank's capital and surplus to the greater of 10 percent of a member bank's Tier 1 capital or 10 percent of the deposits of a bank's branches in that country.

Six comments requested that the Board remove the limitations in the authority to invest in, and underwrite and deal in, obligations of a foreign government that restricts such authority to the country in which the branch is located. The comments noted the globalization of financial markets and stated that eliminating the restriction would give branches additional flexibility in managing their assets and would give banks greater flexibility in organizing their government securities activities. The Board has rejected this suggestion because it would permit banking organizations to build global government securities operations in a branch of the bank rather than through a separate subsidiary, which is contrary to the Board's policy of protecting insured banks from the direct risk of securities activities.

Finally, the term "political subdivision" has been substituted for the current language of "municipality or other local or regional governmental entity." This term is generally intended to mean municipalities or local or regional governments with independent taxing authority.

Operating Subsidiaries

Regulation K currently permits foreign branches, with the Board's specific approval, to establish wholly-owned subsidiaries where required by local law. The Board's proposal removed the condition that such subsidiaries be required by local law. A number of comments supported this proposal and some requested even broader authority to establish operating subsidiaries, including elimination of the requirement that such subsidiaries be wholly-owned by the branch. The Board has adopted its proposal, thereby removing the restriction that such subsidiaries be required by local law. This revision will give U.S. banking organizations greater flexibility in their foreign operations by permitting them, with the approval of the Board, to establish operating subsidiaries in countries where a bank operates a branch whenever permitted — rather than required — by local law. In addition, in response to the comments that in some foreign jurisdictions 100 percent ownership of an operating subsidiary by a branch may not be legally permissible, the Board has revised the authority to permit less than 100 percent ownership where local law or regulation requires local investors to hold directors' qualifying shares or equivalent types of share interests. Any investments by a branch in an operating subsidiary, however, are subject to the Board's prior approval and the Board would not generally expect investments by another investor to be substantial.

Export Trading Companies

The Board proposed to amend formally its provisions governing export trading companies to conform with certain standards mandated by Congress in the Omnibus Trade and Competitiveness Act of 1988 (P. L. 100-418). The Board has previously implemented the statutory requirements administratively. The Board proposed to (1) neutralize the effect of third party transactions for purposes of determining whether a company is a permissible bank-affiliated export trading company; (2) provide companies with a longer period to satisfy the revenues test for purposes of determining their status as a permissible export trading company; and (3) eliminate certain Board

regarding AIB's investment in Henry Ansbacher & Co., Limited, London, England (the "Ansbacher letter").

Delegation Rules regarding leverage ratios and dollar amounts of inventory for bank-affiliated export trading companies.

The Board received two comments on this proposal. One banking organization stated that the amendments would be useful. In addition, the United States Department of Commerce ("Commerce"), which has a role in implementing other aspects of the Bank Export Services Act, the statute that authorizes bank-affiliated export trading companies, generally supported the proposed revisions. Commerce suggested, however, an amendment to the Board's proposal that would have the effect of permitting revenues derived from third country trade to be considered as derived from the export of a service produced in the United States. Under this approach, such revenues could be counted as derived from exports for purposes of satisfying requirements for export trading company status. This issue was raised at the time the statute mandating these amendments was adopted and the proposal was rejected by the Congress. Accordingly, the Board has adopted the revisions with regard to export trading companies as proposed without making the revision requested by Commerce.

Other Technical Revisions

Other technical revisions that are not substantive in nature have been made to Regulation K to clarify existing provisions.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that this final rule will not have a significant economic impact on a substantial number of small entities that are subject to the regulation.

List of Subjects

12 CFR Part 211

Accounting for fees on international loans, Allocated transfer risk reserve, Banking, Banks, Export trading companies, Exports, Federal Reserve System, Foreign banking, Holding companies, Investment made through debt-for-equity conversions, Investments, Reporting and recordkeeping requirements, Reporting and disclosure of international assets.

12 CFR Part 265

Authority delegations (Government agencies), Federal Reserve System.

For the reasons set forth above, the Board has amended 12 CFR part 211,

subparts A, B, and C, and part 265 as follows:

PART 211—INTERNATIONAL BANKING OPERATIONS

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

Authority: Federal Reserve Act (12 U.S.C. 221 *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); the International Lending Supervision Act (Title IX, Pub. L. 98-181, 97 Stat. 1153, 12 U.S.C. 3901 *et seq.*); and the Export Trading Company Act Amendments of 1988 (Title III, Pub. L. 100-418, 102 Stat. 1384 (1988)).

2. Subpart A (§§ 211.1 through 211.7) is revised to read as follows:

Subpart A—International Operations of United States Banking Organizations

Sec.

