Board of Governors of the Federal Reserve System

Regulation Y
Bank Holding Companies and Change in Bank Control

12 CFR 225; as amended effective April 1, 2022

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Subpart H—Notice of Addition or Change of Directors and Senior Executive Officers

Section

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AUTHORITY: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3906, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801, and 6805.

4–001

SUBPART A—GENERAL PROVISIONS

SECTION 225.1—Authority, Purpose, and Scope

(a) *Authority.* This part[1] (Regulation Y) is issued by the Board of Governors of the Federal Reserve System (Board) under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) (BHC Act); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13)) (Bank Control Act); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)); section 914 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 1831i); section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972); and the International Lending Supervision Act of 1983 (Pub. L. 98-181, title IX). The BHC Act is codified at 12 U.S.C. 1841 *et seq.*

(b) *Purpose.* The principal purposes of this part are to—

(1) regulate the acquisition of control of banks by companies and individuals;

(2) define and regulate the nonbanking activities in which bank holding companies and foreign banking organizations with United States operations may engage; and

(3) set forth the procedures for securing approval for such transactions and activities.

4–002

(c) *Scope.*

(1) Subpart A contains general provisions and definitions of terms used in this regulation.

(2) Subpart B governs acquisitions of bank or bank holding company securities and assets by bank holding companies or by any company that will become a bank holding company as a result of the acquisition.

(3) Subpart C defines and regulates the nonbanking activities in which bank holding companies and foreign banking organizations may engage directly or through a subsidiary. The Board's Regulation K governs, certain nonbanking activities conducted by foreign banking organizations and certain foreign activities conducted by bank holding companies (12 CFR 211, International Banking Operations).

[1] Code of Federal Regulations, title 12, chapter II, part 225.

(4) Subpart D specifies situations in which a company is presumed to control voting securities or to have the power to exercise a controlling influence over the management or policies of a bank or other company, sets forth the procedures for making a control determination, and provides rules governing the effectiveness of divestitures by bank holding companies.
(5) Subpart E governs changes in bank control resulting from the acquisition by individuals or companies (other than bank holding companies) of voting securities of a bank holding company or state member bank of the Federal Reserve System.
(6) Subpart F specifies the limitations that govern companies that control so-called nonbank banks and the activities of nonbank banks.
(7) Subpart G prescribes minimum standards that apply to the performance of real estate appraisals and identifies transactions that require state-certified appraisers.
(8) Subpart H identifies the circumstances when written notice must be provided to the Board prior to the appointment of a director or senior officer of a bank holding company and establishes procedures for obtaining the required Board approval.
(9) Subpart I establishes the procedure by which a bank holding company may elect to become a financial holding company, enumerates the consequences if a financial holding company ceases to meet a requirement applicable to a financial holding company, lists the activities in which a financial holding company may engage, establishes the procedure by which a person may request the Board to authorize additional activities as financial in nature or incidental thereto, and establishes the procedure by which a financial holding company may seek approval to engage in an activity that is complementary to a financial activity.
(10) Subpart J governs the conduct of merchant banking investment activities by financial holding companies as permitted under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)).
(11) Subpart K governs the period of time that firms subject to section 13 of the Bank Holding Company Act (12 U.S.C. 1851) have to bring their activities, investments, and relationships into compliance with the requirements of such section.
(12) [Reserved]
(13) Appendix C contains the Board's policy statement governing small bank holding companies.
(14) [Reserved]
(15) [Reserved]

4–003

SECTION 225.2—Definitions

Except as modified in this section or unless the context otherwise requires, the terms used in this regulation have the same meanings as set forth in the relevant statutes.

(a) *Affiliate* means any company that controls, is controlled by, or is under common control with, another company.

(b) (1) *Bank* means—
(i) an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); or
(ii) an institution organized under the laws of the United States which both—
(A) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and
(B) is engaged in the business of making commercial loans.
(2) ''Bank'' does not include those institutions qualifying under the exceptions listed in section 2(c)(2) of the BHC Act (12 U.S.C. 1841(c)(2)).

4–004

(c) (1) *Bank holding company* means any company (including a bank) that has direct or indirect control of a bank, other than control that results from the ownership or control of—
(i) voting securities held in good faith in a fiduciary capacity (other than as provided in paragraphs (e)(2)(ii) and (iii) of this section) without sole discretionary voting authority, or as otherwise exempted under section 2(a)(5)(A) of the BHC Act;

(ii) voting securities acquired and held only for a reasonable period of time in connection with the underwriting of securities, as provided in section 2(a)(5)(B) of the BHC Act;

(iii) voting rights to voting securities acquired for the sole purpose and in the course of participating in a proxy solicitation, as provided in section 2(a)(5)(C) of the BHC Act;

(iv) voting securities acquired in satisfaction of debts previously contracted in good faith, as provided in section 2(a)(5)(D) of the BHC Act, if the securities are divested within two years of acquisition (or such later period as the Board may permit by order); or

(v) voting securities of certain institutions owned by a thrift institution or a trust company, as provided in sections 2(a)(5)(E) and (F) of the BHC Act.

(2) Except for the purposes of section 225.4(b) of this subpart and subpart E of this part, or as otherwise provided in this part, the term ''bank holding company'' includes a foreign banking organization. For the purposes of subpart B of this part, ''bank holding company'' includes a foreign banking organization only if it owns or controls a bank in the United States.

4–005

(d) (1) *Company* includes any bank, corporation, general or limited partnership, association or similar organization, business trust, or any other trust unless by its terms it must terminate either within 25 years, or within 21 years and 10 months after the death of individuals living on the effective date of the trust.

(2) ''Company'' does not include any organization, the majority of the voting securities of which are owned by the United States or any state.

(3) *Testamentary trusts exempt.* Unless the Board finds that the trust is being operated as a business trust or company, a trust is presumed not to be a company if the trust—

(i) terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effective date of the trustor within 25 years;

(ii) is a testamentary or inter vivos trust established by an individual or individuals for the benefit of natural persons (or trusts for the benefit of natural persons) who are related by blood, marriage, or adoption;

(iii) contains only assets previously owned by the individual or individuals who established the trust;

(iv) is not a Massachusetts business trust; and

(v) does not issue shares, certificates, or any other evidence of ownership.

(4) *Qualified limited partnerships exempt.* ''Company'' does not include a qualified limited partnership, as defined in section 2(o)(10) of the BHC Act.

4–006

(e) (1) *Control* of a company means (except for the purposes of subpart E of this part)—

(i) ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting securities of the company, directly or indirectly or acting through one or more other persons;

(ii) control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the company;

(iii) the power to exercise, directly or indirectly, a controlling influence over the management or policies of the company, as determined by the Board after notice and opportunity for hearing in accordance with section 225.31 of subpart D of this regulation; or

(iv) conditioning in any manner the transfer of 25 percent or more of the outstanding shares of any class of voting securities of a company upon the transfer of 25 percent or more of the outstanding shares of any class of voting securities of another company.

4–007

(2) A company is deemed to control voting securities or assets owned, controlled, or held, directly or indirectly:

(i) By the company, or by any subsidiary of the company;
(ii) That the company has power to vote or to dispose of;
(iii) In a fiduciary capacity for the benefit of the company or any of its subsidiaries;
(iv) In a fiduciary capacity (including by pension and profit-sharing trusts) for the benefit of the shareholders, members, or employees (or individuals serving in similar capacities) of the company or any of its subsidiaries; or
(v) According to the standards under section 225.9 of this part.

4–008

(f) *Foreign banking organization* and *qualifying foreign banking organization* have the same meanings as provided in section 211.21(n) and section 211.23 of the Board's Regulation K (12 CFR 211.21(n) and 211.23).

(g) *Insured depository institution* includes an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)) and a savings association.

(h) *Lead insured depository institution* means the largest insured depository institution controlled by the bank holding company as of the quarter ending immediately prior to the proposed filing, based on a comparison of the average total risk-weighted assets controlled during the previous 12-month period be each insured depository institution subsidiary of the holding company. For purposes of this paragraph (h), for a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), average total risk-weighted assets equal the qualifying community banking organization's average total consolidated assets (as used in section 217.12 of this chapter).

4–008.1

(i) *Management official* means any officer, director (including honorary or advisory directors), partner, or trustee of a bank or other company, or any employee of the bank or other company with policymaking functions.

(j) *Nonbank bank* means any institution that—
(1) became a bank as a result of enactment of the Competitive Equality Amendments of 1987 (Pub. L. No. 100-86), on the date of enactment (August 10, 1987); and
(2) was not controlled by a bank holding company on the day before the enactment of the Competitive Equality Amendments of 1987 (August 9, 1987).

(k) *Outstanding shares* means any voting securities, but does not include securities owned by the United States or by a company wholly owned by the United States.

(*l*) *Person* includes an individual, bank, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

4–008.2

(m) *Savings association* means—
(1) any federal savings association or federal savings bank;
(2) any building and loan association, savings and loan association, homestead association, or cooperative bank if such association or cooperative bank is a member of the Savings Association Insurance Fund; and
(3) any savings bank or cooperative which is deemed by the director of the Office of Thrift Supervision to be a savings association under section 10(*l*) of the Home Owners' Loan Act.

4–009

(n) *Shareholder.*
(1) *Controlling shareholder* means a person that owns or controls, directly or indirectly, 25 percent or more of any class of voting securities of a bank or other company.
(2) *Principal shareholder* means a person that owns or controls, directly or indirectly, 10 percent or more of any class of voting securities of a bank or other company, or any person that the Board determines has the power, directly or indirectly, to exercise a controlling influence over the management or policies of a bank or other company.

(o) *Subsidiary* means a bank or other com-

pany that is controlled by another company, and refers to a direct or indirect subsidiary of a bank holding company. An indirect subsidiary is a bank or other company that is controlled by a subsidiary of the bank holding company.

(p) *United States* means the United States and includes any state of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

4–010

(q) (1) *Voting securities* means shares of common or preferred stock, general or limited partnership shares or interests, or similar interests if the shares or interest, by statute, charter, or in any manner, entitle the holder—

(i) to vote for or to select directors, trustees, or partners (or persons exercising similar functions of the issuing company); or

(ii) to vote on or to direct the conduct of the operations or other significant policies of the issuing company.

(2) *Nonvoting securities.* Common shares, preferred shares, limited partnership interests, limited liability company interests, or similar interests are not voting securities if:

(i) Any voting rights associated with the securities are limited solely to the type customarily provided by statute with regard to matters that would significantly and adversely affect the rights or preference of the security, such as the issuance of additional amounts or classes of senior securities, the modification of the terms of the security, the dissolution of the issuing company, or the payment of dividends by the issuing company when preferred dividends are in arrears;

(ii) The securities represent an essentially passive investment or financing device and do not otherwise provide the holder with control over the issuing company; and

(iii) The securities do not entitle the holder, by statute, charter, or in any manner, to select or to vote for the selection of directors, trustees, or partners (or persons exercising similar functions) of the issuing company; except that limited partnership interests or membership interests in limited liability companies are not voting securities due to voting rights that are limited solely to voting for the removal of a general partner or managing member (or persons exercising similar functions at the company) for cause, to replace a general partner or managing member (or persons exercising similar functions at the company) due to incapacitation or following the removal of such person, or to continue or dissolve the company after removal of the general partner or managing member (or persons exercising similar functions at the company).

(3) *Class of voting shares.* Shares of stock issued by a single issuer are deemed to be the same class of voting shares, regardless of differences in dividend rights or liquidation preference, if the shares are voted together as a single class on all matters for which the shares have voting rights other than matters described in paragraph (o)(2)(i) of this section that affect solely the rights or preferences of the shares.

4–010.1

(r) *Well capitalized.*

(1) *Bank holding company.* In the case of a bank holding company,[1] ''well capitalized'' means that—

(i) on a consolidated basis, the bank holding company maintains a total risk-based capital ratio of 10.0 percent or greater, as defined in 12 CFR 217.10;

(ii) on a consolidated basis, the bank holding company maintains a tier 1 risk based capital ratio of 6.0 percent or greater, as defined in 12 CFR 217.10; and

(iii) the bank holding company is not subject to any written agreement, order, capital directive, or prompt-corrective-

[1] For purposes of this subpart and subparts B and C of this part, a bank holding company that is subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement in appendix C of this part will be deemed to be ''well capitalized'' if the bank holding company meets the requirements for expedited/waived processing in appendix C.

action directive issued by the Board to meet and maintain a specific capital level for any capital measure.

(2) *Insured and uninsured depository institution.*

(i) *Insured depository institution.* In the case of an insured depository institution, ''well capitalized'' means that the institution has and maintains at least the capital levels required to be well capitalized under the capital adequacy regulations or guidelines applicable to the institution that have been adopted by the appropriate federal banking agency for the institution under section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

(ii) *Uninsured depository institution.* In the case of a depository institution the deposits of which are not insured by the Federal Deposit Insurance Corporation, ''well capitalized'' means that the institution has and maintains at least the capital levels required for an insured depository institution to be well capitalized.

(3) *Foreign banks.*

(i) *Standards applied.* For purposes of determining whether a foreign banking organization qualifies under paragraph (r)(1) of this section—

(A) a foreign banking organization whose home-country supervisor, as defined in section 211.21 of the Board's Regulation K (12 CFR 211.21), has adopted capital standards consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord) may calculate its capital ratios under the home-country standard; and

(B) a foreign banking organization whose home-country supervisor has not adopted capital standards consistent in all respects with the Basel Accord shall obtain a determination from the Board that its capital is equivalent to the capital that would be required of a U.S. banking organization under paragraph (r)(1) of this section.

(ii) *Branches and agencies.* For purposes of determining, under paragraph (r)(1) of this section, whether a branch or agency of a foreign banking organization is well capitalized, the branch or agency shall be deemed to have the same capital ratios as the foreign banking organization.

(4) Notwithstaning paragraphs (r)(1) through (3) of this section:

(i) A bank holding company that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) is well capitalized if it satisfies the requirements of paragraph (r)(1)(iii) of this section.

(ii) A depository institution that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) is well capitalized.

4–010.2

(s) *Well managed.*

(1) *In general.* Except as otherwise provided in this part, a company or depository institution is well managed if—

(i) at its most recent inspection or examination or subsequent review by the appropriate federal banking agency for the company or institution (or the appropriate state banking agency in an examination described in section 10(d) of the Federal Deposit Insurance Act (12 U.S.C. 1820(d)), the company or institution received—

(A) at least a satisfactory composite rating; and

(B) at least a satisfactory rating for management, if such a rating is given.

(ii) In the case of a company or depository institution that has not received an inspection or examination rating, the Board has determined, after a review of the managerial and other resources of the company or depository institution and after consulting with the appropriate federal and state banking agencies, as applicable, for the company or institution, that the company or institution is well managed.

(2) *Merged depository institutions.*

(i) *Merger involving well-managed insti-*

tutions. A depository institution that results from the merger of two or more depository institutions that are well managed shall be considered to be well managed unless the Board determines otherwise after consulting with the appropriate federal and state banking agencies, as applicable, for each depository institution involved in the merger.

(ii) *Merger involving a poorly rated institution.* A depository institution that results from the merger of a depository institution that is well managed with one or more depository institutions that are not well managed or have not been examined shall be considered to be well managed if the Board determines, after a review of the managerial and other resources of the resulting depository institution and after consulting with the appropriate federal and state banking agencies for the institutions involved in the merger, as applicable, that the resulting institution is well managed.

(3) *Foreign banking organizations.* Except as otherwise provided in this part, a foreign banking organization is considered well managed if the combined operations of the foreign banking organization in the United States have received at least a satisfactory composite rating at the most recent annual assessment.

(t) *Depository institution.* For purposes of this part, the term ''depository institution'' has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(u) *Voting percentage.* For purposes of this part, the percentage of a class of a company's voting securities controlled by a person is the greater of:

(1) The quotient, expressed as a percentage, of the number of shares of the class of voting securities controlled by the person, divided by the number of shares of the class of voting securities that are issued and outstanding, both as adjusted by section 225.9 of this part; and

(2) The quotient, expressed as a percentage, of the number of votes that may be cast by the person on the voting securities controlled by the person, divided by the total votes that are legally entitled to be cast by the issued and outstanding shares of the class of voting securities, both as adjusted by section 225.9 of this part.

4–011

SECTION 225.3—Administration

(a) *Delegation of authority.* Designated Board members and officers and the Federal Reserve Banks are authorized by the Board to exercise various functions prescribed in this regulation and in the Board's Rules Regarding Delegation of Authority (12 CFR 265) and the Board's Rules of Procedure (12 CFR 262).

(b) *Appropriate Federal Reserve Bank.* In administering this regulation, the appropriate Federal Reserve Bank is as follows:

(1) For a bank holding company (or a company applying to become a bank holding company): the Reserve Bank of the Federal Reserve District in which the company's banking operations are principally conducted, as measured by total domestic deposits in its subsidiary banks on the date it became (or will become) a bank holding company;

(2) For a foreign banking organization that has no subsidiary bank and is not subject to paragraph (b)(1) of this section: the Reserve Bank of the Federal Reserve District in which the total assets of the organization's United States branches, agencies, and commercial lending companies are the largest as of the later of January 1, 1980, or the date it becomes a foreign banking organization;

(3) For an individual or company submitting a notice under subpart E of this part: the Reserve Bank of the Federal Reserve District in which the banking operations of the bank holding company or state member bank to be acquired are principally conducted, as measured by total domestic deposits on the date the notice is filed.

4–012

SECTION 225.4—Corporate Practices

(a) *Bank holding company policy and operations.*

(1) A bank holding company shall serve as

a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*), the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

4–013

(b) *Purchase or redemption by a bank holding company of its own securities.*

(1) *Filing notice.* Except as provided in paragraph (b)(6), a bank holding company shall give the Board prior written notice before purchasing or redeeming its equity securities if the gross consideration for the purchase or redemption, when aggregated with the net consideration paid by the company for all such purchases or redemptions during the preceding 12 months, is equal to 10 percent or more of the company's consolidated net worth. For the purposes of this section, ''net consideration'' is the gross consideration paid by the company for all of its equity securities purchased or redeemed during the period minus the gross consideration received for all of its equity securities sold during the period.

(2) *Contents of notice.* Any notice under this section shall be filed with the appropriate Reserve Bank and shall contain the following information:

(i) the purpose of the transaction, a description of the securities to be purchased or redeemed, the total number of each class outstanding, the gross consideration to be paid, and the terms and sources of funding for the transaction;

(ii) a description of all equity securities redeemed within the preceding 12 months, the net consideration paid, and the terms of any debt incurred in connection with those transactions; and

(iii) (A) if the bank holding company has consolidated assets of $3 billion or more, consolidated *pro forma* risk-based capital and leverage ratio calculations for the bank holding company as of the most recent quarter, and, if the redemption is to be debt funded, a parent-only *pro forma* balance sheet as of the most recent quarter; or

(B) if the bank holding company has consolidated assets of less than $3 billion, a *pro forma* parent-only balance sheet as of the most recent quarter, and, if the redemption is to be debt funded, one-year income statement and cash-flow projections.

4–014

(3) *Acting on notice.* Within 15 calendar days of receipt of a notice under this section, the appropriate Reserve Bank shall either approve the transaction proposed in the notice or refer the notice to the Board for decision. If the notice is referred to the Board for decision, the Board shall act on the notice within 30 calendar days after the Reserve Bank receives the notice.

(4) *Factors considered in acting on notice.*

(i) The Board may disapprove a proposed purchase or redemption if it finds that the proposal would constitute an unsafe or unsound practice, or would violate any law, regulation, Board order, directive, or any condition imposed by, or written agreement with, the Board.

(ii) In determining whether a proposal constitutes an unsafe or unsound practice, the Board shall consider whether the bank holding company's financial condition, after giving effect to the proposed purchase or redemption, meets the financial standards applied by the Board under section 3 of the BHC Act, including 12 CFR part 217, and the Board's Policy Statement for Small Bank Holding Companies (appendix C of this part).

(5) *Disapproval and hearing.*

(i) The Board shall notify the bank holding company in writing of the reasons for

a decision to disapprove any proposed purchase or redemption. Within 10 calendar days of receipt of a notice of disapproval by the Board, the bank holding company may submit a written request for a hearing.

(ii) The Board shall order a hearing within 10 calendar days of receipt of the request if it finds that material facts are in dispute, or if it otherwise appears appropriate. Any hearing conducted under this paragraph shall be held in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR 263).

(iii) At the conclusion of the hearing, the Board shall by order approve or disapprove the proposed purchase or redemption on the basis of the record of the hearing.

4–014.1

(6) *Exception for well-capitalized bank holding companies.* A bank holding company is not required to obtain prior Board approval for the redemption or purchase of its equity securities under this section provided—

(i) both before and immediately after the redemption, the bank holding company is well capitalized;

(ii) the bank holding company is well managed; and

(iii) the bank holding company is not the subject of any unresolved supervisory issues.

(7) *Exception for certain bank holding companies.* This section 225.4(b) shall not apply to any bank holding company that is subject to section 225.8 of Regulation Y (12 CFR 225.8).

4–015

(c) *Deposit insurance.* Every bank that is a bank holding company or a subsidiary of a bank holding company shall obtain Federal Deposit Insurance and shall remain an ''insured bank'' as defined in section 3(h) of the Federal Deposit Insurance Act (12 USC 1813(h)).

4–015.1

(d) *Acting as transfer agent or clearing agent.* A bank holding company or any nonbanking subsidiary that is a ''bank,'' as defined in section 3(a)(6) of the Securities Exchange Act of 1934 (15 USC 78c(a)(6)), and that is a transfer agent of securities, a municipal securities dealer, a clearing agency, or a participant in a clearing agency (as those terms are defined in section 3(a) of the Securities Exchange Act (12 USC 78c(a)), shall be subject to sections 208.31-208.33 of the Board's Regulation H (12 CFR 208.31-208.33) as if it were a state member bank.

4–015.2

(e) *Reporting requirement for credit secured by certain bank holding company stock.* Each executive officer or director of a bank holding company the shares of which are not publicly traded shall report annually to the board of directors of the bank holding company the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the bank holding company. For purposes of this paragraph, the terms ''executive officer'' and ''director'' shall have the meaning given in section 215.2 of Regulation O (12 CFR 215.2).

(f) *Suspicious-activity report.* A bank holding company or any nonbank subsidiary thereof, or a foreign bank that is subject to the BHC Act or any nonbank subsidiary of such foreign bank operating in the United States, shall file a suspicious-activity report in accordance with the provisions of section 208.62 of the Board's Regulation H (12 CFR 208.62).

4–015.3

(g) *Requirements for financial holding companies engaged in securities underwriting, dealing, or market-making activities.*

(1) Any intraday extension of credit by a bank or thrift, or U.S. branch or agency of a foreign bank to an affiliated company engaged in underwriting, dealing in, or making a market in securities pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 USC 1843(k)(4)(E)) must be on market terms consistent with section 23B of the Federal Reserve Act (12 USC 371c-1).

(2) A foreign bank that is or is treated as a financial holding company under this part shall ensure that—

(i) any extension of credit by any U.S. branch or agency of such foreign bank to an affiliated company engaged in underwriting, dealing in, or making a market in securities pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 USC 1843(k)(4)(E)), conforms to sections 23A and 23B of the Federal Reserve Act (12 USC 371c and 371c-1) as if the branch or agency were a member bank;

(ii) any purchase by any U.S. branch or agency of such foreign bank, as principal or fiduciary, of securities for which a securities affiliate described in paragraph (g)(2)(i) of this section is a principal underwriter conforms to sections 23A and 23B of the Federal Reserve Act (12 USC 371c and 371c-1) as if the branch or agency were a member bank; and

(iii) its U.S. branches and agencies not advertise or suggest that they are responsible for the obligations of a securities affiliate described in paragraph (g)(2)(i) of this section, consistent with section 23B(c) of the Federal Reserve Act (12 USC 371c-1) as if the branches or agencies were member banks.

4–015.4

(h) *Protection of customer information and consumer information.* A bank holding company shall comply with the Interagency Guidelines Establishing Information Security Standards, as set forth in appendix F of this part, prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 USC 6801 and 6805) [at 4–863]. A bank holding company shall dispose of consumer information in accordance with the rules set forth at 16 CFR 682.

4–016

SECTION 225.5—Registration, Reports, and Inspections

(a) *Registration of bank holding companies.* Each company shall register within 180 days after becoming a bank holding company by furnishing information in the manner and form prescribed by the Board. A company that receives the Board's prior approval under subpart B of this regulation to become a bank holding company may complete this registration requirement through submission of its first annual report to the Board as required by paragraph (b) of this section.

(b) *Reports of bank holding companies.* Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.

(c) *Examinations and inspections.* The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operations and activities. The Board shall rely, as far as possible, on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of the bank holding company or of the branch or agency of the foreign bank.

4–017

SECTION 225.6—Penalties for Violations

(a) *Criminal and civil penalties.*

(1) Section 8 of the BHC Act provides criminal penalties for willful violation, and civil penalties for violation, by any company or individual, of the BHC Act or any regulation or order issued under it, or for making a false entry in any book, report, or statement of a bank holding company.

(2) Civil money penalty assessments for violations of the BHC Act shall be made in accordance with subpart C of the Board's Rules of Practice for Hearings (12 CFR 263, subpart C). For any willful violation of

the Bank Control Act or any regulation or order issued under it, the Board may assess a civil penalty as provided in 12 U.S.C. 1817(j)(15).

(b) *Cease-and-desist proceedings.* For any violation of the BHC Act, the Bank Control Act, this regulation, or any order or notice issued thereunder, the Board may institute a cease-and-desist proceeding in accordance with the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*).

4–017.1

SECTION 225.7—Exceptions to Tying Restrictions

(a) *Purpose.* This section establishes exceptions to the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)). These exceptions are in addition to those in section 106. The section also restricts tying of electronic benefit transfer services by bank holding companies and their nonbank subsidiaries.

(b) *Exceptions to statute.* Subject to the limitations of paragraph (c) of this section, a bank may—

(1) *Extension to affiliates of statutory exceptions preserving traditional banking relationships.* Extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement that a customer—

(i) obtain a loan, discount, deposit, or trust service from an affiliate of the bank; or

(ii) provide to an affiliate of the bank some additional credit, property, or service that the bank could require to be provided to itself pursuant to section 106(b)(1)(C) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(1)(C)).

(2) *Safe harbor for combined-balance discounts.* Vary the consideration for any product or package of products based on a customer's maintaining a combined minimum balance in certain products specified by the bank (eligible products), if—

(i) the bank offers deposits, and all such deposits are eligible products; and

(ii) balances in deposits count at least as much as nondeposit products toward the minimum balance.

(3) *Safe harbor for foreign transactions.* Engage in any transaction with a customer if that customer is—

(i) a corporation, business, or other person (other than an individual) that—

(A) is incorporated, chartered, or otherwise organized outside the United States; and

(B) has its principal place of business outside the United States; or

(ii) an individual who is a citizen of a foreign country and is not resident in the United States.

4–017.2

(c) *Limitations on exceptions.* Any exception granted pursuant to this section shall terminate upon a finding by the Board that the arrangement is resulting in anticompetitive practices. The eligibility of a bank to operate under any exception granted pursuant to this section shall terminate upon a finding by the Board that its exercise of this authority is resulting in anticompetitive practices.

(d) *Extension of statute to electronic benefit transfer services.* A bank holding company or nonbank subsidiary of a bank holding company that provides electronic benefit transfer services shall be subject to the anti-tying restrictions applicable to such services set forth in section 7(i)(11) of the Food Stamp Act of 1977 (7 U.S.C. 2016(i)(11)).

(e) For purposes of this section, ''bank'' has the meaning given that term in section 106(a) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971), but shall also include a United States branch, agency, or commercial lending company subsidiary of a foreign bank that is subject to section 106 pursuant to section 8(d) of the International Banking Act of 1978 (12 U.S.C. 3106(d)), and any company made subject to section 106 by section 4(f)(9) or 4(h) of the BHC Act.

4–017.5

SECTION 225.8—Capital Planning and Stress Capital Buffer Requirement*

(a) *Purpose.* This section establishes capital planning and prior notice and approval requirements for capital distributions by certain bank holding companies. This section also establishes the Board's process for determining the stress capital buffer requirement applicable to these bank holding companies.

(b) *Scope and reservation of authority.*

(1) *Applicability.* Except as provided in paragraph (c) of this section, this section applies to:

(i) Any top-tier bank holding company domiciled in the United States with average total consolidated assets of $100 billion or more ($100 billion asset threshold);

(ii) Any other bank holding company domiciled in the United States that is made subject to this section, in whole or in part, by order of the Board;

(iii) Any U.S. intermediate holding company subject to this section pursuant to 12 CFR 252.153; and

(iv) Any nonbank financial company supervised by the Board that is made subject to this section pursuant to a rule or order of the Board.

(2) *Average total consolidated assets.* For purposes of this section, average total consolidated assets means the average of the total consolidated assets as reported by a bank holding company on its Consolidated Financial Statements for Holding Companies (FR Y-9C) for the four most recent consecutive quarters. If the bank holding company has not filed the FR Y-9C for each of the four most recent consecutive quarters, average total consolidated assets means the average of the company's total consolidated assets, as reported on the company's FR Y-9C, for the most recent quarter or consecutive quarters, as applicable. Average total consolidated assets are measured on the as-of date of the most recent FR Y-9C used in the calculation of the average.

(3) *Ongoing applicability.* A bank holding company (including any successor bank holding company) that is subject to any requirement in this section shall remain subject to such requirements unless and until its total consolidated assets fall below $100 billion for each of four consecutive quarters, as reported on the FR Y-9C and effective on the as-of date of the fourth consecutive FR Y-9C.

(4) *Reservation of authority.* Nothing in this section shall limit the authority of the Federal Reserve to issue or enforce a capital directive or take any other supervisory or enforcement action, including an action to address unsafe or unsound practices or conditions or violations of law.

(5) *Rule of construction.* Unless the context otherwise requires, any reference to bank holding company in this section shall include a U.S. intermediate holding company and shall include a nonbank financial company supervised by the Board to the extent this section is made applicable pursuant to a rule or order of the Board.

(6) *Application of this section by order.* The Board may apply this section, in whole or in part, to a bank holding company by order based on the institution's size, level of complexity, risk profile, scope of operations, or financial condition.

(c) *Transition periods for certain bank holding companies.*

(1) A bank holding company that meets the $100 billion asset threshold (as measured under paragraph (b) of this section) on or before September 30 of a calendar year must comply with the requirements of this section beginning on January 1 of the next calendar year, unless that time is extended by the Board in writing. Notwithstanding the previous sentence, the Board will not provide a bank holding company with notice of its stress capital buffer requirement until the first year in which the Board conducts an analysis of the bank holding company pursuant to 12 CFR 252.44.

(2) A bank holding company that meets the $100 billion asset threshold after September

* For guidance on supervisory assessment of capital planning and positions: *see* 3–1506.311 (for LISCC firms and large and complex firms) and 3–1506.312 (for large and noncomplex firms).

30 of a calendar year must comply with the requirements of this section beginning on January 1 of the second calendar year after the bank holding company meets the $100 billion asset threshold, unless that time is extended by the Board in writing. Notwithstanding the previous sentence, the Board will not provide a bank holding company with notice of its stress capital buffer requirement until the first year in which the Board conducts an analysis of the bank holding company pursuant to 12 CFR 252.44.

(3) The Board, or the appropriate Reserve Bank with the concurrence of the Board, may require a bank holding company described in paragraph (c)(1) or (2) of this section to comply with any or all of the requirements of this section if the Board, or appropriate Reserve Bank with concurrence of the Board, determines that the requirement is appropriate on a different date based on the company's risk profile, scope of operation, or financial condition and provides prior notice to the company of the determination.

(d) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Advanced approaches* means the risk-weighted assets calculation methodologies at 12 CFR part 217, subpart E, as applicable.

(2) *Average total nonbank assets* means the average of the total nonbank assets, calculated in accordance with the instructions to the FR Y-9LP, for the four most recent calendar quarters or, if the bank holding company has not filed the FR Y-9LP for each of the four most recent calendar quarters, for the most recent quarter or quarters, as applicable.

(3) *Capital action* means any issuance of a debt or equity capital instrument, any capital distribution, and any similar action that the Federal Reserve determines could impact a bank holding company's consolidated capital.

(4) *Capital distribution* means a redemption or repurchase of any debt or equity capital instrument, a payment of common or preferred stock dividends, a payment that may be temporarily or permanently suspended by the issuer on any instrument that is eligible for inclusion in the numerator of any minimum regulatory capital ratio, and any similar transaction that the Federal Reserve determines to be in substance a distribution of capital.

(5) *Capital plan* means a written presentation of a bank holding company's capital planning strategies and capital adequacy process that includes the mandatory elements set forth in paragraph (e)(2) of this section.

(6) *Capital plan cycle* means the period beginning on January 1 of a calendar year and ending on December 31 of that year.

(7) *Capital policy* means a bank holding company's written principles and guidelines used for capital planning, capital issuance, capital usage and distributions, including internal capital goals; the quantitative or qualitative guidelines for capital distributions; the strategies for addressing potential capital shortfalls; and the internal governance procedures around capital policy principles and guidelines.

(8) *Category IV bank holding company* means any bank holding company or U.S. intermediate holding company subject to this section that, as of December 31 of the prior capital plan cycle, is a Category IV banking organization pursuant to 12 CFR 252.5.

(9) *Common equity tier 1 capital* has the same meaning as under 12 CFR part 217.

(10) *Effective capital distribution limitations* means any limitations on capital distributions established by the Board by order or regulation, including pursuant to 12 CFR 217.11, 225.4, 252.63, 252.165, and 263.202, provided that, for any limitations based on risk-weighted assets, such limitations must be calculated using the standardized approach, as set forth in 12 CFR part 217, subpart D.

(11) *Final planned capital distributions* means the planned capital distributions included in a capital plan that include the adjustments made pursuant to paragraph (h) of this section, if any.

(12) *GSIB surcharge* has the same meaning as under 12 CFR 217.403.

(13) *Internal baseline scenario* means a scenario that reflects the bank holding company's expectation of the economic and financial outlook, including expectations related to the bank holding company's capital adequacy and financial condition.

(14) *Internal stress scenario* means a scenario designed by a bank holding company that stresses the specific vulnerabilities of the bank holding company's risk profile and operations, including those related to the bank holding company's capital adequacy and financial condition.

(15) *Nonbank financial company supervised by the Board* means a company that the Financial Stability Oversight Council has determined under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323) shall be supervised by the Board and for which such determination is still in effect.

(16) *Planning horizon* means the period of at least nine consecutive quarters, beginning with the quarter preceding the quarter in which the bank holding company submits its capital plan, over which the relevant projections extend.

(17) *Regulatory capital ratio* means a capital ratio for which the Board has established minimum requirements for the bank holding company by regulation or order, including, as applicable, the bank holding company's regulatory capital ratios calculated under 12 CFR part 217 and the deductions required under 12 CFR 248.12; except that the bank holding company shall not use the advanced approaches to calculate its regulatory capital ratios.

(18) *Severely adverse scenario* has the same meaning as under 12 CFR part 252, subpart E.

(19) *Stress capital buffer requirement* means the amount calculated under paragraph (f) of this section.

(20) *Supervisory stress test* means a stress test conducted using a severely adverse scenario and the assumptions contained in 12 CFR part 252, subpart E.

(21) *U.S. intermediate holding company* means the top-tier U.S. company that is required to be established pursuant to 12 CFR 252.153.

(e) *Capital planning requirements and procedures.*

(1) *Annual capital planning.*

(i) A bank holding company must develop and maintain a capital plan.

(ii) A bank holding company must submit its complete capital plan to the Board and the appropriate Reserve Bank by April 5 of each calendar year, or such later date as directed by the Board or by the appropriate Reserve Bank with concurrence of the Board.

(iii) The bank holding company's board of directors or a designated committee thereof must at least annually and prior to submission of the capital plan under paragraph (e)(1)(ii) of this section:

(A) Review the robustness of the bank holding company's process for assessing capital adequacy;

(B) Ensure that any deficiencies in the bank holding company's process for assessing capital adequacy are appropriately remedied; and

(C) Approve the bank holding company's capital plan.

(2) *Mandatory elements of capital plan.* A capital plan must contain at least the following elements:

(i) An assessment of the expected uses and sources of capital over the planning horizon that reflects the bank holding company's size, complexity, risk profile, and scope of operations, assuming both expected and stressful conditions, including:

(A) Estimates of projected revenues, losses, reserves, and *pro forma* capital levels, including regulatory capital ratios, and any additional capital measures deemed relevant by the bank holding company, over the planning horizon under a range of scenarios, including:

(*1*) If the bank holding company is a Category IV bank holding company, the Internal baseline scenario and at least one Internal stress scenario, as well as any additional scenarios, based on financial conditions or the macroeconomic outlook, or based on the bank holding compa-

ny's financial condition, size, complexity, risk profile, or activities, or risks to the U.S. economy, that the Federal Reserve may provide the bank holding company after giving notice to the bank holding company; or

(*2*) If the bank holding company is not a Category IV bank holding company, any scenarios provided by the Federal Reserve, the Internal baseline scenario, and at least one Internal stress scenario;

(B) A discussion of the results of any stress test required by law or regulation, and an explanation of how the capital plan takes these results into account; and

(C) A description of all planned capital actions over the planning horizon. Planned capital actions must be consistent with effective capital distribution limitations, except as may be adjusted pursuant to paragraph (h) of this section. In determining whether a bank holding company's planned capital distributions are consistent with effective capital distribution limitations, a bank holding company must assume that:

(*1*) Any countercyclical capital buffer amount currently applicable to the bank holding company remains at the same level, except that the bank holding company must reflect any increases or decreases in the countercyclical capital buffer amount that have been announced by the Board at the times indicated by the Board's announcement for when such increases or decreases will take effect; and

(*2*) Any GSIB surcharge currently applicable to the bank holding company when the capital plan is submitted remains at the same level, except that the bank holding company must reflect any increase in its GSIB surcharge pursuant to 12 CFR 217.403(d)(1), beginning in the fifth quarter of the planning horizon.