- 211.1 Authority, purpose, and scope.
- 211.2 Definitions.
- 211.3 Foreign branches of U.S. banking organizations.
- 211.4 Edge and Agreement corporations.
- 211.5 Investments and activities abroad.
- 211.6 Lending limits and capital requirements.
- 211.7 Supervision and reporting.

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") (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 in international banking and for investments in foreign organizations.

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

- (1) Corporations organized under section 25(a) of the FRA (12 U.S.C. 611-631), "Edge corporations";

- (2) Corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601-604a), "Agreement corporations";

- (3) 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

- (4) 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 Adequacy Guidelines* means the Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (12 CFR part 208, app. A).

(c) *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.

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

(e) *Eligible country* means a country that, since 1980, has restructured its sovereign debt held by foreign creditors, and any other country that the Board deems to be eligible.

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

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

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

- (1) Voting or nonvoting shares;
- (2) General or limited partnership interests;

- (3) Any other form of interest conferring ownership rights, including warrants, debt, or any other interests

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).

that are convertible into shares or other ownership rights in the organization; or

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

(i) *Foreign or foreign country* refers to one or more foreign nations, and includes the overseas territories, dependencies, and insular possessions of those nations and of the United States, and the Commonwealth of Puerto Rico.

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

- (1) Is organized under the laws of a foreign country;
- (2) Engages in the business of banking;
- (3) Is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations;
- (4) Receives deposits to a substantial extent in the regular course of its business; and
- (5) Has the power to accept demand deposits.

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

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

(m) *Investment* means:

- (1) The ownership or control of equity;
- (2) Binding commitments to acquire equity;
- (3) Contributions to the capital and surplus of an organization; and
- (4) The holding of an organization's subordinated debt when the investor and the investor's affiliates hold more than 5 percent of the equity of the organization.

(n) *Investor* means an Edge corporation, Agreement corporation, bank holding company, or member bank.

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

(p) *Loans and extensions of credit* means all direct and indirect advances of funds to a person made on the basis of any obligation of that person to repay funds.

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

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

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

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

(1) 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

(2) Does not have authority to make business decisions for the account of the organization represented.

(u) *Subsidiary* means an organization more than 50 percent of the voting shares of which is held directly or indirectly, or which is otherwise controlled or capable of being controlled, by the investor or an affiliate of the investor under any authority. Among other circumstances, an investor is considered to control an organization if the investor or an affiliate is a general partner of the organization or if the investor and its affiliates directly or indirectly own or control more than 50 percent of the equity of the organization.

(v) *Tier 1 capital* has the same meaning as provided under the Capital Adequacy Guidelines (12 CFR part 208, appendix A).

§ 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 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 countries may establish a branch in an additional foreign country, unless notified otherwise by the Board.²

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.

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

(i) The national government of the country in which the branch is located;

(ii) An agency or instrumentality of the national government where supported by the taxing authority, guarantee, or full faith and credit of the national government; and

(iii) A political subdivision of the country;

Provided however that, no member bank may hold, or be under commitment with respect to, such obligations for its own account in an aggregate amount exceeding the greater of:

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

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

(3) *Other Investments.* Invest in:

(i) The securities of the central bank, clearing houses, governmental entities other than those authorized under

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.

paragraph (b)(2) of this section, 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 automated electronic payments networks, professional societies, schools, and the like necessary to the business of the branch; Provided however that, 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 1 percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or on the date of acquisition of the branch in the case of a branch that has not so reported);

(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 however that:

(i) The credit extension is reported promptly to the branch's home office; and

(ii) 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, acquire all of the shares of a company (except where local law requires other investors to hold directors' qualifying shares or similar types of instruments) that engages solely in activities:

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

(ii) That are incidental to the activities of the foreign branch; 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.* Member banks shall maintain reserves against foreign branch deposits when required by part 204 of this chapter (Regulation D).

§ 211.4 Edge and Agreement corporations.

(a) *Organization.*—(1) *Board authority.* The Board shall have the authority to approve:

(i) The establishment of Edge corporations; and

(ii) Investments by member banks and bank holding companies in Agreement corporations.

(2) *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.

(3) *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.

(4) *Federal Register notice.* The Board shall 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.

(5) *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.

(6) *Authority to commence business.*

(i) 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.

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

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

(8) *Shareholders meeting.* An Edge Corporation shall provide in its bylaws that:

(i) A shareholders meeting shall be convened at the request of the Board within five days after the Board gives notice of the request to the Edge corporation;

(ii) Any shareholder or group of shareholders that owns or controls 25 percent or more of the shares of the Edge corporation shall attend such a meeting in person or by proxy; and

(iii) Failure by a shareholder or authorized representative to attend any such meeting in person or by proxy may result in removal or barring of such shareholders or any representatives from further participation in the management or affairs of the Edge corporation.