(ii) A detailed description of the bank holding company's process for assessing capital adequacy, including:

(A) A discussion of how the bank holding company will, under expected and stressful conditions, maintain capital commensurate with its risks, maintain capital above the regulatory capital ratios, and serve as a source of strength to its subsidiary depository institutions;

(B) A discussion of how the bank holding company will, under expected and stressful conditions, maintain sufficient capital to continue its operations by maintaining ready access to funding, meeting its obligations to creditors and other counterparties, and continuing to serve as a credit intermediary;

(iii) The bank holding company's capital policy; and

(iv) A discussion of any expected changes to the bank holding company's business plan that are likely to have a material impact on the bank holding company's capital adequacy or liquidity.

(3) *Data collection.* Upon the request of the Board or appropriate Reserve Bank, the bank holding company shall provide the Federal Reserve with information regarding:

(i) The bank holding company's financial condition, including its capital;

(ii) The bank holding company's structure;

(iii) Amount and risk characteristics of the bank holding company's on- and off-balance sheet exposures, including exposures within the bank holding company's trading account, other trading-related exposures (such as counterparty-credit risk exposures) or other items sensitive to changes in market factors, including, as appropriate, information about the sensitivity of positions to changes in market rates and prices;

(iv) The bank holding company's relevant policies and procedures, including risk management policies and procedures;

(v) The bank holding company's liquidity profile and management;

(vi) The loss, revenue, and expense estimation models used by the bank holding company for stress scenario analysis, in-

cluding supporting documentation regarding each model's development and validation; and

(vii) Any other relevant qualitative or quantitative information requested by the Board or by the appropriate Reserve Bank to facilitate review of the bank holding company's capital plan under this section.

(4) *Resubmission of a capital plan.*

(i) A bank holding company must update and resubmit its capital plan to the appropriate Reserve Bank within 30 calendar days of the occurrence of one of the following events:

(A) The bank holding company determines there has been or will be a material change in the bank holding company's risk profile, financial condition, or corporate structure since the bank holding company last submitted the capital plan to the Board and the appropriate Reserve Bank under this section; or

(B) The Board, or the appropriate Reserve Bank with concurrence of the Board, directs the bank holding company in writing to revise and resubmit its capital plan for any of the following reasons:

(*1*) The capital plan is incomplete or the capital plan, or the bank holding company's internal capital adequacy process, contains material weaknesses;

(*2*) There has been, or will likely be, a material change in the bank holding company's risk profile (including a material change in its business strategy or any risk exposure), financial condition, or corporate structure;

(*3*) The Internal stress scenario(s) are not appropriate for the bank holding company's business model and portfolios, or changes in financial markets or the macro-economic outlook that could have a material impact on a bank holding company's risk profile and financial condition require the use of updated scenarios; or

(ii) The Board, or the appropriate Reserve Bank with concurrence of the Board, may extend the 30-day period in paragraph (e)(4)(i) of this section for up to an additional 60 calendar days, or such longer period as the Board or the appropriate Reserve Bank, with concurrence of the Board, determines appropriate.

(iii) Any updated capital plan must satisfy all the requirements of this section; however, a bank holding company may continue to rely on information submitted as part of a previously submitted capital plan to the extent that the information remains accurate and appropriate.

(5) *Confidential treatment of information submitted.* The confidentiality of information submitted to the Board under this section and related materials shall be determined in accordance with applicable exemptions under the Freedom of Information Act (5 U.S.C. 552(b)) and the Board's Rules Regarding Availability of Information (12 CFR part 261).

(f) *Calculation of the stress capital buffer requirement.*

(1) *General.* The Board will determine the stress capital buffer requirement that applies under 12 CFR 217.11 pursuant to this paragraph (f). For each bank holding company that is not a Category IV bank holding company, the Board will calculate the bank holding company's stress capital buffer requirement annually. For each Category IV bank holding company, the Board will calculate the bank holding company's stress capital buffer requirement biennially, occurring in each calendar year ending in an even number, and will adjust the bank holding company's stress capital buffer requirement biennially, occurring in each calendar year ending in an odd number. Notwithstanding the previous sentence, the Board will calculate the stress capital buffer requirement of a Category IV bank holding company in a year ending in an odd number with respect to which that company makes an election pursuant to 12 CFR 252.44(d)(2)(ii).

(2) *Stress capital buffer requirement calculation.* A bank holding company's stress

capital buffer requirement is equal to the greater of:

(i) The following calculation:

(A) The ratio of a bank holding company's common equity tier 1 capital to risk-weighted assets, as calculated under 12 CFR part 217, subpart D, as of the final quarter of the previous capital plan cycle, unless otherwise determined by the Board; *minus*

(B) The lowest projected ratio of the bank holding company's common equity tier 1 capital to risk-weighted assets, as calculated under 12 CFR part 217, subpart D, in any quarter of the planning horizon under a supervisory stress test; *plus*

(C) The ratio of:

(*1*) The sum of the bank holding company's planned common stock dividends (expressed as a dollar amount) for each of the fourth through seventh quarters of the planning horizon; to

(*2*) The risk-weighted assets of the bank holding company in the quarter in which the bank holding company had its lowest projected ratio of common equity tier 1 capital to risk-weighted assets, as calculated under 12 CFR part 217, subpart D, in any quarter of the planning horizon under a supervisory stress test; and

(ii) 2.5 percent.

(3) *Recalculation of stress capital buffer requirement.* If a bank holding company resubmits its capital plan pursuant to paragraph (e)(4) of this section, the Board may recalculate the bank holding company's stress capital buffer requirement. The Board will provide notice of whether the bank holding company's stress capital buffer requirement will be recalculated within 75 calendar days after the date on which the capital plan is resubmitted, unless the Board provides notice to the company that it is extending the time period.

(4) *Adjustment of stress capital buffer requirement.* In each calendar year in which the Board does not calculate a Category IV bank holding company's stress capital buffer requirement pursuant to paragraph (f)(1) of this section, the Board will adjust the Category IV bank holding company's stress capital buffer requirement to be equal to the result of the calculation set forth in paragraph (f)(2) of this section, using the same values that were used to calculate the stress capital buffer requirement most recently provided to the bank holding company, except that the value used in paragraph (f)(2)(i)(C)(*1*) of this section will be equal to the bank holding company's planned common stock dividends (expressed as a dollar amount) for each of the fourth through seventh quarters of the planning horizon as set forth in the capital plan submitted by the bank holding company in the calendar year in which the Board adjusts the bank holding company's stress capital buffer requirement.

(g) *Review of capital plans by the Federal Reserve.* The Board, or the appropriate Reserve Bank with concurrence of the Board, will consider the following factors in reviewing a bank holding company's capital plan:

(1) The comprehensiveness of the capital plan, including the extent to which the analysis underlying the capital plan captures and addresses potential risks stemming from activities across the bank holding company and the bank holding company's capital policy;

(2) The reasonableness of the bank holding company's capital plan, the assumptions and analysis underlying the capital plan, and the robustness of its capital adequacy process;

(3) Relevant supervisory information about the bank holding company and its subsidiaries;

(4) The bank holding company's regulatory and financial reports, as well as supporting data that would allow for an analysis of the bank holding company's loss, revenue, and reserve projections;

(5) The results of any stress tests conducted by the bank holding company or the Federal Reserve; and

(6) Other information requested or required by the Board or the appropriate Reserve Bank, as well as any other information relevant, or related, to the bank holding company's capital adequacy.

(h) *Federal Reserve notice of stress capital buffer requirement; final planned capital distributions.*

(1) *Notice.* The Board will provide a bank holding company with notice of its stress capital buffer requirement and an explanation of the results of the supervisory stress test. Unless otherwise determined by the Board, notice will be provided by June 30 of the calendar year in which the capital plan was submitted pursuant to paragraph (e)(1)(ii) of this section or within 90 calendar days of receiving notice that the Board will recalculate the bank holding company's stress capital buffer requirement pursuant to paragraph (f)(3) of this section.

(2) *Response to notice.*

(i) *Request for reconsideration of stress capital buffer requirement.* A bank holding company may request reconsideration of a stress capital buffer requirement provided under paragraph (h)(1) of this section. To request reconsideration of a stress capital buffer requirement, a bank holding company must submit to the Board a request pursuant to paragraph (i) of this section.

(ii) *Adjustments to planned capital distributions.* Within two business days of receipt of notice of a stress capital buffer requirement under paragraph (h)(1) or (i)(5) of this section, as applicable, a bank holding company must:

(A) Determine whether the planned capital distributions for the fourth through seventh quarters of the planning horizon under the Internal baseline scenario would be consistent with effective capital distribution limitations assuming the stress capital buffer requirement provided by the Board under paragraph (h)(1) or (i)(5) of this section, as applicable, in place of any stress capital buffer requirement in effect; and

(*1*) If the planned capital distributions for the fourth through seventh quarters of the planning horizon under the Internal baseline scenario would not be consistent with effective capital distribution limitations assuming the stress capital buffer requirement provided by the Board under paragraph (h)(1) or (i)(5) of this section, as applicable, in place of any stress capital buffer requirement in effect, the bank holding company must adjust its planned capital distributions such that its planned capital distributions would be consistent with effective capital distribution limitations assuming the stress capital buffer requirement provided by the Board under paragraph (h)(1) or (i)(5) of this section, as applicable, in place of any stress capital buffer requirement in effect; or

(*2*) If the planned capital distributions for the fourth through seventh quarters of the planning horizon under the Internal baseline scenario would be consistent with effective capital distribution limitations assuming the stress capital buffer requirement provided by the Board under paragraph (h)(1) or (i)(5) of this section, as applicable, in place of any stress capital buffer requirement in effect, the bank holding company may adjust its planned capital distributions. A bank holding company may not adjust its planned capital distributions to be inconsistent with the effective capital distribution limitations assuming the stress capital buffer requirement provided by the Board under paragraph (h)(1) or (i)(5) of this section, as applicable; and

(B) Notify the Board of any adjustments made to planned capital distributions for the fourth through seventh quarters of the planning horizon under the Internal baseline scenario.

(3) *Final planned capital distributions.* The Board will consider the planned capital distributions, including any adjustments made pursuant to paragraph (h)(2)(ii) of this section, to be the bank holding company's final planned capital distributions on the later of:

(i) The expiration of the time for re-

questing reconsideration under paragraph (i) of this section; and

(ii) The expiration of the time for adjusting planned capital distributions pursuant to paragraph (h)(2)(ii) of this section.

(4) *Effective date of final stress capital buffer requirement.*

(i) The Board will provide a bank holding company with its final stress capital buffer requirement and confirmation of the bank holding company's final planned capital distributions by August 31 of the calendar year that a capital plan was submitted pursuant to paragraph (e)(1)(ii) of this section, unless otherwise determined by the Board. A stress capital buffer requirement will not be considered final so as to be agency action subject to judicial review under 5 U.S.C. 704 during the pendency of a request for reconsideration made pursuant to paragraph (i) of this section or before the time for requesting reconsideration has expired.

(ii) Unless otherwise determined by the Board, a bank holding company's final planned capital distributions and final stress capital buffer requirement shall:

(A) Be effective on October 1 of the calendar year in which a capital plan was submitted pursuant to paragraph (e)(1)(ii) of this section; and

(B) Remain in effect until superseded.

(5) *Publication.* With respect to any bank holding company subject to this section, the Board may disclose publicly any or all of the following:

(i) The stress capital buffer requirement provided to a bank holding company under paragraph (h)(1) or (i)(5) of this section;

(ii) Adjustments made pursuant to paragraph (h)(2)(ii);

(iii) A summary of the results of the supervisory stress test; and

(iv) Other information.

(i) *Administrative remedies; request for reconsideration.* The following requirements and procedures apply to any request under this paragraph (i):

(1) *General.* To request reconsideration of a stress capital buffer requirement, provided under paragraph (h) of this section, a bank holding company must submit a written request for reconsideration.

(2) *Timing of request.* A request for reconsideration of a stress capital buffer requirement, provided under paragraph (h) of this section, must be received within 15 calendar days of receipt of a notice of a bank holding company's stress capital buffer requirement.

(3) *Contents of request.*

(i) A request for reconsideration must include a detailed explanation of why reconsideration should be granted (that is, why a stress capital buffer requirement should be reconsidered). With respect to any information that was not previously provided to the Federal Reserve in the bank holding company's capital plan, the request should include an explanation of why the information should be considered.

(ii) A request for reconsideration may include a request for an informal hearing on the bank holding company's request for reconsideration.

(4) *Hearing.*

(i) The Board may, in its sole discretion, order an informal hearing if the Board finds that a hearing is appropriate or necessary to resolve disputes regarding material issues of fact.

(ii) An informal hearing shall be held within 30 calendar days of a request, if granted, provided that the Board may extend this period upon notice to the requesting party.

(5) *Response to request.* Within 30 calendar days of receipt of the bank holding company's request for reconsideration of its stress capital buffer requirement submitted under paragraph (i)(2) of this section or within 30 days of the conclusion of an informal hearing conducted under paragraph (i)(4) of this section, the Board will notify the company of its decision to affirm or modify the bank holding company's stress capital buffer requirement, provided that the Board may extend this period upon notice to the bank holding company.

(6) *Distributions during the pendency of a request for reconsideration.* During the pen-

dency of the Board's decision under paragraph (i)(5) of this section, the bank holding company may make capital distributions that are consistent with effective distribution limitations, unless prior approval is required under paragraph (j)(1) of this section.

(j) *Approval requirements for certain capital actions.*

(1) *Circumstances requiring approval—Resubmission of a capital plan.* Unless it receives prior approval pursuant to paragraph (j)(3) of this section, a bank holding company may not make a capital distribution (excluding any capital distribution arising from the issuance of a capital instrument eligible for inclusion in the numerator of a regulatory capital ratio) if the capital distribution would occur after the occurrence of an event requiring resubmission under paragraph (e)(4)(i)(A) or (B) of this section.

(2) *Contents of request.* A request for a capital distribution under this section must contain the following information:

(i) The bank holding company's capital plan or a discussion of changes to the bank holding company's capital plan since it was last submitted to the Federal Reserve;

(ii) The purpose of the transaction;

(iii) A description of the capital distribution, including for redemptions or repurchases of securities, the gross consideration to be paid and the terms and sources of funding for the transaction, and for dividends, the amount of the dividend(s); and

(iv) Any additional information requested by the Board or the appropriate Reserve Bank (which may include, among other things, an assessment of the bank holding company's capital adequacy under a severely adverse scenario, a revised capital plan, and supporting data).

(3) *Approval of certain capital distributions.*

(i) The Board, or the appropriate Reserve Bank with concurrence of the Board, will act on a request for prior approval of a capital distribution within 30 calendar days after the receipt of all the information required under paragraph (j)(2) of this section.

(ii) In acting on a request for prior approval of a capital distribution, the Board, or appropriate Reserve Bank with concurrence of the Board, will apply the considerations and principles in paragraph (g) of this section, as appropriate. In addition, the Board, or the appropriate Reserve Bank with concurrence of the Board, may disapprove the transaction if the bank holding company does not provide all of the information required to be submitted under paragraph (j)(2) of this section.

(4) *Disapproval and hearing.*

(i) The Board, or the appropriate Reserve Bank with concurrence of the Board, will notify the bank holding company in writing of the reasons for a decision to disapprove any proposed capital distribution. Within 15 calendar days after receipt of a disapproval by the Board, the bank holding company may submit a written request for a hearing.

(ii) The Board may, in its sole discretion, order an informal hearing if the Board finds that a hearing is appropriate or necessary to resolve disputes regarding material issues of fact. An informal hearing shall be held within 30 calendar days of a request, if granted, provided that the Board may extend this period upon notice to the requesting party.

(iii) Written notice of the final decision of the Board shall be given to the bank holding company within 60 calendar days of the conclusion of any informal hearing ordered by the Board, provided that the Board may extend this period upon notice to the requesting party.

(iv) While the Board's decision is pending and until such time as the Board, or the appropriate Reserve Bank with concurrence of the Board, approves the capital distribution at issue, the bank holding company may not make such capital distribution.

(k) *Post notice requirement.* A bank holding company must notify the Board and the ap-

propriate Reserve Bank within 15 days of making a capital distribution if:

(1) The capital distribution was approved pursuant to paragraph (j)(3) of this section; or

(2) The dollar amount of the capital distribution will exceed the dollar amount of the bank holding company's final planned capital distributions, as measured on an aggregate basis beginning in the fourth quarter of the planning horizon through the quarter at issue.

4–017.6

SECTION 225.9—Control over Securities

(a) *Contingent rights, convertible securities, options, and warrants.*

(1) A person that controls a security, option, warrant, or other financial instrument that is convertible into, exercisable for, exchangeable for, or otherwise may become a security controls each security that could be acquired as a result of such conversion, exercise, exchange, or similar occurrence.

(2) If a financial instrument of the type described in paragraph (a)(1) of this section is convertible into, exercisable for, exchangeable for, or otherwise may become a number of securities that varies according to a formula, rate, or other variable metric, the number of securities controlled under paragraph (a)(1) of this section is the maximum number of securities that the financial instrument could be converted into, be exercised for, be exchanged for, or otherwise become under the formula, rate, or other variable metric.

(3) Notwithstanding paragraph (a)(1) of this section, a person does not control voting securities due to controlling a financial instrument if the financial instrument:

(i) By its terms is not convertible into, is not exercisable for, is not exchangeable for, and may not otherwise become voting securities in the hands of the person or an affiliate of the person; and

(ii) By its terms is only convertible into, exercisable for, exchangeable for, or may otherwise become voting securities in the hands of a transferee after a transfer:

(A) In a widespread public distribution;

(B) To the issuing company;

(C) In transfers in which no transferee (or group of associated transferees) would receive 2 percent or more of the outstanding securities of any class of voting securities of the issuing company; or

(D) To a transferee that would control more than 50 percent of every class of voting securities of the issuing company without any transfer from the person.

(4) Notwithstanding paragraph (a)(1) of this section, a person that has agreed to acquire securities or other financial instruments pursuant to a securities purchase agreement does not control such securities or financial instruments until the person acquires the securities or financial instruments.

(5) Notwithstanding paragraph (a)(1) of this section, a right that provides a person the ability to acquire securities in future issuances or to convert nonvoting securities into voting securities does not cause the person to control the securities that could be acquired under the right, so long as the right does not allow the person to acquire a higher percentage of the class of securities than the person controlled immediately prior to the future acquisition.

(6) Notwithstanding paragraph (a)(1) of this section, a preferred security that would be a nonvoting security but for a right to vote on directors that activates only after six or more quarters of unpaid dividends is not considered to be a voting security until the security holder is entitled to exercise the voting right.

(7) For purposes of determining the percentage of a class of voting securities or the total equity percentage of a company controlled by a person that controls a financial instrument of the type described in paragraph (a)(1) of this section:

(i) The securities controlled by the person under paragraphs (a)(1) through (6) of this section are deemed to be issued and outstanding; and

(ii) Any securities controlled by anyone other than the person under paragraph (a)(1) through (6) of this section are not deemed to be issued and outstanding, unless by the terms of the financial instruments the securities controlled by the other persons must be issued and outstanding in order for the securities of the person to be issued and outstanding.

(b) *Restriction on securities.* A person that enters into an agreement or understanding with a second person under which the rights of the second person are restricted in any manner with respect to securities that are controlled by the second person, controls the securities of the second person, unless the restriction is:

(1) A requirement that the second person offer the securities for sale to the first person for a reasonable period of time prior to transferring the securities to a third party;

(2) A requirement that, if the second person agrees to sell the securities, the second person provide the first person with the opportunity to participate in the sale of the securities by the second person;

(3) A requirement under which the second person agrees to sell its securities to a third party if a majority of security holders agrees to sell their securities to the third party;

(4) Incident to a *bona fide* loan transaction in which the securities serve as collateral;

(5) A short-term and revocable proxy;

(6) A restriction on transferability that continues only for a reasonable amount of time necessary to complete an acquisition by the first person of the securities from the second person, including the time necessary to obtain required approval from an appropriate government authority with respect to the acquisition;

(7) A requirement that the second person vote the securities in favor of a specific acquisition of control of the issuing company, or against competing transactions, if the restriction continues only for a reasonable amount of time necessary to complete the transaction, including the time necessary to obtain required approval from an appropriate government authority with respect to an acquisition or merger; or

(8) An agreement among security holders of the issuing company intended to preserve the tax status or tax benefits of the company, such as qualification of the issuing company as a Subchapter S corporation, as defined in 26 U.S.C. 1361(a)(1) or any successor statute, or prevention of events that could impair deferred tax assets, such as net operating loss carryforwards, as described in 26 U.S.C. 382 or any successor statute.

(c) *Securities held by senior management officials or controlling equity holders of a company.* A company that controls 5 percent or more of any class of voting securities of another company controls all securities issued by the second company that are controlled by senior management officials, directors, or controlling shareholders of the first company, or by immediate family members of such persons, unless the first company controls less than 15 percent of each class of voting securities of the second company and the senior management officials, directors, and controlling shareholders of the first company, and immediate family members of such persons, control 50 percent or more of each class of voting securities of the second company.

(d) *Reservation of authority.* Notwithstanding paragraphs (a) through (c) of this section, the Board may determine that securities are or are not controlled by a company based on the facts and circumstances presented.

4–017.7

SECTION 225.10—Temporary Relief for 2020 and 2021

(a) Except as provided in paragraph (c) of this section and subject to the provisions of paragraph (d) of this section, from December 2, 2020, through December 31, 2021, the consolidated assets, consolidated risk-weighted assets, total consolidated assets, and total assets of a bank holding company for purposes of sections 225.4(b)(2)(iii)(A) and (B), 225.14(a)(1)(v)(A)(*1*) and (*2*), 225.14(a)(1)(vi), 225.23(a)(1)(iii)(A)(*1*) and (*2*), 225.24(a)(2)(iv) and (v), and

225.28(b)(11)(vi) shall be determined based on the lesser of each such amount as of December 31, 2019, and as of the otherwise applicable asset measurement date of the relevant paragraph.

(b) Except as provided in paragraph (c) of this section and subject to the provisions of paragraph (d) of this section, from December 2, 2020, through December 31, 2021, for purposes of determining the applicability of sections 224.14(c)(6)(ii), 225.17(a)(6), and 225.23(c)(5)(ii) of this part and appendix C to this part, the *pro forma* consolidated assets of a bank holding company and the consolidated risk-weighted assets of a bank holding company immediately following consummation of a transaction each shall be calculated as the lesser of:

(1) Such amount calculated as the sum of the assets of each company involved in the proposed business combination, as well as any company with which any such company has combined since December 31, 2019, as of December 31, 2019; and

(2) Such amount calculated as the sum of the assets of each company involved in the proposed business combination as of the end of the most recent calendar quarter.

(c) The relief provided under paragraphs (a) and (b) of this section does not apply to a bank holding company if the Board determines that permitting the bank holding company to determine its assets in accordance with that paragraph would not be commensurate with the risk profile of the bank holding company. When making this determination, the Board will consider all relevant factors, including the extent of asset growth of the bank holding company since December 31, 2019; the causes of such growth, including whether growth occurred as a result of mergers or acquisitions; whether such growth is likely to be temporary or permanent; whether the bank holding company has become involved in any additional activities since December 31, 2019; the asset size of any parent companies; and the type of assets held by the bank holding company. In making a determination pursuant to this section, the Board will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

(d) Nothing in this section limits the discretion of the Board or its delegatee to disallow the use of any expedited action process, require the submission of additional information in connection with a notice or application, or consider the ability of a bank holding company filing a notice or application under this part to comply with any statutory or regulatory requirements that may be applicable to the bank holding company upon expiration of the relief provided by this section.

4–018

SUBPART B—ACQUISITION OF BANK SECURITIES OR ASSETS

SECTION 225.11—Transactions Requiring Board Approval

The following transactions require an application for the Board's prior approval under section 3 of the Bank Holding Company Act except as exempted under section 225.12 or as otherwise covered by section 225.17 of this subpart.

(a) *Formation of bank holding company.* Any action that causes a bank or other company to become a bank holding company.

(b) *Acquisition of subsidiary bank.* Any action that causes a bank to become a subsidiary of a bank holding company.

(c) *Acquisition of control of bank or bank holding company securities.*

(1) The acquisition by a bank holding company of direct or indirect ownership or control of any voting securities of a bank or bank holding company, if the acquisition results in the company's control of more than 5 percent of the outstanding shares of any class of voting securities of the bank or bank holding company.

(2) An acquisition includes the purchase of additional securities through the exercise of preemptive rights, but does not include securities received in a stock dividend or stock split that does not alter the bank hold-

ing company's proportional share of any class of voting securities.

(d) *Acquisition of bank assets.* The acquisition by a bank holding company or by a subsidiary thereof (other than a bank) of all or substantially all of the assets of a bank.

(e) *Merger of bank holding companies.* The merger or consolidation of bank holding companies, including a merger through the purchase of assets and assumption of liabilities.

(f) *Transactions by foreign banking organization.* Any transaction described in paragraphs (a) through (e) of this section by a foreign banking organization that involves the acquisition of an interest in a U.S. bank or in a bank holding company for which application would be required if the foreign banking organization were a bank holding company.

4–019

SECTION 225.12—Transactions Not Requiring Board Approval

The following transactions do *not* require the Board's approval under section 225.11 of this subpart:

(a) *Acquisition of securities in fiduciary capacity.* The acquisition by a bank or other company (other than a trust that is a company) of control of voting securities of a bank or bank holding company in good faith in a fiduciary capacity, unless—

(1) the acquiring bank or other company has sole discretionary authority to vote the securities and retains the authority for more than two years; or

(2) the acquisition is for the benefit of the acquiring bank or other company, or its shareholders, employees, or subsidiaries.

4–020

(b) *Acquisition of securities in satisfaction of debts previously contracted.* The acquisition by a bank or other company of control of voting securities of a bank or bank holding company in the regular course of securing or collecting a debt previously contracted in good faith, if the acquiring bank or other company divests the securities within two years of acquisition. The Board or Reserve Bank may grant requests for up to three one-year extensions.

(c) *Acquisition of securities by bank holding company with majority control.* The acquisition by a bank holding company of additional voting securities of a bank or bank holding company if more than 50 percent of the outstanding voting securities of the bank or bank holding company is lawfully controlled by the acquiring bank holding company prior to the acquisition.

4–021

(d) *Acquisitions involving bank mergers and internal corporate reorganizations.*

(1) *Transactions subject to Bank Merger Act.* The merger or consolidation of a subsidiary bank of a bank holding company with another bank, or the purchase of assets by the subsidiary bank, or a similar transaction involving subsidiary banks of a bank holding company, if the transaction requires the prior approval of a federal supervisory agency under the Bank Merger Act (12 U.S.C. 1828(c)) and does not involve the acquisition of shares of a bank. This exception does not include—

(i) the merger of a nonsubsidiary bank and a nonoperating subsidiary bank formed by a company for the purpose of acquiring the nonsubsidiary bank; or

(ii) any transaction requiring the Board's prior approval under section 225.11(e) of this subpart.

The Board may require an application under this subpart if it determines that the merger or consolidation would have a significant adverse impact on the financial condition of the bank holding company, or otherwise requires approval under section 3 of the BHC Act.

4–021.1

(2) *Certain acquisitions subject to the Bank Merger Act.* The acquisition by a bank holding company of shares of a bank or company controlling a bank or the merger of a company controlling a bank with the bank holding company, if the transaction is part of the merger or consolidation of the bank with a subsidiary bank (other than a

nonoperating subsidiary bank) of the acquiring bank holding company, or is part of the purchase of substantially all of the assets of the bank by a subsidiary bank (other than a nonoperating subsidiary bank) of the acquiring bank holding company, and if—

(i) the bank merger, consolidation, or asset purchase occurs simultaneously with the acquisition of the shares of the bank or bank holding company or the merger of holding companies, and the bank is not operated by the acquiring bank holding company as a separate entity other than as the survivor of the merger, consolidation, or asset purchase;

(ii) the transaction requires the prior approval of a federal supervisory agency under the Bank Merger Act (12 U.S.C. 1828(c));

(iii) the transaction does not involve the acquisition of any nonbank company that would require prior approval under section 4 of the Bank Holding Company Act (12 U.S.C. 1843);

(iv) both before and after the transaction, the acquiring bank holding company meets the requirements of 12 CFR part 217;

(v) at least 10 days prior to the transaction, the acquiring bank holding company has provided to the Reserve Bank written notice of the transaction that contains—

(A) a copy of the filing made to the appropriate federal banking agency under the Bank Merger Act; and

(B) a description of the holding company's involvement in the transaction, the purchase price, and the source of funding for the purchase price; and

(vi) prior to expiration of the period provided in paragraph (d)(2)(v) of this section, the Reserve Bank has not informed the bank holding company that an application under section 225.11 is required.

4–021.11

(3) *Internal corporate reorganizations.*

(i) Subject to paragraph (d)(3)(ii) of this section, any of the following transactions performed in the United States by a bank holding company:

(A) the merger of holding companies that are subsidiaries of the bank holding company;

(B) the formation of a subsidiary holding company;[1]

(C) the transfer of control or ownership of a subsidiary bank or a subsidiary holding company between one subsidiary holding company and another subsidiary holding company or the bank holding company.

(ii) A transaction described in paragraph (d)(3)(i) of this section qualifies for this exception if—

(A) the transaction represents solely a corporate reorganization involving companies and insured depository institutions that, both preceding and following the transaction, are lawfully controlled and operated by the bank holding company;

(B) the transaction does not involve the acquisition of additional voting shares of an insured depository institution that, prior to the transaction, was less than majority-owned by the bank holding company;

(C) the bank holding company is not organized in mutual form; and

(D) both before and after the transaction, the bank holding company meets the Board's capital adequacy guidelines (appendixes A, B, C, D, and E of this part).

4–021.2

(e) *Holding securities in escrow.* The holding of voting securities of a bank or bank holding company in an escrow arrangement for the benefit of an applicant pending the Board's action on an application for approval of the proposed acquisition, if title to the securities and the voting rights remain with the seller and payment for the securities has not been made to the seller.

(f) *Acquisition of foreign banking organization.* The acquisition of a foreign banking organization where the foreign banking organi-

[1] In the case of a transaction that results in the formation or designation of a new bank holding company, the new bank holding company must complete the registration requirements described in section 225.5.

zation does not directly or indirectly own or control a bank in the United States, unless the acquisition is also by a foreign banking organization and otherwise subject to section 225.11(f) of this subpart.

4–022

SECTION 225.13—Factors Considered in Acting on Bank Acquisition Proposals

(a) *Factors requiring denial.* As specified in section 3(c) of the BHC Act, the Board may not approve any application under this subpart if—

(1) the transaction would result in a monopoly or would further any combination or conspiracy to monopolize, or to attempt to monopolize, the business of banking in any part of the United States;

(2) the effect of the transaction may be substantially to lessen competition in any section of the country, tend to create a monopoly, or in any other manner be in restraint of trade, unless the Board finds that the transaction's anticompetitive effects are clearly outweighed by its probable effect in meeting the convenience and needs of the community;

(3) the applicant has failed to provide the Board with adequate assurances that it will make available such information on its operations or activities, and the operations or activities of any affiliate of the applicant, that the Board deems appropriate to determine and enforce compliance with the BHC Act and other applicable federal banking statutes, and any regulations thereunder; or

(4) in the case of an application involving a foreign banking organization, the foreign banking organization is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country, as provided in section 211.24(c)(1)(ii) of the Board's Regulation K (12 CFR 211.24(c)(1)(ii)).

4–023

(b) *Other factors.* In deciding applications under this subpart, the Board also considers the following factors with respect to the applicant, its subsidiaries, any banks related to the applicant through common ownership or management, and the bank or banks to be acquired:

(1) *Financial condition.* Their financial condition and future prospects, including whether current and projected capital positions and levels of indebtedness conform to standards and policies established by the Board.

(2) *Managerial resources.* The competence, experience, and integrity of the officers, directors, and principal shareholders of the applicant, its subsidiaries and the banks and bank holding companies concerned; their record of compliance with laws and regulations; and the record of the applicant and its affiliates of fulfilling any commitments to, and any conditions imposed by, the Board in connection with prior applications.

(3) *Convenience and needs of the community.* The convenience and needs of the communities to be served, including the record of performance under the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*) and regulations issued thereunder, including the Board's Regulation BB (12 CFR 228.)

4–024

(c) *Interstate transactions.* The Board may approve any application or notice under this subpart by a bank holding company to acquire control of all or substantially all of the assets of a bank located in a state other than the home state of the bank holding company, without regard to whether the transaction is prohibited under the law of any state, if the transaction complies with the requirements of section 3(d) of the BHC Act (12 U.S.C. 1842(d)).

(d) *Conditional approvals.* The Board may impose conditions on any approval, including conditions to address competitive, financial, managerial, safety-and-soundness, convenience-and-needs, compliance or other concerns, to ensure that approval is consistent with the relevant statutory factors and other provisions of the BHC Act.

4–024.1

SECTION 225.14—Expedited Action for Certain Bank Acquisitions by Well-Run Bank Holding Companies

(a) *Filing of notice.*

(1) *Information required and public notice.* As an alternative to the procedure provided in section 225.15, a bank holding company that meets the requirements of paragraph (c) of this section may satisfy the prior-approval requirements of section 225.11 in connection with the acquisition of shares, assets, or control of a bank, or a merger or consolidation between bank holding companies, by providing the appropriate Reserve Bank with a written notice containing the following:

(i) a certification that all of the criteria in paragraph (c) of this section are met;

(ii) a description of the transaction that includes identification of the companies and insured depository institutions involved in the transaction[1] and identification of each banking market affected by the transaction;

(iii) a description of the effect of the transaction on the convenience and needs of the communities to be served and of the actions being taken by the bank holding company to improve the CRA performance of any insured depository institution subsidiary that does not have at least a satisfactory CRA performance rating at the time of the transaction;

(iv) evidence that notice of the proposal has been published in accordance with section 225.16(b)(1);

(v) (A) if the bank holding company is not a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), and:

(*1*) if the bank holding company has consolidated assets of $3 billion or more, an abbreviated consolidated *pro forma* balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* risk-based capital ratios for the acquiring bank holding company as of the most recent quarter, and a description of the purchase price and the terms and sources of funding for the transaction; or

(*2*) if the bank holding company has consolidated assets of less than $3 billion, a *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, and a description of the purchase price, the terms and sources of funding for the transaction, and the sources and schedule for retiring any debt incurred in the transaction;

(B) if the bank holding company is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), an abbreviated consolidated *pro forma* balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* leverage ratio (as calculated under section 217.12 of this chapter) for the acquiring bank holding company as of the most recent quarter, and a description of the purchase price and the terms and sources of funding for the transaction;

(vi) if the bank holding company has consolidated assets of less than $300 million, a list of and biographical information regarding any directors or senior executive officers of the resulting bank holding company that are not directors or

[1] If, in connection with a transaction under this subpart, any person or group of persons proposes to acquire control of the acquiring bank holding company for purposes of the Bank Control Act or section 225.41, the person or group of persons may fulfill the notice requirements of the Bank Control Act and section 225.43 by providing, as part of the submission by the acquiring bank holding company under this subpart, identifying and biographical information required in paragraph (6)(A) of the Bank Control Act (12 U.S.C. 1817(j)(6)(A)), as well as any financial or other information requested by the Reserve Bank under section 225.43.

senior executive officers of the acquiring bank holding company or of a company or institution to be acquired;

(vii) (A) For each insured depository institution (that is not a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter)) whose tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, tier 1 capital and total capital of the institution on a *pro forma* basis; and

(B) For each insured depository institution that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) whose tier 1 capital (as defined in section 217.2 of this chapter and calculated in accordance with section 217.12(b) of this chapter) or total assets change as a result of the transaction, the total assets and tier 1 capital of the institution of a *pro forma* basis; and

(viii) the market indexes for each relevant banking market reflecting the *pro forma* effect of the transaction.

(2) *Waiver of unnecessary information.* The Reserve Bank may reduce the information requirements in paragraph (a)(1)(v) through (viii) as appropriate.

4–024.2

(b) (1) *Action on proposals under this section.* The Board or the appropriate Reserve Bank shall act on a proposal submitted under this section or notify the bank holding company that the transaction is subject to the procedure in section 225.15 within five business days after the close of the public-comment period. The Board and the Reserve Bank shall not approve any proposal under this section prior to the third business day following the close of the public-comment period, unless an emergency exists that requires expedited or immediate action. The Board may extend the period for action under this section for up to five business days.

(2) *Acceptance of notice in event expedited procedure not available.* In the event that the Board or the Reserve Bank determines after the filing of a notice under this section that a bank holding company may not use the procedure in this section and must file an application under section 225.15, the application shall be deemed accepted for purposes of section 225.15 as of the date that the notice was filed under this section.