(b) *Nature and ownership of shares.*—(1) *Shares.* (i) Shares of stock in an Edge corporation may not include no-par value shares and shall be issued and transferred only on its books and in compliance with section 25(a) of the FRA and this subpart.

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

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

(B) Conspicuously set forth the substance of:

(1) Any limitations upon the rights of ownership and transfer of shares imposed by section 25(a) of the FRA; and

(2) Any rules that the Edge corporation prescribes in its by-laws to ensure compliance with this paragraph.

(iii) 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 the Board may require;

(B) Ensure that any transaction by an Edge corporation with an affiliate⁴ 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) Invest no more than 10 percent of the institution's capital and surplus in the aggregate amount of stock held in all Edge corporations; and

(E) In the case of a foreign institution not subject to section 4 of the BHC Act:

(1) 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

(2) 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.

(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. A notice under this paragraph need not be

filed where a change in control is effected through a transaction requiring the Board's approval under section 3 of the BHC Act (12 U.S.C. 1842).

(ii) *Board review.* In reviewing a notice filed under this paragraph, the Board shall consider the factors set forth in paragraph (a)(5) 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.*—(1) *Prior notice.* (i) 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.

(ii) The notice to the Reserve Bank shall include a copy of the notice of the proposal published in a newspaper of general circulation in the communities to be served by the branch.

(iii) The newspaper notice may appear no earlier than 90 calendar days prior to submission of notice of the proposal to the Reserve Bank. The newspaper notice must provide an opportunity for the public to give written comment on the proposal to the appropriate Reserve Bank for at least 30 days after the date of publication.

(2) *Factors considered.* The factors considered in acting upon a proposal to establish a branch are enumerated in paragraph (a)(5) of this section.

(3) *Expiration of authority.* 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, and from foreign persons.

(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 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 that are not currently employed in its international or foreign business, if held or invested in the United States, shall be in the form of:

(i) Cash;

(ii) Deposits with depository institutions, as described in part 204 of this chapter (Regulation D), and other Edge and Agreement corporations;

(iii) Money market instruments (including repurchase agreements with respect to such instruments), such as

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.

bankers' acceptances, federal funds sold, and commercial paper; and

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

(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, including acquisitions of obligations of foreign governments;

(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 foreign governments and their agencies and instrumentalities;

foreign persons; and organizations of the type described in paragraph 211.4(e)(1)(ii)(G) of this section.

(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 activities 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.* Subject to the limitations in paragraph (b)(2) of this section, an investor may directly or indirectly:

(i) 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; provided however that, in the case of an acquisition of a going concern, existing activities that are not otherwise permissible for a subsidiary may account for not more than 5 percent of either the consolidated assets or revenues of the acquired organization;

(ii) Invest in a joint venture provided that, unless otherwise permitted by the Board, not more than 10 percent of the joint venture's consolidated assets or revenues are attributable to activities not listed in paragraph (d) of this section; and

(iii) Make portfolio investments in an organization, provided however that:

(A) The total direct and indirect portfolio investments by the investor and its affiliates in organizations engaged in activities that are not

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.

permissible for joint ventures do not exceed:

(1) 40 percent of the total equity of the organization, when combined with shares in the organization held in trading or dealing accounts pursuant to paragraph (d)(14) of this section and shares in the organization held under any other authority; or

(2) 25 percent of the investor's Tier 1 capital where the investor is a bank holding company or 100 percent of Tier 1 capital for any other investor, when combined with underwriting commitments and shares held in trading or dealing accounts pursuant to paragraph (d)(14) of this section;⁷ and

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

(2) *Direct investments by member banks.* A member bank's direct investments under section 25 of the FRA shall be limited to:

(i) Foreign banks;

(ii) 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; and

(iii) Subsidiaries established pursuant to § 211.3(b)(9) of this subpart.

(3) *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 in the same organization held by affiliates under any authority.

(4) *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 5 percent of the shares of a foreign company that engages directly or indirectly in business in the United States that is not permitted to an Edge corporation; or

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

(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. Except as the Board may otherwise determine, in order for an investor to make investments under the general consent procedure, the investor and any other investor of which it is a subsidiary shall be in compliance with applicable minimum standards for capital adequacy. The Board may at any time, upon notice, modify or 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:⁹

(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) \$25 million; or

(B) 5 percent of the investor's Tier 1 capital in the case of a member bank, bank holding company, or Edge corporation engaged in banking, or 25 percent of the investor's Tier 1 capital in the case of an Edge corporation not engaged in banking;

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 In determining compliance with these limits, an investor shall combine the value of all shares of an organization held in trading or dealing accounts under paragraph 211.5(d)(14) of this section with investments in the same organization. Shares held in trading or dealing accounts are also subject to the limits in paragraph 211.5(d)(14) of this section.

(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 Tier 1 capital; 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 cost¹⁰ 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 twelve 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. 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;

¹⁰ 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.

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

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

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

(9) General insurance agency and brokerage;

(10) Data processing;

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

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

(13) Underwriting, distributing and dealing in debt securities outside the United States;

(14) Underwriting, distributing, and dealing in equity securities outside the United States as follows:

(i) By an investor, or an affiliate, that had commenced such activities prior to March 27, 1991, and subject to limitations in effect at that time (12 CFR part 211 (1990)); or

(ii) With the approval of the Board, underwriting equity securities if:

(A) Commitments by an investor and its affiliates for the shares of an organization do not in the aggregate exceed the lesser of \$60 million or 25 percent of the investor's Tier 1 capital unless the underwriter is covered by binding commitments from subunderwriters or other purchasers

obtained by the investor or its affiliates; and

(B) Commitments by an investor and its affiliates for the shares of an organization in excess of those permitted by paragraph (d)(14)(ii)(A) of this section provided that:

(1) The underwriting level approved by the Board for the investor and its affiliates in excess of the limitations of paragraph (d)(14)(ii)(A) of this section is fully deducted from the capital of the bank holding company, and from the capital of the bank where the securities activities are conducted by a subsidiary of a U.S. bank;¹¹ and

(2) In the Board's judgment such bank holding company and bank would remain strongly capitalized after such deduction from capital; and

(iii) With the approval of the Board, dealing in the shares of an organization (including the shares of a U.S. organization with respect to foreign persons only and subject to the limitations on owning or controlling shares of a company in section 4 of the BHC Act and the Board's Regulation Y (12 CFR part 225)) where the shares held in the trading or dealing accounts of an investor and its affiliates, when combined with any shares held pursuant to the authority provided under paragraph (b) of this section, do not in the aggregate exceed the lesser of \$30 million or 10 percent of the investor's Tier 1 capital, provided however that:

(A) For purposes of determining compliance with the limitations of this paragraph (d)(14)(iii) and paragraph (b)(1)(iii)(A)(2) of this section, long and short positions in the same security may be netted and positions in a security may be offset by futures, forwards, options, and similar instruments referenced to the same security through hedging methods approved by the Board, except that any position in a security shall not be deemed to have been reduced by more than 75 percent;

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

(C) Any shares acquired pursuant to an underwriting commitment for up to 90 days after the payment date for such underwriting shall not be subject to the dollar and percentage limitations of paragraph (d)(14)(iii) of this section or the investment provisions of paragraph (b) of this section, other than the aggregate limits in paragraph (b)(1)(iii)(A)(2) of this section; and

(D) Shares of an organization held in all trading and dealing accounts, when

¹¹ Fifty percent of such capital deductions shall be from Tier 1 capital.

combined with all other equity interests in the organization held by the investor and its affiliates, other than underwriting commitments for shares and shares held pursuant to an underwriting for 90 days following the payment date for such shares, must conform to the permissible limits for investments in an organization under paragraph (b) of this section.¹²

(iv) Underwriting commitments for shares and shares held by an affiliate authorized to underwrite equity securities under section 4(c)(8) of the BHC Act shall not be included in determining compliance with the aggregate limits in paragraph (b)(1)(iii)(A)(2) and the limits of paragraphs (d)(14)(ii)(A) and (iii) of this section, except that shares held by such an affiliate shall be included for purposes of determining compliance with paragraph (d)(14)(iii)(D) of this section.

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

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

(i) Investments in, and loans and extensions of credit (other than loans and extensions of credit fully secured in accordance with the requirements of section 23A of the FRA (12 U.S.C. 371c) or with such other standards as the Board may require) to, the company by the investor or its affiliates are deducted from the capital of the investor;¹³ and

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

(17) Acting as a futures commission merchant for financial instruments of the type, and on exchanges, that the Board has previously approved, provided however that:

(i) Activities are conducted in accordance with the standards set forth in § 225.25(b)(18) of the Board's Regulation Y (12 CFR 225.25(b)(18)); and

¹² Underwriting commitments are combined with shares held by an investor and its affiliates (other than an affiliate authorized to deal in shares under section 4(c)(8) of the BHC Act) in dealing or trading accounts and with portfolio investments for purposes of determining compliance with the aggregate limits in paragraph (b)(1)(iii)(A)(2) of this section.

¹³ Fifty percent of such capital deduction shall be from Tier 1 capital.