4–024.3

(c) *Criteria for use of expedited procedure.* The procedure in this section is available only if—

(1) *Well-capitalized organization.*

(i) *Bank holding company.* Both at the time of and immediately after the proposed transaction, the acquiring bank holding company is well capitalized;

(ii) *Insured depository institutions.* Both at the time of and immediately after the proposed transaction—

(A) the lead insured depository institution of the acquiring bank holding company is well capitalized;

(B) well-capitalized insured depository institutions control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the acquiring bank holding company; and

(C) no insured depository institution controlled by the acquiring bank holding company is undercapitalized;

(2) *Well-managed organization.*

(i) *Satisfactory examination ratings.* At the time of the transaction, the acquiring bank holding company, its lead insured depository institution, and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the holding company are well managed and have received at least a satisfactory rating for compliance at their most recent examination if such a rating was given;

(ii) *No poorly managed institutions.* No insured depository institution controlled

by the acquiring bank holding company has received 1 of the 2 lowest composite ratings at the later of the institution's most recent examination or subsequent review by the appropriate federal banking agency for the institution;

(iii) *Recently acquired institutions excluded.* Any insured depository institution that has been acquired by the bank holding company during the 12-month period preceding the date on which written notice is filed under paragraph (a) of this section may be excluded for purposes of paragraph (c)(2)(ii) if—

(A) the bank holding company has developed a plan acceptable to the appropriate federal banking agency for the institution to restore the capital and management of the institution; and

(B) All insured depository institutions excluded under this paragraph represent, in the aggregate, less than 10 percent of the aggregate total risk-weighted assets of all insured depository institutions controlled by the bank holding company;

4–024.4

(3) *Convenience-and-needs criteria.*

(i) *Effect on the community.* The record indicates that the proposed transaction would meet the convenience and needs of the community standard in the BHC Act; and

(ii) *Established CRA performance record.* At the time of the transaction, the lead insured depository institution of the acquiring bank holding company and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured institutions controlled by the holding company have received a satisfactory or better composite rating at the most recent examination under the Community Reinvestment Act;

(4) *Public comment.* No comment that is timely and substantive as provided in section 225.16 is received by the Board or the appropriate Reserve Bank other than a comment that supports approval of the proposal;

(5) *Competitive criteria.*

(i) *Competitive screen.* Without regard to any divestitures proposed by the acquiring bank holding company, the acquisition does not cause—

(A) insured depository institutions controlled by the acquiring bank holding company to control in excess of 35 percent of market deposits in any relevant banking market; or

(B) the Herfindahl-Hirschman index to increase by more than 200 points in any relevant banking market with a post-acquisition index of at least 1800; and

(ii) *Department of Justice.* The Department of Justice has not indicated to the Board that consummation of the transaction is likely to have a significantly adverse effect on competition in any relevant banking market;

4–024.5

(6) *Size of acquisition.*

(i) *In general.*

(A) *Limited growth.* Except as provided in paragraphs (c)(6)(ii) and (iii) of this section, the sum of the aggregate risk-weighted assets to be acquired in the proposal and the aggregate risk-weighted assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the consolidated risk-weighted assets of the acquiring bank holding company. For purposes paragraph (c)(6) of this section, *other qualifying transactions* means any transaction approved under this section or section 225.23 during the 12 months prior to filing the notice under this section; and

(B) *Individual size limitation.* Except as provided in paragraph (c)(6)(iii) of this section, the total risk-weighted assets to be acquired do not exceed $7.5 billion;

(ii) *Small bank holding companies.* Paragraph (c)(6)(i)(A) shall not apply if, immediately following consummation of the proposed transaction, the consolidated risk-weighted assets of the acquiring bank holding company are less than $300 million;

(iii) *Qualifying community banking organizations.* Paragraphs (c)(6)(i)(A) and (B) of this section shall not apply if:

(A) The acquiring bank holding company is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter);

(B) The sum of the total assets to be acquired in the proposal and the total assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the average total consolidated assets (as used in section 217.12 of this chapter) of the acquiring bank holding company as last reported to the Board; and

(C) The total assets to be acquired do not exceed $7.5 billion;

(7) *Supervisory actions.* During the 12-month period ending on the date on which the bank holding company proposes to consummate the proposed transaction, no formal administrative order, including a written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, asset-maintenance agreement, or other formal enforcement action, is or was outstanding against the bank holding company or any insured depository institution subsidiary of the holding company, and no formal administrative enforcement proceeding involving any such enforcement action, order, or directive is or was pending;

4–024.6

(8) *Interstate acquisitions.* Board approval of the transaction is not prohibited under section 3(d) of the BHC Act;

(9) *Other supervisory considerations.* Board approval of the transaction is not prohibited under the informational sufficiency or comprehensive home-country supervision standards set forth in section 3(c)(3) of the BHC Act; and

(10) *Notification.* The acquiring bank holding company has not been notified by the Board, in its discretion, prior to the expiration of the period in paragraph (b)(1) of this section that an application under section 225.15 is required in order to permit closer review of any financial, managerial, competitive, convenience-and-needs, or other matter related to the factors that must be considered under this part.

4–024.7

(d) *Comment by primary banking supervisor.*

(1) *Notice.* Upon receipt of a notice under this section, the appropriate Reserve Bank shall promptly furnish notice of the proposal and a copy of the information filed pursuant to paragraph (a) of this section to the primary banking supervisor of the insured depository institutions to be acquired.

(2) *Comment period.* The primary banking supervisor shall have 30 calendar days (or such shorter time as agreed to by the primary banking supervisor) from the date of the letter giving notice in which to submit its views and recommendations to the Board.

(3) *Action subject to supervisor's comment.* Action by the Board or the Reserve Bank on a proposal under this section is subject to the condition that the primary banking supervisor not recommend in writing to the Board disapproval of the proposal prior to the expiration of the comment period described in paragraph (d)(2) of this section. In such event, any approval given under this section shall be revoked and, if required by section 3(b) of the BHC Act, the Board shall order a hearing on the proposal.

(4) *Emergencies.* Notwithstanding paragraphs (d)(2) and (d)(3) of this section, the Board may provide the primary banking supervisor with 10 calendar days' notice of a proposal under this section if the Board finds that an emergency exists requiring expeditious action, and may act during the notice period or without providing notice to the primary banking supervisor if the Board finds that it must act immediately to prevent probable failure.

(5) *Primary banking supervisor.* For purposes of this section and section 225.15(b), the primary banking supervisor for an institution is—

(i) the Office of the Comptroller of the

Currency, in the case of a national banking association or District bank;
(ii) the appropriate supervisory authority for the state in which the bank is chartered, in the case of a state bank;
(iii) the director of the Office of Thrift Supervision, in the case of a savings association.

4–024.8

(e) *Branches and agencies of foreign banking organizations.* For purposes of this section, a U.S. branch or agency of a foreign banking organization shall be considered to be an insured depository institution. A U.S. branch or agency of a foreign banking organization shall be subject to paragraph (c)(3)(ii) of this section only to the extent it is insured by the Federal Deposit Insurance Corporation in accordance with section 6 of the International Banking Act of 1978 (12 U.S.C. 3104).

(f) *Qualifying community banking organizations.* For purposes of this section, a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) controls total risk-weighted assets equal to the qualifying community banking organization's average total consolidated assets (as used in section 217.12 of this chapter) as last reported to its primary banking supervisor.

4–025

SECTION 225.15—Procedures for Other Bank Acquisition Proposals

(a) *Filing application.* Except as provided in section 225.14, an application for the Board's prior approval under this subpart shall be governed by the provisions of this section and shall be filed with the appropriate Reserve Bank on the designated form.

(b) *Notice to primary banking supervisor.* Upon receipt of an application under this subpart, the Reserve Bank shall promptly furnish notice and a copy of the application to the primary banking supervisor of the bank to be acquired. The primary supervisor shall have 30 calendar days from the date of the letter giving notice in which to submit its views and recommendations to the Board.

(c) *Accepting application for processing.* Within 7 business days after the Reserve Bank receives an application under this section, the Reserve Bank shall accept it for processing as of the date the application was filed or return the application if it is substantially incomplete. Upon accepting an application, the Reserve Bank shall immediately send copies to the Board. The Reserve Bank or the Board may request additional information necessary to complete the record of an application at any time after accepting the application for processing.

4–026

(d) *Action on applications.*
(1) *Action under delegated authority.* The Reserve Bank shall approve an application under this section within 30 calendar days after the acceptance date for the application, unless the Reserve Bank, upon notice to the applicant, refers the application to the Board for decision because action under delegated authority is not appropriate.
(2) *Board action.* The Board shall act on an application under this subpart that is referred to it for decision within 60 calendar days after the acceptance date for the application, unless the Board notifies the applicant that the 60-day period is being extended for a specified period and states the reasons for the extension. In no event may the extension exceed the 91-day period provided in section 225.16(f). The Board may, at any time, request additional information that it believes is necessary for its decision.

4–026.5

SECTION 225.16—Public Notice, Comments, Hearings, and Other Provisions Governing Applications and Notices

(a) *In general.* The provisions of this section apply to all notices and applications filed under section 225.14 and section 225.15.

(b) *Public notice.*
(1) *Newspaper publication.*

(i) *Location of publication.* In the case of each notice or application submitted under section 225.14 or section 225.15, the applicant shall publish a notice in a newspaper of general circulation, in the form and at the locations specified in section 262.3 of the Rules of Procedure (12 CFR 262.3).

(ii) *Contents of notice.* A newspaper notice under this paragraph shall provide an opportunity for interested persons to comment on the proposal for a period of at least 30 calendar days.

(iii) *Timing of publication.* Each newspaper notice published in connection with a proposal under this paragraph shall be published no more than 15 calendar days before and no later than 7 calendar days following the date that a notice or application is filed with the appropriate Reserve Bank.

(2) *Federal Register notice.*

(i) *Publication by Board.* Upon receipt of a notice or application under section 225.14 or section 225.15, the Board shall promptly publish notice of the proposal in the *Federal Register* and shall provide an opportunity for interested persons to comment on the proposal for a period of no more than 30 days.

(ii) *Request for advance publication.* A bank holding company may request that, during the 15-day period prior to filing a notice or application under section 225.14 or section 225.15, the Board publish notice of a proposal in the *Federal Register*. A request for advance *Federal Register* publication shall be made in writing to the appropriate Reserve Bank and shall contain the identifying information prescribed by the Board for *Federal Register* publication.

(3) *Waiver or shortening of notice.* The Board may waive or shorten the required notice periods under this section if the Board determines that an emergency exists requiring expeditious action on the proposal, or if the Board finds that immediate action is necessary to prevent the probable failure of an insured depository institution.

4–026.6

(c) *Public comment.*

(1) *Timely comments.* Interested persons may submit information and comments regarding a proposal filed under this subpart. A comment shall be considered timely for purposes of this subpart if the comment, together with all supplemental information, is submitted in writing in accordance with the Board's Rules of Procedure and received by the Board or the appropriate Reserve Bank prior to the expiration of the latest public-comment period provided in paragraph (b) of this section.

(2) *Extension of comment period.*

(i) *In general.* The Board may, in its discretion, extend the public comment period regarding any proposal submitted under this subpart.

(ii) *Requests in connection with obtaining application or notice.* In the event that an interested person has requested a copy of a notice or application submitted under this subpart, the Board may, in its discretion and based on the facts and circumstances, grant such person an extension of the comment period for up to 15 calendar days.

(iii) *Joint requests by interested person and acquiring company.* The Board will grant a joint request by an interested person and the acquiring bank holding company for an extension of the comment period for a reasonable period for a purpose related to the statutory factors the Board must consider under this subpart.

(3) *Substantive comment.* A comment will be considered substantive for purposes of this subpart unless it involves individual complaints, or raises frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues.

4–027

(d) *Notice to attorney general.* The Board or Reserve Bank shall immediately notify the attorney general of approval of any notice or application under section 225.14 or section 225.15.

(e) *Hearings.* As provided in section 3(b) of the BHC Act, the Board shall order a hearing

on any application or notice under section 225.15 if the Board receives from the primary supervisor of the bank to be acquired, within the 30-day period specified in section 225.15(b), a written recommendation of disapproval of an application. The Board may order a formal or informal hearing or other proceeding on the application or notice, as provided in section 262.3(i)(2) of the Board's Rules of Procedure. Any request for a hearing (other than from the primary supervisor) shall comply with section 262.3(e) of the Rules of Procedure (12 CFR 262.3(e)).

4–028

(f) *Approval through failure to act.*

(1) *Ninety-one-day rule.* An application or notice under section 225.14 or section 225.15 shall be deemed approved if the Board fails to act on the application or notice within 91 calendar days after the date of submission to the Board of the complete record on the application. For this purpose, the Board acts when it issues an order stating that the Board has approved or denied the application or notice, reflecting the votes of the members of the Board, and indicating that a statement of the reasons for the decision will follow promptly.

(2) *Complete record.* For the purpose of computing the commencement of the 91-day period, the record is complete on the latest of—

(i) the date of receipt by the Board of an application that has been accepted by the Reserve Bank;

(ii) the last day provided in any notice for receipt of comments and hearing requests on the application;

(iii) the date of receipt by the Board of the last relevant material regarding the application that is needed for the Board's decision, if the material is received from a source outside of the Federal Reserve System; or

(iv) the date of completion of any hearing or other proceeding.

4–029

(g) *Exceptions to notice and hearing requirements.*

(1) *Probable bank failure.* If the Board finds it must act immediately on an application in order to prevent the probable failure of a bank or bank holding company, the Board may modify or dispense with the notice and hearing requirements of this section.

(2) *Emergency.* If the Board finds that, although immediate action on an application or notice is not necessary, an emergency exists requiring expeditious action, the Board shall provide the primary supervisor 10 days to submit its recommendation. The Board may act on such an application or notice without a hearing and may modify or dispense with the other notice and hearing requirements of this section.

4–029.1

(h) *Waiting period.* A transaction approved under section 225.14 or section 225.15 shall not be consummated until 30 days after the date of approval of the application, except that a transaction may be consummated—

(1) immediately upon approval, if the Board has determined under paragraph (g) of this section that the application or notice involves a probable bank failure;

(2) on or after the 5th calendar day following the date of approval, if the Board has determined under paragraph (g) of this section that an emergency exists requiring expeditious action; or

(3) on or after the 15th calendar day following the date of approval, if the Board has not received any adverse comments from the United States attorney general relating to the competitive factors and the attorney general has consented to the shorter waiting period.

4–029.2

SECTION 225.17—Notice Procedure for One-Bank Holding Company Formations

(a) *Transactions that qualify under this section.* An acquisition by a company of control of a bank may be consummated 30 days after providing notice to the appropriate Reserve Bank in accordance with paragraph (b) of this section, provided that all of the following conditions are met:

(1) the shareholder or shareholders who control at least 67 percent of the shares of the bank will control, immediately after the reorganization, at least 67 percent of the shares of the holding company in substantially the same proportion, except for changes in shareholders' interests resulting from the exercise of dissenting shareholders' rights under state or federal law;[4]

(2) no shareholder or group of shareholders acting in concert will, following the reorganization, own or control 10 percent or more of any class of voting shares of the bank holding company unless that shareholder or group of shareholders was authorized, after review under the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)) by the appropriate federal banking agency for the bank, to own or control 10 percent or more of any class of voting shares of the bank;[5]

(3) the bank is adequately capitalized (as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o));

(4) the bank has received at least a composite ''satisfactory'' rating at its most recent examination, in the event that the bank was examined;

(5) at the time of the reorganization, neither the bank nor any of its officers, directors, or principal shareholders is involved in any unresolved supervisory or enforcement matters with any appropriate federal banking agency;

(6) the company demonstrates that any debt that it incurs at the time of the reorganization, and the proposed means of retiring this debt, will not place undue burden on the holding company or its subsidiary on a *pro forma* basis;[6]

(7) the holding company would not, as a result of the reorganization, acquire control of any additional bank or engage in any activities other than those of managing and controlling banks; and

(8) during this period, neither the appropriate Reserve Bank nor the Board objected to the proposal or required the filing of an application under section 225.15 of this subpart.

4–029.21

(b) *Contents of notice.* A notice filed under this paragraph shall include—

(1) certification by the notificant's board of directors that the requirements of 12 U.S.C. 1842(a)(C) and this section are met by the proposal;

(2) a list identifying all principal shareholders of the bank prior to the reorganization and of the holding company following the reorganization, and specifying the percentage of shares held by each principal shareholder in the bank and proposed to be held in the new holding company;

(3) a description of the resulting management of the proposed bank holding company and its subsidiary bank, including—

(i) biographical information regarding any senior officers and directors of the resulting bank holding company who were *not* senior officers or directors of the bank prior to the reorganization; and,

(ii) a detailed history of the involvement of any officer, director, or principal shareholder of the resulting bank holding company in any administrative or criminal proceeding;

(4) *pro forma* financial statements for the holding company, and a description of the amount, source and terms of debt, if any, that the bank holding company proposes to incur, and information regarding the sources and timing for debt service and retirement.

[4] A shareholder of a bank in reorganization will be considered to have the same proportional interest in the holding company if the shareholder interest increases, on a pro rata basis, as a result of either the redemption of shares from dissenting shareholders by the bank or bank holding company or the acquisition of shares of dissenting shareholders by the remaining shareholders.

[5] This procedure is not available in cases in which the exercise of dissenting shareholders' rights would cause a company that is not a bank holding company (other than the company in formation) to be required to register as a bank holding company. This procedure also is not available for the formation of a bank holding company organized in mutual form.

[6] For a banking organization with consolidated assets, on Continued

Continued

a *pro forma* basis, of less than $3 billion (other than a banking organization that will control a de novo bank), this requirement is satisfied if the proposal complies with the Board's Small Bank Holding Company and Savings and Loan Holding Company Policy Statement (appendix C of this part [at 4–868]).

4–029.22

(c) *Acknowledgment of notice.* Within seven calendar days following receipt of a notice under this section, the Reserve Bank shall provide the notificant with a written acknowledgment of receipt of the notice. This written acknowledgment shall indicate that the transaction described in the notice may be consummated on the 30th calendar day after the date of receipt of the notice if the Reserve Bank or the Board has not objected to the proposal during that time.

(d) *Application required upon objection.* The Reserve Bank or the Board may object to a proposal during the notice period by providing the bank holding company with a written explanation of the reasons for the objection. In such case, the bank holding company may file an application for prior approval of the proposal pursuant to section 225.15 of this subpart.

4–030

SUBPART C—NONBANKING ACTIVITIES AND ACQUISITIONS BY BANK HOLDING COMPANIES

SECTION 225.21—Prohibited Nonbanking Activities and Acquisitions; Exempt Bank Holding Companies

(a) *Prohibited nonbanking activities and acquisitions.* Except as provided in section 225.22 of this subpart, a bank holding company or a subsidiary may not engage in, or acquire or control, directly or indirectly, voting securities or assets of a company engaged in, any activity other than—

(1) banking or managing or controlling banks and other subsidiaries authorized under the BHC Act; and

(2) an activity that the Board determines to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, including any incidental activities that are necessary to carry on such an activity, if the bank holding company has obtained the prior approval of the Board for that activity in accordance with and subject to the requirements of this regulation.

4–031

(b) *Exempt bank holding companies.* The following bank holding companies are exempt from the provisions of this subpart:

(1) *Family-owned companies.* Any company that is a ''company covered in 1970,'' as defined in section 2(b) of the BHC Act, more than 85 percent of the voting securities of which was collectively owned on June 30, 1968, and continuously thereafter, by members of the same family (or their spouses) who are lineal descendants of common ancestors.

(2) *Labor, agricultural, and horticultural organizations.* Any company that was on January 4, 1977, both a bank holding company and a labor, agricultural, or horticultural organization exempt from taxation under section 501 of the Internal Revenue Code (26 U.S.C. 501(c)).

(3) *Companies granted hardship exemption.* Any bank holding company that has controlled only one bank since before July 1, 1968, and that has been granted an exemption by the Board under section 4(d) of the BHC Act, subject to any conditions imposed by the Board.

(4) *Companies granted exemption on other grounds.* Any company that acquired control of a bank before December 10, 1982, without the Board's prior approval under section 3 of the BHC Act, on the basis of a narrow interpretation of the term ''demand deposit'' or ''commercial loan'' if the Board has determined that—

(i) coverage of the company as a bank holding company under this subpart would be unfair or represent an unreasonable hardship; and

(ii) exclusion of the company from coverage under this regulation is consistent with the purposes of the BHC Act and section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)). The provisions of section 225.4 of subpart A of this regulation do not apply to a company exempt under this paragraph.

4–032

SECTION 225.22—Exempt Nonbanking Activities and Acquisitions

(a) *Certain de novo activities.* A bank holding company may, either directly or indirectly, engage de novo in any nonbanking activity listed in section 225.28(b) (other than operation of an insured depository institution) without obtaining the Board's prior approval if the bank holding company—

(1) meets the requirements of paragraphs (c)(1), (2), and (6) of section 225.23;

(2) conducts the activity in compliance with all Board orders and regulations governing the activity; and

(3) within 10 business days after commencing the activity, provides written notice to the appropriate Reserve Bank describing the activity, identifying the company or companies engaged in the activity, and certifying that the activity will be conducted in accordance with the Board's orders and regulations and that the bank holding company meets the requirements of paragraphs (c)(1), (2), and (6) of section 225.23.

4–032.1

(b) *Servicing activities.* A bank holding company may, without the Board's prior approval under this subpart, furnish services to or perform services for, or establish or acquire a company that engages solely in furnishing services to or performing services for—

(1) the bank holding company or its subsidiaries in connection with their activities as authorized by law, including services that are necessary to fulfill commitments entered into by the subsidiaries with third parties, if the bank holding company or servicing company complies with the Board's published interpretations and does not act as principal in dealing with third parties; and

(2) the internal operations of the bank holding company or its subsidiaries. Services for the internal operations of the bank holding company or its subsidiaries include, but are not limited to—

(i) accounting, auditing, and appraising;

(ii) advertising and public relations;

(iii) data processing and data transmission services, data bases, or facilities;

(iv) personnel services;

(v) courier services;

(vi) holding or operating property used wholly or substantially by a subsidiary in its operations or for its future use;

(vii) liquidating property acquired from a subsidiary;

(viii) liquidating property acquired from any sources either prior to May 9, 1956, or the date on which the company became a bank holding company, whichever is later; and

(ix) selling, purchasing, or underwriting insurance, such as blanket bond insurance, group insurance for employees, and property and casualty insurance.

(c) *Safe deposit business.* A bank holding company or nonbank subsidiary may, without the Board's prior approval, conduct a safe deposit business, or acquire voting securities of a company that conducts such a business.

4–033

(d) *Nonbanking acquisitions not requiring prior Board approval.* The Board's prior approval is not required under this subpart for the following acquisitions:

(1) *DPC acquisitions.*

(i) Voting securities or assets, acquired by foreclosure or otherwise, in the ordinary course of collecting a debt previously contracted (DPC property) in good faith, if the DPC property is divested within two years of acquisition.

(ii) The Board may, upon request, extend this two-year period for up to three additional years. The Board may permit additional extensions for up to 5 years (for a total of 10 years), for shares, real estate or other assets where the holding company demonstrates that each extension would not be detrimental to the public interest and either the bank holding company has made good faith attempts to dispose of such shares, real estate or other assets or disposal of the shares, real estate or other assets during the initial period would have been detrimental to the company.

(iii) Transfers of DPC property within the bank holding company system do not

extend any period for divestiture of the property.

(2) *Securities or assets required to be divested by subsidiary.* Voting securities or assets required to be divested by a subsidiary at the request of an examining federal or state authority (except by the Board under the BHC Act or this regulation), if the bank holding company divests the securities or assets within two years from the date acquired from the subsidiary.

(3) *Fiduciary investments.* Voting securities or assets acquired by a bank or other company (other than a trust that is a company) in good faith in a fiduciary capacity, if the voting securities or assets are—

(i) held in the ordinary course of business; and

(ii) not acquired for the benefit of the company or its shareholders, employees, or subsidiaries.

4–034

(4) *Securities eligible for investment by national bank.* Voting securities of the kinds and amounts explicitly eligible by federal statute (other than section 4 of the Bank Service Corporation Act, 12 U.S.C. 1864) for investment by a national bank, and voting securities acquired prior to June 30, 1971, in reliance on section 4(c)(5) of the BHC Act and interpretations of the Comptroller of the Currency under section 5136 of the Revised Statutes (12 U.S.C. 24(7)).

(5) *Securities or property representing 5 percent or less of a company.* Voting securities of a company or property that, in the aggregate, represent 5 percent or less of the outstanding shares of any class of voting securities of a company, or that represent a 5 percent interest or less in the property, subject to the provisions of 12 CFR 225.137.

(6) *Securities of investment company.* Voting securities of an investment company that is solely engaged in investing in securities and that does not own or control more than 5 percent of the outstanding shares of any class of voting securities of any company.

(7) *Assets acquired in ordinary course of business.* Assets of a company acquired in the ordinary course of business, subject to the provisions of 12 CFR 225.132, if the assets relate to activities in which the acquiring company has previously received Board approval under this regulation to engage.

4–035

(8) *Asset acquisitions by lending company or industrial bank.* Assets of an office(s) of a company, all or substantially all of which relate to making, acquiring, or servicing loans if—

(i) the acquiring company has previously received Board approval under this regulation or is not required to obtain prior Board approval under this regulation to engage in lending activities or industrial banking activities;

(ii) the assets acquired during any 12-month period do not represent more than 50 percent of the risk-weighted assets (on a consolidated basis) of the acquiring lending company or industrial bank, or more than $100 million, whichever amount is less;

(iii) the assets acquired do not represent more than 50 percent of the selling company's consolidated assets that are devoted to lending activities or industrial banking business;

(iv) the acquiring company notifies the Reserve Bank of the acquisition within 30 days after the acquisition; and

(v) the acquiring company, after giving effect to the transaction, meets the requirements of 12 CFR part 217, and the Board has not previously notified the acquiring company that it may not acquire assets under the exemption in this paragraph (d).

(vi) *Qualifying community banking organizations.* For purposes of paragraph (d)(8)(ii) of this section, a lending company or industrial bank that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), or is a subsidiary of such a qualifying commu-

nity banking organization, has risk-weighted assets equal to:

(A) Its average total consolidated assets (as used in section 217.12 of this chapter) as most recently reported to its primary banking supervisor (as defined in section 225.14(d)(5)); or

(B) Its total assets, if the company or industrial bank does not report such average total consolidated assets.

4–036

(e) *Acquisition of securities by subsidiary banks.*

(1) *National bank.* A national bank or its subsidiary may, without the Board's approval under this subpart, acquire or retain securities on the basis of section 4(c)(5) of the BHC Act in accordance with the regulations of the Comptroller of the Currency.

(2) *State bank.* A state-chartered bank or its subsidiary may, insofar as federal law is concerned, and without the Board's prior approval under this subpart—

(i) acquire or retain securities, on the basis of section 4(c)(5) of the BHC Act, of the kinds and amounts explicitly eligible by federal statute for investment by a national bank; or

(ii) acquire or retain all (but, except for directors' qualifying shares, not less than all) of the securities of a company that engages solely in activities in which the parent bank may engage, at locations at which the bank may engage in the activity, and subject to the same limitations as if the bank were engaging in the activity directly.

(f) *Activities and securities of new bank holding companies.* A company that becomes a bank holding company may, for a period of two years, engage in nonbanking activities and control voting securities or assets of a nonbank subsidiary, if the bank holding company engaged in such activities or controlled such voting securities or assets on the date it became a bank holding company. The Board may grant requests for up to three one-year extensions of the two-year period.

4–037

(g) *Grandfathered activities and securities.* Unless the Board orders divestiture or termination under section 4(a)(2) of the BHC Act, a ''company covered in 1970,'' as defined in section 2(b) of the BHC Act, may—

(1) retain voting securities or assets and engage in activities that it has lawfully held or engaged in continuously since June 30, 1968; and

(2) acquire voting securities of any newly formed company to engage in such activities.

(h) *Securities or activities exempt under Regulation K.* A bank holding company may acquire voting securities or assets and engage in activities as authorized in Regulation K (12 CFR 211).

4–037.1

SECTION 225.23—Expedited Action for Certain Nonbanking Proposals by Well-Run Bank Holding Companies

(a) *Filing of notice.*

(1) *Information required.* A bank holding company that meets the requirements of paragraph (c) of this section may satisfy the notice requirement of this subpart in connection with the acquisition of voting securities or assets of a company engaged in nonbanking activities that the Board has permitted by order or regulation (other than an insured depository institution),[1] or a proposal to engage de novo, either directly or indirectly, in a nonbanking activity that the Board has permitted by order or by regulation, by providing the appropriate Reserve Bank with a written notice containing the following:

(i) a certification that all of the criteria in paragraph (c) of this section are met;

(ii) a description of the transaction that includes identification of the companies involved in the transaction, the activities

[1] A bank holding company may acquire voting securities or assets of a savings association or other insured depository institution that is not a bank by using the procedures in section 225.14 of subpart B if the bank holding company and the proposal qualify under that section as if the savings association or other institution were a bank for purposes of that section.

to be conducted, and a commitment to conduct the proposed activities in conformity with the Board's regulations and orders governing the conduct of the proposed activity;

(iii) if the proposal involves an acquisition of a going concern:

(A) if the acquiring bank holding company is not a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter):

(*1*) if the bank holding company has consolidated assets of $3 billion or more, an abbreviated consolidated *pro forma* balance sheet for the acquiring bank holding company as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* risk-based capital ratios for the acquiring bank holding company as of the most recent quarter, a description of the purchase price and the terms and sources of funding for the transaction, and the total revenue and net income of the company to be acquired; or

(*2*) if the bank holding company has consolidated assets of less than $3 billion, a *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, a description of the purchase price and the terms and sources of funding for the transaction and the sources and schedule for retiring any debt incurred in the transaction, and the total assets, off-balance sheet items, revenue and net income of the company to be acquired;

(B) if the acquiring bank holding company is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), an abbreviated consolidated *pro forma* balance sheet for the acquiring bank holding company as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* leverage ratio for the acquiring bank holding company as of the most recent quarter, a description of the purchase price and the terms and sources of funding for the transaction, and the total revenue and net income of the company to be acquired;

(C) for each insured depository institution (that is not a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter)) whose tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, tier 1 capital and total capital of the institution on a *pro forma* basis; and

(D) for each insured depository institution that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) whose tier 1 capital (as defined in section 217.2 of this chapter and calculated in accordance with section 217.12(b) of this chapter) or total assets change as a result of the transaction, the total assets and tier 1 capital of the institution on a *pro forma* basis;

(iv) identification of the geographic markets in which competition would be affected by the proposal, a description of the effect of the proposal on competition in the relevant markets, a list of the major competitors in that market in the proposed activity if the affected market is local in nature, and, if requested, the market indexes for the relevant market; and

(v) a description of the public benefits

that can reasonably be expected to result from the transaction.

(2) *Waiver of unnecessary information.* The Reserve Bank may reduce the information requirements in paragraphs (1)(iii) and (iv) as appropriate.

4–037.2

(b) (1) *Action on proposals under this section.* The Board or the appropriate Reserve Bank shall act on a proposal submitted under this section, or notify the bank holding company that the transaction is subject to the procedure in section 225.24, within 12 business days following the filing of all of the information required in paragraph (a) of this section.

(2) *Acceptance of notice if expedited procedure not available.* If the Board or the Reserve Bank determines, after the filing of a notice under this section, that a bank holding company may not use the procedure in this section and must file a notice under section 225.24, the notice shall be deemed accepted for purposes of section 225.24 as of the date that the notice was filed under this section.

4–037.3

(c) *Criteria for use of expedited procedure.* The procedure in this section is available only if—

(1) *Well-capitalized organization.*

(i) *Bank holding company.* Both at the time of and immediately after the proposed transaction, the acquiring bank holding company is well capitalized;

(ii) *Insured depository institutions.* Both at the time of and immediately after the transaction—

(A) the lead insured depository institution of the acquiring bank holding company is well capitalized;

(B) well-capitalized insured depository institutions control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the acquiring bank holding company; and

(C) no insured depository institution controlled by the acquiring bank holding company is undercapitalized;

(2) *Well-managed organization.*

(i) *Satisfactory examination ratings.* At the time of the transaction, the acquiring bank holding company, its lead insured depository institution, and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the holding company are well managed and have received at least a satisfactory rating for compliance at their most recent examination if such rating was given;

(ii) *No poorly managed institutions.* No insured depository institution controlled by the acquiring bank holding company has received 1 of the 2 lowest composite ratings at the later of the institution's most recent examination or subsequent review by the appropriate federal banking agency for the institution;

(iii) *Recently acquired institutions excluded.* Any insured depository institution that has been acquired by the bank holding company during the 12-month period preceding the date on which written notice is filed under paragraph (a) of this section may be excluded for purposes of paragraph (c)(2)(ii) of this section if—

(A) the bank holding company has developed a plan acceptable to the appropriate federal banking agency for the institution to restore the capital and management of the institution; and

(B) all insured depository institutions excluded under this paragraph represent, in the aggregate, less than 10 percent of the aggregate total risk-weighted assets of all insured depository institutions controlled by the bank holding company;

4–037.4

(3) *Permissible activity.*

(i) The Board has determined by regulation or order that each activity proposed to be conducted is so closely related to banking, or managing or controlling banks, as to be a proper incident thereto; and

(ii) The Board has not indicated that proposals to engage in the activity are sub-

ject to the notice procedure provided in section 225.24;

(4) *Competitive criteria.*

(i) *Competitive screen.* In the case of the acquisition of a going concern, the acquisition, without regard to any divestitures proposed by the acquiring bank holding company, does not cause—

(A) the acquiring bank holding company to control in excess of 35 percent of the market share in any relevant market; or

(B) the Herfindahl-Hirschman index to increase by more than 200 points in any relevant market with a post-acquisition index of at least 1800; and

(ii) *Other competitive factors.* The Board has not indicated that the transaction is subject to close scrutiny on competitive grounds;

4–037.5

(5) *Size of acquisition.*

(i) *In general.*

(A) *Limited growth.* Except as provided in paragraphs (c)(5)(ii) and (iii) of this section, the sum of aggregate risk-weighted assets to be acquired in the proposal and the aggregate risk-weighted assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the consolidated risk-weighted assets of the acquiring bank holding company. For purposes of paragraph (c)(5) of this section, ''other qualifying transactions'' means any transaction approved under this section or section 225.14 during the 12 months prior to filing the notice under this section;

(B) *Consideration paid.* Except as provided in paragraph (c)(5)(iii) of this section, the gross consideration to be paid by the acquiring bank holding company in the proposal does not exceed 15 percent of the consolidated tier 1 capital of the acquiring bank holding company; and

(C) *Individual size limitation.* Except as provided in paragraph (c)(5)(iii) of this section, the total risk-weighted assets to be acquired do not exceed $7.5 billion;

(ii) *Small bank holding companies.* Paragraph (c)(5)(i)(A) shall not apply if, immediately following consummation of the proposed transaction, the consolidated risk-weighted assets of the acquiring bank holding company are less than $300 million;

(iii) *Qualifying community banking organizations.* Paragraphs (c)(5)(i)(A) through (C) of this section shall not apply if:

(A) the acquiring bank holding company is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter); and

(B) the sum of the total assets to be acquired in the proposal and the total assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the average total consolidated assets (as used in section 217.12 of this chapter) of the acquiring bank holding company as last reported to the Board;

(C) the gross consideration to be paid by the acquiring bank holding company in the proposal does not exceed 15 percent of the tier 1 capital (as defined in section 217.2 of this chapter and calculated in accordance with section 217.12(b) of this chapter) of the acquiring bank holding company; and

(D) the total assets to be acquired do not exceed $7.5 billion;

(6) *Supervisory actions.* During the 12-month period ending on the date on which the bank holding company proposes to consummate the proposed transaction, no formal administrative order, including a written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, asset-maintenance agreement, or other formal enforcement order is or was outstanding against the bank holding company or any insured depository institution subsidiary of the holding company, and no

formal administrative enforcement proceeding involving any such enforcement action, order, or directive is or was pending; and

(7) *Notification.* The bank holding company has not been notified by the Board, in its discretion, prior to the expiration of the period in paragraph (b) that a notice under section 225.24 is required in order to permit closer review of any potential adverse effect or other matter related to the factors that must be considered under this part.

4–037.6

(d) *Branches and agencies of foreign banking organizations.* For purposes of this section, a U.S. branch or agency of a foreign banking organization shall be considered to be an insured depository institution.

(e) *Qualifying community banking organizations.* For purposes of this section, a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) controls total risk-weighted assets equal to the qualifying community banking organization's average total consolidated assets (as used in section 217.12 of this chapter) as last reported to its primary banking supervisor.

4–038

SECTION 225.24—Procedures for Other Nonbanking Proposals

(a) *Notice required for nonbanking activities.* Except as provided in section 225.22 and section 225.23, a notice for the Board's prior approval under section 225.21(a) to engage in or acquire a company engaged in a nonbanking activity shall be filed by a bank holding company (including a company seeking to become a bank holding company) with the appropriate Reserve Bank in accordance with this section and the Board's Rules of Procedure (12 CFR 262.3).

(1) *Engaging de novo in listed activities.* A bank holding company seeking to commence or to engage de novo, either directly or through a subsidiary, in a nonbanking activity listed in section 225.28 shall file a notice containing a description of the activities to be conducted and the identity of the company that will conduct the activity.