(ii) Prior approval must be obtained for activities conducted on an exchange that requires members to guarantee or otherwise contract to cover losses suffered by other members.

(18) Acting as principal or agent in swap transactions¹⁴ subject to any limitations applicable to state member banks under the Board's Regulation H (12 CFR part 208), except that where such activities involve contracts related to a commodity, such contracts must provide an option for cash settlement and the option must be exercised upon settlement.

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

(20) 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 are not 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.

(f) *Investments made through debt-for-equity conversions—(1) Permissible investments.* A bank holding company may make investments through the conversion of sovereign or private debt obligations of an eligible country, either through direct exchange of the debt obligations for the investment or by a payment for the debt in local currency, the proceeds of which, including an additional cash investment not exceeding in the aggregate more than 10 percent of the fair value of the debt obligations being converted as part of such investment, are used to purchase the following investments:

(i) *Public sector companies.* A bank holding company may acquire up to and including 100 percent of the shares of (or other ownership interests in) any foreign company located in an eligible country if the shares are acquired from the government of the eligible country or from its agencies or instrumentalities.

(ii) *Private sector companies.* A bank holding company may acquire up to and including 40 percent of the shares, including voting shares, of (or other

ownership interests in) any other foreign company located in an eligible country subject to the following conditions:

(A) A bank holding company may acquire more than 25 percent of the voting shares of the foreign company only if another shareholder or control group of shareholders unaffiliated with the bank holding company holds a larger block of voting shares of the company;

(B) The bank holding company and its affiliates may not lend or otherwise extend credit to the foreign company in amounts greater than 50 percent of the total loans and extensions of credit to the foreign company; and

(C) The bank holding company's representation on the board of directors or on management committees of the foreign company may be no more than proportional to its shareholding in the foreign company.

(2) *Investments by bank subsidiary of bank holding company.* Upon application, the Board may permit an indirect investment to be made pursuant to this paragraph through an insured bank subsidiary of the bank holding company where the bank holding company demonstrates that such ownership is consistent with the purposes of the FRA. In granting its consent, the Board may impose such conditions as it deems necessary or appropriate to prevent adverse effects, including prohibiting loans from the bank to the company in which the investment is made.

(3) *Divestiture—(i) Time limits for divestiture.* The bank holding company shall divest the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (unless the retention of the shares or other ownership interest is otherwise permissible at the time required for divestiture) within the longer of:

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

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

Provided however that, in either event divestiture occurs within fifteen years of the date of the acquisition.

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

(iii) *Other conditions requiring divestiture.* All investments made pursuant to this paragraph are subject to paragraphs (b)(4)(i)(A) and (B) of this section requiring prompt divestiture (unless the Board upon application authorizes retention) if the company invested in engages in impermissible business in the United States that exceeds in the aggregate 10 percent of the company's consolidated assets or revenues calculated on an annual basis; provided however that, such company may not engage in activities in the United States that consist of banking or financial operations (as defined in § 211.23(f)(5)(iii)(B) of this chapter), or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act, except under regulations of the Board or with the prior approval of the Board.

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

(ii) All other investments shall be made in accordance with the procedures of paragraph (c) of this section requiring prior notice or specific consent.

(5) *Conditions—(i) Name.* Any company acquired pursuant to this paragraph shall not bear a name similar to the name of the acquiring bank holding company or any of its affiliates.

(ii) *Confidentiality.* Neither the bank holding company nor its affiliates shall provide to any company acquired pursuant to this paragraph any confidential business information or other information concerning customers that are engaged in the same or related lines of business as the company.

§ 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 acceptances outstanding in excess of 200 percent of its Tier 1 capital; and

(ii) All acceptances outstanding for any one person in excess of 10 percent of its Tier 1 capital; Provided however that, 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

¹⁴ Swap transactions involving equity instruments are separately authorized under paragraph (d)(14) of this section.

international shipment of goods and the Edge corporation is:

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

(ii) Covered by participation agreements from other banks, as such agreements are described in section 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 Tier 1 capital;¹⁵ 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" has the meaning set forth in § 211.2(p) of this part¹⁶ and, for purposes of this paragraph, include:

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

(ii) Any liability of the lender to advance funds to or on behalf of a person pursuant to a guarantee, standby letter of credit, or similar agreements;

(iii) Investments in the securities of another organization except where the organization is a subsidiary; and

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

(B) Any organization if at least 25 percent of such an obligation or of the total credit is also supported by the full faith and credit of, or participated in by, any institution designated in paragraph (b)(3)(vi)(A) of this section in such manner that default to the lender will necessarily include default to that entity. The total loans and extensions of credit under this paragraph (b)(3)(vi)(B) to any person shall at no time exceed 100 percent of the Tier 1 capital of the Edge corporation.