(2) *Acquiring company engaged in listed activities.* A bank holding company seeking to acquire or control voting securities or assets of a company engaged in a nonbanking activity listed in section 225.28 shall file a notice containing the following:

(i) a description of the proposal, including a description of each proposed activity, and the effect of the proposal on competition among entities engaging in each proposed activity in each relevant market with relevant market indexes;

(ii) the identity of any entity involved in the proposal, and if the notificant proposes to conduct the activity through an existing subsidiary, a description of the existing activities of the subsidiary;

(iii) a statement of the public benefits that can reasonably be expected to result from the proposal;

(iv) if the bank holding company has consolidated assets of $150 million or more—

(A) parent company and consolidated *pro forma* balance sheets for the acquiring bank holding company as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction;

(B) consolidated *pro forma* risk-based capital and leverage ratio calculations for the acquiring bank holding company as of the most recent quarter (or, in the case of a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter), consolidated *pro forma* leverage ratio calculations under section 217.12 of this chapter for the acquiring bank holding company as of the most recent quarter); and

(C) a description of the purchase price and the terms and sources of funding for the transaction;

(v) if the bank holding company has consolidated assets of less than $150 million—

(A) a *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction; and

(B) a description of the purchase price and the terms and sources of funding for the transaction and, if the transaction is debt funded, one-year income statement and cash flow projections for the parent company, and the sources and schedule for retiring any debt incurred in the transaction;

(vi) (A) for each insured depository institution (that is not a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter)) whose tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, tier 1 capital and total capital of the institution on a *pro forma* basis; and

(B) for each insured depository institution that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) whose tier 1 capital (as defined in section 217.2 of this chapter and calculated in accordance with section 217.12(b) of this chapter) or total assets change as a result of the transaction, the total assets and tier 1 capital of the institution on a *pro forma* basis;

(vii) a description of the management expertise, internal controls and risk-management systems that will be utilized in the conduct of the proposed activities; and

(viii) a copy of the purchase agreements, and balance-sheet and income statements for the most recent quarter and year-end for any company to be acquired.

4–039

(b) *Notice provided to Board.* The Reserve Bank shall immediately send to the Board a copy of any notice received under paragraphs (a)(2) or (a)(3) of this section.

(c) *Notice to public.*

(1) *Listed activities and activities approved by order.*

(i) In a case involving an activity listed in section 225.28 or previously approved by the Board by order, the Reserve Bank shall notify the Board for publication in the *Federal Register* immediately upon receipt by the Reserve Bank of—

(A) a notice under this section; or

(B) a written request that notice of a proposal under this section or section 225.23 be published in the *Federal Register*. Such a request may request that *Federal Register* publication occur up to 15 calendar days prior to submission of a notice under this subpart.

(ii) The *Federal Register* notice published under this paragraph shall invite public comment on the proposal, generally for a period of 15 days.

(2) *New activities.*

(i) *In general.* In the case of a notice under this section involving an activity that is not listed in section 225.28 and that has not been previously approved by the Board by order, the Board shall send notice of the proposal to the *Federal Register* for publication, unless the Board determines that the notificant has not demonstrated that the activity is so closely related to banking or to managing or controlling banks as to be a proper incident thereto. The *Federal Register* notice shall invite public comment on the proposal for a reasonable period of time, generally for 30 days.

(ii) *Time for publication.* The Board shall send the notice required under this paragraph to the *Federal Register* within 10 business days of acceptance by the Reserve Bank. The Board may extend the 10-day period for an additional 30 calendar days upon notice to the notificant. In the event notice of a proposal is not published for comment, the Board shall inform the notificant of the reasons for the decision.

4–040

(d) *Action on notices.*

(1) *Reserve Bank action.*

(i) *In general.* Within 30 calendar days after receipt by the Reserve Bank of a notice filed pursuant to paragraphs (a)(1) or (a)(2) of this section, the Reserve Banks shall—

(A) approve the notice; or

(B) refer the notice to the Board for decision because action under delegated authority is not appropriate.

(ii) *Return of incomplete notice.* Within seven calendar days of receipt, the Reserve Bank may return any notice as informationally incomplete that does not contain all of the information required by this subpart. The return of such a notice shall be deemed action on the notice.

(iii) *Notice of action.* The Reserve Bank shall promptly notify the bank holding company of any action or referral under this paragraph.

(iv) *Close of public-comment period.* The Reserve Bank shall not approve any notice under this paragraph (1) prior to the third business day after the close of the public-comment period, unless an emergency exists that requires expedited or immediate action.

(2) *Board action; internal schedule.* The Board seeks to act on every notice referred to it for decision within 60 days of the date that the notice is filed with the Reserve Bank. If the Board is unable to act within this period, the Board shall notify the notificant and explain the reasons and the date by which the Board expects to act.

(3) (i) *Required time limit for System action.* The Board or the Reserve Bank shall act on any notice under this section within 60 days after the submission of a complete notice.

(ii) *Extension of required period for action.*

(A) *In general.* The Board may extend the 60-day period required for Board action under paragraph (d)(3)(i) of this section for an additional 30 days upon notice to the notificant.

(B) *Unlisted activities.* If a notice involves a proposal to engage in an activity that is not listed in section 225.28, the Board may extend the period required for Board action under paragraph (d)(3)(i) of this section for an additional 90 days. This 90-day extension is in addition to the 30-day extension period provided in paragraph (d)(3)(ii)(A) of this section. The Board shall notify the notificant that the notice period has been extended and explain the reasons for the extension.

(4) *Requests for additional information.* The Board or the Reserve Bank may modify the information requirements under this section or at any time request any additional information that either believes is needed for a decision on any notice under this section.

(5) *Tolling of period.* The Board or the Reserve Bank may at any time extend or toll the time period for action on a notice for any period with the consent of the notificant.

4–041

SECTION 225.25—Hearings, Alteration of Activities, and Other Matters

(a) *Hearings.*

(1) *Procedure to request hearing.* Any request for a hearing on a notice under this subpart shall comply with the provisions of 12 CFR 262.3(e).

(2) *Determination to hold hearing.* The Board may order a formal or informal hearing or other proceeding on a notice as provided in 12 CFR 262.3(i)(2). The Board shall order a hearing only if there are disputed issues of material fact that cannot be resolved in some other manner.

(3) *Extension of period for hearing.* The Board may extend the time for action on any notice for such time as is reasonably necessary to conduct a hearing and evaluate the hearing record. Such extension shall not exceed 91 calendar days after the date of submission to the Board of the complete record on the notice. The procedures for computation of the 91-day rule as set forth in section 225.16(f) apply to notices under this subpart that involve hearings.

4–042

(b) *Approval through failure to act.*

(1) Except as provided in paragraph (a) of this section or section 225.24(d)(5), a notice under this subpart shall be deemed to be approved at the conclusion of the period that begins on the date the complete notice is received by the Reserve Bank or the Board and that ends 60 calendar days plus any applicable extension and tolling period thereafter.

(2) *Complete notice.* For purposes of paragraph (b)(1) of this section, a notice shall be deemed to be complete at such time as it contains all information required by this subpart and all other information requested by the Board or the Reserve Bank.

4–043

(c) *Notice to expand or alter nonbanking activities.*

(1) *De novo expansion.* A notice under this subpart is required to open a new office or to form a subsidiary to engage in, or to relocate an existing office engaged in, a nonbanking activity that the Board has previously approved for the bank holding company under this regulation, only if—

(i) the Board's prior approval was limited geographically;

(ii) the activity is to be conducted in a country outside of the United States and the bank holding company has not previously received prior Board approval under this regulation to engage in the activity in that country; or

(iii) the Board or appropriate Reserve Bank has notified the company that a notice under this subpart is required.

(2) *Activities outside United States.* With respect to activities to be engaged in outside the United States that require approval under this subpart, the procedures of this section apply only to activities to be engaged in directly by a bank holding company that is not a qualifying foreign banking organization, or by a nonbank subsidiary of a bank holding company approved under this subpart. Regulation K (12 CFR 211) governs other international operations of bank holding companies.

(3) *Alteration of nonbanking activity.* Unless otherwise permitted by the Board, a notice under this subpart is required to alter a nonbanking activity in any material respect from that considered by the Board in acting on the application or notice to engage in the activity.

4–044

(d) *Emergency savings association acquisitions.* In the case of a notice to acquire a savings association, the Board may modify or dispense with the public-notice and hearing requirements of this section if the Board finds that an emergency exists that requires the Board to act immediately and the primary federal regulator of the institution concurs.

4–045

SECTION 225.26—Factors Considered in Acting on Nonbanking Proposals

(a) *In general.* In evaluating a notice under section 225.23 or section 225.24, the Board shall consider whether the notificant's performance of the activities can reasonably be expected to produce benefits to the public (such as greater convenience, increased competition, and gains in efficiency) that outweigh possible adverse effects (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices).

(b) *Financial and managerial resources.* Consideration of the factors in paragraph (a) of this section includes an evaluation of the financial and managerial resources of the notificant, including its subsidiaries, and any company to be acquired, and the effect of the proposed transaction on those resources, and the management expertise, internal-control and risk-management systems, and capital of the entity conducting the activity.

(c) *Competitive effect of de novo proposals.* Unless the record demonstrates otherwise, the commencement or expansion of a nonbanking activity de novo is presumed to result in benefits to the public through increased competition.

(d) *Denial for lack of information.* The Board may deny any notice submitted under this

subpart if the notificant neglects, fails, or refuses to furnish all information required by the Board.

4–045.1

(e) *Conditional approvals.* The Board may impose conditions on any approval, including conditions to address permissibility, financial, managerial, safety-and-soundness, competitive, compliance, conflicts-of-interest, or other concerns to ensure that approval is consistent with the relevant statutory factors and other provisions of the BHC Act.

4–045.2

SECTION 225.27—Procedures for Determining Scope of Nonbanking Activities

(a) *Advisory opinions regarding scope of previously approved nonbanking activities.*

(1) *Request for advisory opinion.* Any person may submit a request to the Board for an advisory opinion regarding the scope of any permissible nonbanking activity. The request shall be submitted in writing to the Board and shall identify the proposed parameters of the activity, or describe the service or product that will be provided, and contain an explanation supporting an interpretation regarding the scope of the permissible nonbanking activity.

(2) *Response to request.* The Board shall provide an advisory opinion within 45 days of receiving a written request under this paragraph.

4–045.3

(b) *Procedure for consideration of new activities.*

(1) *Initiation of proceeding.* The Board may, at any time, on its own initiative or in response to a written request from a person, initiate a proceeding to determine whether any activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

(2) *Requests for determination.* Any request for a Board determination that an activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto, shall be submitted to the Board in writing, and shall contain evidence that the proposed activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

(3) *Publication.* The Board shall publish in the *Federal Register* notice that it is considering the permissibility of a new activity and invite public comment for a period of at least 30 calendar days. In the case of a request submitted under paragraph (b) of this section, the Board may determine not to publish notice of the request if the Board determines that the requester has provided no reasonable basis for a determination that the activity is so closely related to banking, or managing or controlling banks, as to be a proper incident thereto, and notifies the requester of the determination.

(4) *Comments and hearing requests.* Any comment and any request for a hearing regarding a proposal under this section shall comply with the provisions of section 262.3(e) of the Board's Rules of Procedure (12 CFR 262.3(e)).

4–046

SECTION 225.28—List of Permissible Nonbanking Activities

(a) *Closely related nonbanking activities.* The activities listed in paragraph (b) of this section are so closely related to banking or managing or controlling banks as to be a proper incident thereto, and may be engaged in by a bank holding company or its subsidiary in accordance with requirements of this regulation.

4–047

(b) *Activities determined by regulation to be permissible.*

(1) *Extending credit and servicing loans.* Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company's account or for the account of others.

4–047.1

(2) *Activities related to extending credit.* Any activity usual in connection with mak-

ing, acquiring, brokering, or servicing loans or other extensions of credit, as determined by the Board. The Board has determined that the following activities are usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit:

(i) *Real estate and personal property appraising.* Performing appraisals of real estate and tangible and intangible personal property, including securities.

(ii) *Arranging commercial real estate equity financing.* Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control, and risk of such a real estate project to one or more investors, if the bank holding company and its affiliates do not have an interest in, or participate in managing or developing, a real estate project for which it arranges equity financing, and do not promote or sponsor the development of the property.

4–047.2

(iii) *Check-guaranty services.* Authorizing a subscribing merchant to accept personal checks tendered by the merchant's customers in payment for goods and services, and purchasing from the merchant validly authorized checks that are subsequently dishonored.

(iv) *Collection agency services.* Collecting overdue accounts receivable, either retail or commercial.

(v) *Credit bureau services.* Maintaining information related to the credit history of consumers and providing the information to a credit grantor who is considering a borrower's application for credit or who has extended credit to the borrower.

(vi) *Asset-management, servicing, and collection activities.* Engaging under contract with a third party in asset management, servicing, and collection[3] of assets of a type that an insured depository institution may originate and own, if the company does not engage in real property management or real estate brokerage services as part of these services.

4–047.3

(vii) *Acquiring debt in default.* Acquiring debt that is in default at the time of acquisition, if the company—

(A) divests shares or assets securing debt in default that are not permissible investments for bank holding companies, within the time period required for divestiture of property acquired in satisfaction of a debt previously contracted under section 225.12(b);[4]

(B) stands only in the position of a creditor and does not purchase equity of obligors of debt in default (other than equity that may be collateral for such debt); and

(C) does not acquire debt in default secured by shares of a bank or bank holding company.

(viii) *Real estate settlement servicing.* Providing real estate settlement services.[5]

4–048

(3) *Leasing personal or real property.* Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if—

(i) the lease is on a nonoperating basis;[6]

[3] Asset-management services include acting as agent in the liquidation or sale of loans and collateral for loans, including real estate and other assets acquired through foreclosure or in satisfaction of debts previously contracted.

[4] For this purpose, the divestiture period for property begins on the date that the debt is acquired, regardless of when legal title to the property is acquired.

[5] For purposes of this section, real estate settlement services do not include providing title insurance as principal, agent, or broker.

[6] The requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, engage in operating, servicing, maintaining, or repairing leased property during the lease term. For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, (1) provide servicing, repair, or maintenance of the leased vehicle during the lease term; (2) purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; (3) provide the loan of an automobile during servicing of the leased vehicle; (4) purchase insurance for the lessee; or (5) provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor. The bank holding company may arrange for a third party to provide these services or products.

(ii) the initial term of the lease is at least 90 days;

(iii) in the case of leases involving real property—

(A) at the inception of the initial lease, the effect of the transaction will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial lease; and

(B) the estimated residual value of property for purposes of paragraph (b)(3)(iii)(A) of this section shall not exceed 25 percent of the acquisition cost of the property to the lessor.

4–049

(4) *Operating nonbank depository institutions.*

(i) *Industrial banking.* Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company, so long as the institution is not a bank.

(ii) *Operating savings association.* Owning, controlling, or operating a savings association, if the savings association engages only in deposit-taking activities, lending, and other activities that are permissible for bank holding companies under this subpart C.

(5) *Trust company functions.* Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law, so long as the company is not a bank for purposes of section 2(c) of the Bank Holding Company Act.

4–049.1

(6) *Financial and investment advisory activities.* Acting as investment or financial adviser to any person, including (without, in any way, limiting the foregoing)—

(i) serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(20)), to an investment company registered under that act, including sponsoring, organizing, and managing a closed-end investment company;

(ii) furnishing general economic information and advice, general economic statistical forecasting services, and industry studies;

(iii) providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions, and conducting financial-feasibility studies;[7]

(iv) providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments;

(v) providing educational courses, and instructional materials to consumers on individual financial management matters; and

(vi) providing tax-planning and tax-preparation services to any person.

4–049.2

(7) *Agency transactional services for customer investments.*

(i) *Securities brokerage.* Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services), if the securities brokerage services are restricted to buying and selling securities solely as agent for the account of customers and do not include securities underwriting or dealing.

(ii) *Riskless-principal transactions.* Buying and selling in the secondary market all types of securities on the order of

[7] Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.

customers as a ''riskless principal'' to the extent of engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer. This does not include—

(A) selling bank-ineligible securities[8] at the order of a customer that is the issuer of the securities, or selling bank-ineligible securities in any transaction where the company has a contractual agreement to place the securities as agent of the issuer; or

(B) acting as a riskless principal in any transaction involving a bank-ineligible security for which the company or any of its affiliates acts as underwriter (during the period of the underwriting or for 30 days thereafter) or dealer.[9]

4–049.3

(iii) *Private-placement services.* Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (1933 act) and the rules of the Securities and Exchange Commission, if the company engaged in the activity does not purchase or repurchase for its own account the securities being placed, or hold in inventory unsold portions of issues of these securities.

(iv) *Futures commission merchant.* Acting as a futures commission merchant (FCM) for unaffiliated persons in the execution, clearance, or execution and clearance of any futures contract and option on a futures contract traded on an exchange in the United States or abroad if—

(A) the activity is conducted through a separately incorporated subsidiary of the bank holding company, which may engage in activities other than FCM activities (including, but not limited to, permissible advisory and trading activities); and

(B) the parent bank holding company does not provide a guarantee or otherwise become liable to the exchange or clearing association other than for those trades conducted by the subsidiary for its own account or for the account of any affiliate.

(v) *Other transactional services.* Providing to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (b)(8) of this section, any transaction that is permissible for a state member bank, and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange.

4–049.4

(8) *Investment transactions as principal.*

(i) *Underwriting and dealing in government obligations and money market instruments.* Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including banker's acceptances and certificates of deposit, under the same limitations as would be applicable if the activity were performed by the bank holding company's subsidiary member banks or its subsidiary nonmember banks as if they were member banks.

4–049.5

(ii) *Investing and trading activities.* Engaging as principal in—

[8] A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

[9] A company or its affiliates may not enter quotes for specific bank-ineligible securities in any dealer quotation system in connection with the company's riskless-principal transactions; except that the company or its affiliates may enter ''bid'' or ''ask'' quotations, or publish ''offering wanted'' or ''bid wanted'' notices on trading systems other than NASDAQ or an exchange, if the company or its affiliate does not enter price quotations on different sides of the market for a particular security during any two-day period.

(A) foreign exchange;
(B) forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal approved by the Board), nonfinancial asset, or group of assets, other than a bank-ineligible security[10], if—

(*1*) a state member bank is authorized to invest in the asset underlying the contract;
(*2*) the contract requires cash settlement;
(*3*) the contract allows for assignment, termination, or offset prior to delivery or expiration, and the company—

(*i*) makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or
(*ii*) receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or

(*4*) the contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company—

(*i*) makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or
(*ii*) receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

(C) forward contracts, options,[11] futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires cash settlement.