(c) *Capitalization*. 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, after December 31, 1992, its minimum ratio of qualifying total capital to weighted-risk assets, as determined under the Capital Adequacy Guidelines, shall not be less than 10 percent, of which at least 50 percent shall consist of Tier 1 capital; provided however that for purposes of this paragraph, no limitation shall apply as to the inclusion of subordinated debt that qualifies as Tier 2 capital under the Capital Adequacy Guidelines.

§ 211.7 Supervision and reporting.

(a) *Supervision*—(1) *Foreign branches and subsidiaries*. Organizations 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 shall provide, in particular, information on risk assets, liquidity management, operations, internal controls, and conformance to management policies. Reports on risk assets shall be sufficient to permit an appraisal of credit quality and assessment of exposure to loss, and for this purpose provide full information on the condition of material borrowers. Reports on the operations and controls shall include internal and external audits of the branch or subsidiary.

(2) *Joint ventures*. Investors shall maintain sufficient information with respect to joint ventures to keep informed of their activities and condition. Such information shall include audits and other reports on financial performance, risk exposure, management policies, operations, and 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 paragraphs (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*.

¹⁵ 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.

¹⁶ 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.

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

Subpart B—Foreign Banking Organizations

3. Section 211.21 is revised to read as follows:

§ 211.21 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System ("Board") under the authority of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*) ("BHC Act"); and the International Banking Act of 1978 (12 U.S.C. 3101 *et seq.*) ("IBA").

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

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

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

4. In § 211.22, paragraphs (a)(2), and (a)(5) are revised to read as follows:

§ 211.22 Interstate banking operations of foreign banking organizations.

(a) *Definitions.* ***

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

(5) *Foreign bank*, for purposes of this section, is an organization that is organized under the laws of a foreign

country and that engages in the business of banking.

5. In § 211.23, paragraphs (d), (e), (f)(4), (f)(5), (g), and (h) are revised, and paragraph (i) is added, to read as follows:

§ 211.23 Nonbanking activities of foreign banking organizations.

(d) *Loss of eligibility for exemptions.*

(1) A foreign banking organization that qualified under paragraph (b) of this section shall cease to be eligible for the exemptions of this section if it fails to meet the requirements of paragraph (b) of this section for two consecutive years as reflected in its Annual Reports (F.R. Y-7) filed with the Board.

(2) A foreign banking organization that ceases to be eligible for the exemptions of this section may continue to engage in activities or retain investments commenced or acquired prior to the end of the first fiscal year for which its Annual Report reflects nonconformance with paragraph (b) of this section. Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second Annual Report unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section.

(3) A foreign banking organization that ceases to qualify under paragraph (b) of this section, or an affiliate of such foreign banking organization, that requests a specific determination of eligibility under paragraph (e) of this section may, prior to the Board's determination on eligibility, continue to engage in activities and make investments under the provisions of paragraphs (f)(1), (2) and (4) of this section.

(e) *Specific determination of eligibility for nonqualifying foreign banking organizations.* (1) A foreign banking organization that does not qualify under paragraph (b) of this section for the exemptions afforded by this section, or that has lost its eligibility for the exemptions under paragraph (d) of this section, may apply to the Board for a specific determination of eligibility for the exemptions.

(2) A foreign banking organization may apply for a specific determination prior to the time it ceases to be eligible for the exemptions afforded by this section.

(3) In determining whether eligibility for the exemptions would be consistent with the purposes of the BHC Act and in the public interest, the Board shall consider:

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

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

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

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

(4) Such determination shall be subject to any conditions and limitations imposed by the Board, including any requirements to cease activities or dispose of investments.

(5) Determinations of eligibility would generally not be granted where a majority of the business of the foreign banking organization derives from commercial or industrial activities or where the U.S. banking business of the organization is larger than the non-U.S. banking business conducted directly by the foreign bank or banks (as defined in § 211.2(j) of this part) of the organization.

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

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

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

(i) More than 50 percent of the foreign company's consolidated assets shall be located, and consolidated revenues derived from, outside the United States; provided however that, if the foreign company fails to meet the requirements of this paragraph for two consecutive years (as reflected in Annual Reports (F.R. Y-7)) filed with the Board by the foreign banking organization, the foreign company shall be divested or its activities terminated within one year of the filing of the second consecutive Annual Report that reflects nonconformance with the requirements of this paragraph, unless the Board

grants consent to retain the investment under paragraph (g) of this section;

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 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 must control, an operating company, and its direct or indirect activities in the United States shall be subject to the following limitations:

(A) The foreign company's activities in the United States shall be the same kind of activities or related to the activities engaged in directly or indirectly by the foreign company abroad as measured by the "establishment" categories of the Standard Industrial Classification (SIC) (an activity in the United States shall be considered related to an activity outside the United States if it consists of supply, distribution, or sales in furtherance of the activity);

(B) The foreign company may engage in activities in the United States that consist of banking, securities, insurance or other financial operations, or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act, only under regulations of the Board or with the prior approval of the Board.

(1) Activities within Division H (Finance, Insurance, and Real Estate) of the SIC shall be considered banking or financial operations for this purpose, with the exception of acting as operators of nonresidential buildings (SIC 6512), operators of apartment buildings (SIC 6513), operators of dwellings other than apartment buildings (SIC 6514), and operators of residential mobile home sites (SIC 6515); and operating title abstract offices (SIC 6541); and

(2) The following activities shall be considered financial activities and may be engaged in only with the approval of the Board under subsection (g): Credit reporting services (SIC 7323); computer and data processing services (SIC 7371, 7372, 7373, 7374, 7375, 7376, 7377, 7378, and 7379); armored car services (SIC 7381); management consulting (SIC 8732, 8741, 8742, and 8748); certain rental and leasing activities (SIC 4741, 7352, 7353, 7359, 7513, 7514, 7515, and 7519); accounting, auditing and bookkeeping services (SIC 8721); courier services (SIC 4215 and 4513); and arrangement of passenger transportation (SIC 4724, 4725, and 4729).

(g) *Exemptions under section 4(c)(9) of the BHC Act.* A foreign banking

organization that is of the opinion that other activities or investments may, in particular circumstances, meet the conditions for an exemption under section 4(c)(9) of the BHC Act may apply to the Board for such a determination by submitting to the Reserve Bank of the District in which its banking operations in the United States are principally conducted a letter setting forth the basis for that opinion.

(h) *Reports.* (1) The foreign banking organization shall inform the Board through the organization's Reserve Bank within 30 days after the close of each quarter of all shares of companies engaged, directly or indirectly, in activities in the United States that were acquired during such quarter under the authority of this section.

(2) The foreign banking organization shall also report any direct activities in the United States commenced during such quarter by a foreign subsidiary of the foreign banking organization. This information shall (unless previously furnished) include a brief description of the nature and scope of each company's business in the United States, including the 4-digit SIC numbers of the activities in which the company engages. Such information shall also include the 4-digit SIC numbers of the direct parent of any U.S. company acquired, together with a statement of total assets and revenues of the direct parent.

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

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

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

6. Subpart C (§§ 211.31 through 211.34) is revised to read as follows:

Subpart C—Export Trading Companies

211.31 Authority, purpose, and scope.

211.32 Definitions.

211.33 Investments and extensions of credit.

211.34 Procedures for filing and processing notices.

Subpart C—Export Trading Companies

§ 211.31 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System ("Board") under the authority of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*) ("BHC Act"), the Bank Export Services Act (Title II, Pub. L. 97-290, 96 Stat. 1235 (1982)) ("BESA"), and the Export Trading Company Act Amendments of 1988 (Title III, Pub. L. 100-418, 102 Stat. 1384 (1988)) ("ETC Act Amendments").

(b) *Purpose and scope.* This subpart is in furtherance of the purposes of the BHC Act, the BESA, and the ETC Act Amendments, the latter two statutes being designed to increase U.S. exports by encouraging investments and participation in export trading companies by bank holding companies and the specified investors. The provisions of this subpart apply to the following (hereinafter referred to as "eligible investors"):

(1) Bank holding companies as defined in section 2 of the BHC Act (12 U.S.C. 1841(a));

(2) Edge and Agreement corporations, as described in § 211.1(c) of this part, that are subsidiaries of bank holding companies but are not subsidiaries of banks;

(3) Bankers' banks as described in section 4(c)(14)(F)(iii) of the BHC Act (12 U.S.C. 1843(c)(14)(F)(iii)); and

(4) Foreign banking organizations as defined in § 211.23(a)(2) of this part.

§ 211.32 Definitions.

The definitions of § 211.2 in subpart A apply to this subpart subject to the following:

(a) *Export trading company* means a company that is exclusively engaged in activities related to international trade and, by engaging in one or more export trade services, derives:

(1) At least one-third of its revenues in each consecutive four-year period from the export of, or from facilitating the export of, goods and services produced in the United States by persons other than the export trading company or its subsidiaries; and

(2) More revenues in each four-year period from export activities as described in paragraph (a)(1) of this section than it derives from the import, or facilitating the import, into the United States of goods or services produced outside the United States.

For purposes of this section, "revenues" shall include net sales revenues from exporting, importing, or third party trade

in goods by the export trading company for its own account, and gross revenues derived from all other activities of the export trading company.

(b) The terms *bank, company* and *subsidiary* have the same meanings as those contained in section 2 of the BHC Act (12 U.S.C. 1841).

§ 211.33 Investments and extensions of credit.

(a) *Amount of investments.* In accordance with the procedures of § 211.34 of this subpart, an eligible investor may invest no more than 5 percent of its consolidated capital and surplus in one or more export trading companies, except that an Edge or Agreement corporation not engaged in banking may invest as much as 25 percent of its consolidated capital and surplus but no more than 5 percent of the consolidated capital and surplus of its parent bank holding company.

(b) *Extensions of credit—(1) Amount.* An eligible investor in an export trading company or companies may extend credit directly or indirectly to the export trading company or companies in a total amount that at no time exceeds 10 percent of the investor's consolidated capital and surplus.

(2) *Terms—(i)* An eligible investor in an export trading company may not extend credit directly or indirectly to the export trading company or any of its customers or to any other investor holding 10 percent or more of the shares of the export trading company on terms more favorable than those afforded similar borrowers in similar circumstances, and such extensions of credit shall not involve more than the normal risk of repayment or present other unfavorable features.

(ii) For the purposes of this provision, an investor in an export trading company includes any affiliate of the investor.

(3) *Collateral requirements.* Covered transactions between a bank and an affiliated export trading company in which a bank holding company has invested pursuant to this subpart are subject to the collateral requirements of section 23A of the Federal Reserve Act (12 U.S.C. 371c), except where a bank issues a letter of credit or advances funds to an affiliated export trading company solely to finance the purchase of goods for which:

(i) The export trading company has a bona fide contract for the subsequent sale of the goods; and

(ii) The bank has a security interest in the goods or in the proceeds from their sale at least equal in value to the letter of credit or the advance.

§ 211.34 Procedures for filing and processing notices.

(a) *Filing notice—(1) Prior notice of investment.* An eligible investor shall give the Board 60 days' prior written notice of any investment in an export trading company.

(2) *Subsequent notice—(i)* An eligible investor shall give the Board 60 days' prior written notice of changes in the activities of an export trading company that is a subsidiary of the investor if the export trading company expands its activities beyond those described in the initial notice to include:

(A) Taking title to goods where the export trading company does not have a firm order for the sale of those goods;

(B) Product research and design;

(C) Product modification; or

(D) Activities not specifically covered by the list of activities contained in section 4(c)(14)(F)(ii) of the BHC Act.

(ii) Such an expansion of activities shall be regarded as a proposed investment under this subpart.

(b) *Time period for Board action.* (1) A proposed investment that has not been disapproved by the Board may be made 60 days after the Reserve Bank accepts the notice for processing. A proposed investment may be made before the expiration of the 60-day period if the Board notifies the investor in writing of its intention not to disapprove the investment.

(2) The Board may extend the 60-day period for an additional 30 days if the Board determines that the investor has not furnished all necessary information or that any material information furnished is substantially inaccurate. The Board may disapprove an investment if the necessary information is provided within a time insufficient to allow the Board reasonably to consider the information received.

(3) Within three days of a decision to disapprove an investment, the Board shall notify the investor in writing and state the reasons for the disapproval.

(c) *Time period for investment.* An investment in an export trading company that has not been disapproved shall be made within one year from the date of the notice not to disapprove, unless the time period is extended by the Board or by the appropriate Reserve Bank.

(d) *Time period for calculating revenues.* For any export trading company that commenced operations two years or more prior to August 23, 1988, the four-year period within which to calculate revenues derived from its activities under § 211.32(a) of this part shall be deemed to have commenced with the beginning of the 1988 fiscal year for that export trading company.

FEDERAL RESERVE BANK
OF NEW YORK

At-Dir. No. 10455

May 21, 1991

To the Addressee:

Our Circular No. 10455, dated May 7, 1991, transmitted amendments to Regulation K of the Board of Governors of the Federal Reserve System, expanding the scope of international activities of U.S. banking organizations, and related amendments to the Board's Rules Regarding Delegation of Authority. The following corrections should be made in your copy of those amendments:

1. On page 19549 of the pamphlet containing the amendments to Regulation K, the effective date (except for the provisions that are effective immediately) should be changed to May 26, 1991.

2. On page 19576 of the Regulation K pamphlet, the following language should be added after the end of the 2nd column:

For all other export trading companies, the four-year period shall commence with the first fiscal year after the respective export trading company has been in operation for two years.

3. The effective date of the amendments to the Rules Regarding Delegation of Authority should be changed to May 26, 1991.

4. In the first column of the amendments to the Rules, the citation (in section 265.2(c)(38)) to Regulation K should be changed to 211.5(d)(14).

Circulars Division