4–049.6

(iii) *Buying and selling bullion, and related activities.* Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, copper, and any other metal approved by the Board, for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

4–049.7

(9) *Management consulting and counseling activities.*

(i) *Management consulting.*

(A) Providing management consulting advice[12] —

(*1*) on any matter to unaffiliated depository institutions, including commercial banks, savings and loan associations, savings banks, credit unions, industrial banks, Morris Plan banks, cooperative banks, industrial loan companies, trust companies, and branches or agencies of foreign banks;
(*2*) on any financial, economic, ac-

[10] A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

[11] This reference does not include acting as a dealer in options based on indices of bank-ineligible securities when the options are traded on securities exchanges. These options are securities for purposes of the federal securities laws and bank-ineligible securities for purposes of section 20 of the Glass-Steagall Act, 12 U.S.C. 337. Similarly, this reference does not include acting as a dealer in any other instrument that is a bank-ineligible security for purposes of section 20. A bank holding company may deal in these instruments in accordance with the Board's orders on dealing in bank-ineligible securities.

[12] In performing this activity, bank holding companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. See also the Board's interpretation of bank management consulting advice (12 CFR 225.131 at 4–181).

counting, or audit matter to any other company.

(B) A company conducting management consulting activities under this subparagraph and any affiliate of such company may not—

(*1*) own or control, directly or indirectly, more than 5 percent of the voting securities of the client institution; and

(*2*) allow a management official, as defined in 12 CFR 212.2(h), of the company or any of its affiliates to serve as a management official of the client institution, except where such interlocking relationship is permitted pursuant to an exemption granted under 12 CFR 212.4(b) or otherwise permitted by the Board,

(C) A company conducting management consulting activities may provide management consulting services to customers not described in paragraph (b)(9)(i)(A)(*1*) of this section or regarding matters not described in paragraph (b)(9)(i)(A)(*2*) of this section, if the total annual revenue derived from those management consulting services does not exceed 30 percent of the company's total annual revenue derived from management consulting activities.

4–049.8

(ii) *Employee benefits consulting services.* Providing consulting services to employee benefit, compensation, and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans.

(iii) *Career counseling services.* Providing career counseling services to—

(A) a financial organization[13] and individuals currently employed by, or recently displaced from, a financial organization;

(B) individuals who are seeking employment at a financial organization; and

(C) individuals who are currently employed in or who seek positions in the finance, accounting, and audit departments of any company.

4–050

(10) *Support services.*

(i) *Courier services.* Providing courier services for—

(A) checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

(B) audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.[14]

(ii) *Printing and selling MICR-encoded items.* Printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require magnetic ink character recognition (MICR) encoding.

4–050.1

(11) *Insurance agency and underwriting.*

(i) *Credit insurance.* Acting as principal, agent, or broker for insurance (including home mortgage redemption insurance) that is—

(A) directly related to an extension of credit by the bank holding company or any of its subsidiaries; and

(B) limited to ensuring the repayment of the outstanding balance due on the extension of credit[15] in the event of

[13] "Financial organization" refers to insured depository institution holding companies and their subsidiaries, other than nonbanking affiliates of diversified savings and loan holding companies that engage in activities not permissible under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1842(c)(8)).

[14] See also the Board's interpretation on courier activities (12 CFR 225.129 at 4-180), which sets forth conditions for bank holding company entry into the activity.

[15] "Extension of credit" includes direct loans to borrowers, loans purchased from other lenders, and leases of real or personal property so long as the leases are nonoperating and full-payout leases that meet the requirements of paragraph (b)(3) of this section.

the death, disability, or involuntary unemployment of the debtor.

(ii) *Finance company subsidiary.* Acting as agent or broker for insurance directly related to an extension of credit by a finance company[16] that is a subsidiary of a bank holding company, if—

(A) the insurance is limited to ensuring repayment of the outstanding balance on such extension of credit in the event of loss or damage to any property used as collateral for the extension of credit; and

(B) the extension of credit is not more than $10,000, or $25,000 if it is to finance the purchase of a residential manufactured home[17] and the credit is secured by the home; and

(C) the applicant commits to notify borrowers in writing that—

(*1*) they are not required to purchase such insurance from the applicant;

(*2*) such insurance does not insure any interest of the borrower in the collateral; and

(*3*) the applicant will accept more comprehensive property insurance in place of such single-interest insurance.

4–050.2

(iii) *Insurance in small towns.* Engaging in any insurance agency activity in a place where the bank holding company or a subsidiary of the bank holding company has a lending office and that—

(A) has a population not exceeding 5,000 (as shown in the preceding decennial census); or

(B) has inadequate insurance agency facilities, as determined by the Board, after notice and opportunity for hearing.

(iv) *Insurance agency activities conducted on May 1, 1982.* Engaging in any specific insurance agency activity[18] if the bank holding company, or subsidiary conducting the specific activity, conducted such activity on May 1, 1982, or received Board approval to conduct such activity on or before May 1, 1982.[19] A bank holding company or subsidiary engaging in a specific insurance agency activity under this clause may—

(A) engage in such specific insurance agency activity only at locations—

(*1*) in the state in which the bank holding company has its principal place of business (as defined in 12 U.S.C. 1842(d));

(*2*) in any state or states immediately adjacent to such state; and

(*3*) in any state in which the specific insurance agency activity was conducted (or was approved to be conducted) by such bank holding company or subsidiary thereof or by any other subsidiary of such bank holding company on May 1, 1982; and

(B) provide other insurance coverages that may become available after May 1, 1982, so long as those coverages insure against the types of risks as (or are otherwise functionally equivalent to) coverages sold or approved to be sold on May 1, 1982, by such bank holding company or subsidiary.

4–050.21

(v) *Supervision of retail insurance agents.* Supervising on behalf of insur-

[16] "Finance company" includes all non-deposit-taking financial institutions that engage in a significant degree of consumer lending (excluding lending secured by first mortgages) and all financial institutions specifically defined by individual states as finance companies and that engage in a significant degree of consumer lending.

[17] These limitations increase at the end of each calendar year, beginning with 1982, by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published by the Bureau of Labor Statistics.

[18] Nothing contained in this provision shall preclude a bank holding company subsidiary that is authorized to engage in a specific insurance agency activity under this clause from continuing to engage in the particular activity after merger with an affiliate, if the merger is for legitimate business purposes and prior notice has been provided to the Board.

[19] For the purposes of this paragraph, activities engaged in on May 1, 1982, include activities carried on subsequently as the result of an application to engage in such activities pending before the Board on May 1, 1982, and approved subsequently by the Board or as the result of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition.

ance underwriters the activities of retail insurance agents who sell—

(A) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or its subsidiaries; and

(B) group insurance that protects the employees of the bank holding company or its subsidiaries.

(vi) *Small bank holding companies.* Engaging in any insurance agency activity if the bank holding company has total consolidated assets of $50 million or less. A bank holding company performing insurance agency activities under this paragraph may not engage in the sale of life insurance or annuities except as provided in paragraphs (b)(11)(i) and (iii) of this section, and it may not continue to engage in insurance agency activities pursuant to this provision more than 90 days after the end of the quarterly reporting period in which total assets of the holding company and its subsidiaries exceed $50 million.

(vii) *Insurance agency activities conducted before 1971.* Engaging in any insurance agency activity performed at any location in the United States directly or indirectly by a bank holding company that was engaged in insurance agency activities prior to January 1, 1971, as a consequence of approval by the Board prior to January 1, 1971.

4–050.3

(12) *Community development activities.*

(i) *Financing and investment activities.* Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

(ii) *Advisory activities.* Providing advisory and related services for programs designed primarily to promote community welfare.

4–050.4

(13) *Money orders, savings bonds, and traveler's checks.* The issuance and sale at retail of money orders and similar consumer-type payment instruments; the sale of U.S. savings bonds; and the issuance and sale of traveler's checks.

(14) *Data processing.*

(i) Providing data processing, data storage, and data transmission services, facilities (including data processing, data storage, and data transmission hardware, software, documentation, or operating personnel), databases, advice, and access to such services, facilities, or databases by any technological means, if—

(A) the data to be processed or furnished are financial, banking, or economic; and

(B) the hardware provided in connection therewith is offered only in conjunction with software designed and marketed for the processing, storage, and transmission of financial, banking, or economic data, and where the general-purpose hardware does not constitute more than 30 percent of the cost of any packaged offering.

(ii) A company conducting data processing, data storage, and data transmission activities may conduct data processing, data storage, and data transmission activities not described in paragraph (b)(14)(i) of this section if the total annual revenue derived from those activities does not exceed 49 percent of the company's total annual revenues derived from data processing, data storage, and data transmission activities.

4–050.8

SUBPART D—CONTROL AND DIVESTITURE PROCEEDINGS

SECTION 225.31—Control Proceedings

(a) *Preliminary determination of control.*

(1) The Board in its sole discretion may issue a preliminary determination of control under the procedures set forth in this section in any case in which the Board determines, based on consideration of the facts and circumstances presented, that a first company has the power to exercise a con-

trolling influence over the management or policies of a second company.

(2) If the Board makes a preliminary determination of control under this section, the Board shall send notice to the first company containing a statement of the facts upon which the preliminary determination is based.

4–050.9

(b) *Response to preliminary determination of control.*

(1) Within 30 calendar days after issuance by the Board of a preliminary determination of control or such longer period permitted by the Board in its discretion, the first company against whom the preliminary determination has been made shall:

(i) Consent to the preliminary determination of control and either:

(A) Submit for the Board's approval a specific plan for the prompt termination of the control relationship; or

(B) File an application or notice under this part, as applicable; or

(ii) Contest the preliminary determination by filing a response, setting forth the facts and circumstances in support of its position that no control exists, and, if desired, requesting a hearing or other proceeding.

(2) If the first company fails to respond to the preliminary determination of control within 30 days or such longer period permitted by the Board in its discretion, the first company will be deemed to have waived its right to present additional information to the Board or to request a hearing or other proceeding regarding the preliminary determination of control.

4–051

(c) *Hearing and final determination.*

(1) The Board shall order a hearing or other appropriate proceeding upon the petition of a first company that contests a preliminary determination of control if the Board finds that material facts are in dispute. The Board may, in its discretion, order a hearing or other appropriate proceeding without a petition for such a proceeding by the first company.

(2) At a hearing or other proceeding, any applicable presumptions established under this subpart shall be considered in accordance with the Federal Rules of Evidence and the Board's Rules of Practice for Formal Hearings (12 CFR part 263).

(3) After considering the submissions of the first company and other evidence, including the record of any hearing or other proceeding, the Board will issue a final order determining whether the first company has the power to exercise a controlling influence over the management or policies of the second company. If a controlling influence is found, the Board may direct the first company to terminate the control relationship or to file an application or notice for the Board's approval to retain the control relationship.

(d) *Submission of evidence.*

(1) In connection with contesting a preliminary determination of control under paragraph (b)(1)(ii) of this section, a first company may submit to the Board evidence or any other relevant information related to its control of a second company.

(2) Evidence or other relevant information submitted to the Board pursuant to paragraph (d)(1) of this section must be in writing and may include a description of all current and proposed relationships between the first company and the second company, including relationships of the type that are identified under any of the rebuttable presumptions in sections 225.32 and 225.33 of this part, copies of any formal agreements related to such relationships, and a discussion regarding why the Board should not determine the first company to control the second company.

(e) *Definitions.* For purposes of this subpart:

(1) *Board of directors* means the board of directors of a company or a set of individuals exercising similar functions at a company.

(2) *Director representative* means any individual that represents the interests of a first company through service on the board of directors of a second company. For purposes of this paragraph (e)(2), examples of persons who are directors of a second com-

pany and generally would be considered director representatives of a first company include:

(i) A current officer, employee, or director of the first company;

(ii) An individual who was an officer, employee, or director of the first company within the prior two years; and

(iii) An individual who was nominated or proposed to be a director of the second company by the first company.

(iv) A director representative does not include a nonvoting observer.

(3) *First company* means the company whose potential control of a second company is the subject of determination by the Board under this subpart.

(4) *Investment adviser* means a company that:

(i) Is registered as an investment adviser with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et seq* .);

(ii) Is registered as a commodity trading advisor with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq*.);

(iii) Is a foreign equivalent of an investment adviser or commodity trading advisor, as described in paragraph (e)(4)(i) or (ii) of this section; or

(iv) Engages in any of the activities set forth in section 225.28(b)(6)(i) through (iv) of this part.

(5) *Limiting contractual right* means a contractual right of the first company that would allow the first company to restrict significantly, directly or indirectly, the discretion of the second company, including its senior management officials and directors, over operational and policy decisions of the second company.

(i) Examples of limiting contractual rights may include, but are not limited to, a right that allows the first company to restrict or to exert significant influence over decisions related to:

(A) Activities in which the second company may engage, including a prohibition on entering into new lines of business, making substantial changes to or discontinuing existing lines of business, or entering into a contractual arrangement with a third party that imposes significant financial obligations on the second company;

(B) How the second company directs the proceeds of the first company's investment;

(C) Hiring, firing, or compensating one or more senior management officials of the second company, or modifying the second company's policies or budget concerning the salary, compensation, employment, or benefits plan for its employees;

(D) The second company's ability to merge or consolidate, or its ability to acquire, sell, lease, transfer, spin-off, recapitalize, liquidate, dissolve, or dispose of subsidiaries or assets;

(E) The second company's ability to make investments or expenditures;

(F) The second company achieving or maintaining a financial target or limit, including, for example, a debt-to-equity ratio, a fixed charges ratio, a net worth requirement, a liquidity target, a working capital target, or a classified assets or nonperforming loans limit;

(G) The second company's payment of dividends on any class of securities, redemption of senior instruments, or voluntary prepayment of indebtedness;

(H) The second company's ability to authorize or issue additional junior equity or debt securities, or amend the terms of any equity or debt securities issued by the second company;

(I) The second company's ability to engage in a public offering or to list or de-list securities on an exchange, other than a right that allows the securities of the first company to have the same status as other securities of the same class;

(J) The second company's ability to amend its articles of incorporation or by-laws, other than in a way that is solely defensive for the first company;

(K) The removal or selection of any independent accountant, auditor, investment adviser, or investment banker employed by the second company; or

(L) The second company's ability to significantly alter accounting methods and policies, or its regulatory, tax, or liability status (e.g., converting from a stock corporation to a limited liability company); and

(ii) A limiting contractual right does not include a contractual right that would not allow the first company to significantly restrict, directly or indirectly, the discretion of the second company over operational and policy decisions of the second company. Examples of contractual rights that are not limiting contractual rights may include:

(A) A right that allows the first company to restrict or to exert significant influence over decisions relating to the second company's ability to issue securities senior to securities owned by the first company;

(B) A requirement that the first company receive financial reports or other information of the type ordinarily available to common stockholders;

(C) A requirement that the second company maintain its corporate existence;

(D) A requirement that the second company consult with the first company on a reasonable periodic basis;

(E) A requirement that the second company provide notices of the occurrence of material events affecting the second company;

(F) A requirement that the second company comply with applicable statutory and regulatory requirements;

(G) A market standard requirement that the first company receive similar contractual rights as those held by other investors in the second company;

(H) A requirement that the first company be able to purchase additional securities issued by the second company in order to maintain the first company's percentage ownership in the second company;

(I) A requirement that the second company ensure that any security holder who intends to sell its securities of the second company provide other security holders of the second company or the second company itself the opportunity to purchase the securities before the securities can be sold to a third party; or

(J) A requirement that the second company take reasonable steps to ensure the preservation of tax status or tax benefits, such as status of the second company as a Subchapter S corporation or the protection of the value of net operating loss carry-forwards.

(6) *Second company* means the company whose potential control by a first company is the subject of determination by the Board under this subpart.

(7) *Senior management official* means any person who participates or has the authority to participate (other than in the capacity as a director) in major policymaking functions of a company.

(f) *Reservation of authority.* Nothing in this subpart shall limit the authority of the Board to take any supervisory or enforcement action otherwise permitted by law, including an action to address unsafe or unsound practices or conditions, or violations of law.

4–051.1

SECTION 225.32—Rebuttable Presumptions of Control of a Company

(a) *General.*

(1) In any proceeding under section 225.31(b) or (c) of this part, a first company is presumed to control a second company in the situations described in paragraphs (b) through (i) of this section. The Board also may find that a first company controls a second company based on other facts and circumstances.

(2) For purposes of the presumptions in this section, any company that is a subsidiary of the first company and also a subsidiary of the second company is considered to be a subsidiary of the first company and not a subsidiary of the second company.

4–051.2

(b) *Management contract or similar agreement.* The first company enters into any agreement, understanding, or management contract (other than to serve as investment adviser) with the second company, under which the first company directs or exercises significant influence or discretion over the general management, overall operations, or core business or policy decisions of the second company. Examples of such agreements include where the first company is a managing member, trustee, or general partner of the second company, or exercises similar powers and functions.

(c) *Total equity.* The first company controls one third or more of the total equity of the second company.

(d) *Ownership or control of 5 percent or more of voting securities.* The first company controls 5 percent or more of the outstanding securities of any class of voting securities of the second company, and:

(1) (i) Director representatives of the first company or any of its subsidiaries comprise 25 percent or more of the board of directors of the second company or any of its subsidiaries; or

(ii) Director representatives of the first company or any of its subsidiaries are able to make or block the making of major operational or policy decisions of the second company or any of its subsidiaries;

(2) Two or more employees or directors of the first company or any of its subsidiaries serve as senior management officials of the second company or any of its subsidiaries;

(3) An employee or director of the first company or any of its subsidiaries serves as the chief executive officer, or serves in a similar capacity, of the second company or any of its subsidiaries;

(4) The first company or any of its subsidiaries enters into transactions or has business relationships with the second company or any of its subsidiaries that generate in the aggregate 10 percent or more of the total annual revenues or expenses of the second company, each on a consolidated basis; or

(5) The first company or any of its subsidiaries has any limiting contractual right with respect to the second company or any of its subsidiaries, unless such limiting contractual right is part of an agreement to merge with or make a controlling investment in the second company that is reasonably expected to close within one year and such limiting contractual right is designed to ensure that the second company continues to operate in the ordinary course until the merger or investment is consummated or such limiting contractual right requires the second company to take an action necessary for the merger or investment to be consummated.

(e) *Ownership or control of 10 percent or more of voting securities.* The first company controls 10 percent or more of the outstanding securities of any class of voting securities of the second company, and:

(1) The first company or any of its subsidiaries propose a number of director representatives to the board of directors of the second company or any of its subsidiaries in opposition to nominees proposed by the management or board of directors of the second company or any of its subsidiaries that, together with any director representatives of the first company or any of its subsidiaries on the board of directors of the second company or any of its subsidiaries, would comprise 25 percent or more of the board of directors of the second company or any of its subsidiaries;

(2) Director representatives of the first company and its subsidiaries comprise more than 25 percent of any committee of the board of directors of the second company or any of its subsidiaries that can take action that binds the second company or any of its subsidiaries; or

(3) The first company or any of its subsidiaries enters into transactions or has business relationships with the second company or any of its subsidiaries that:

(i) Are not on market terms; or

(ii) Generate in the aggregate 5 percent or more of the total annual revenues or expenses of the second company, each on a consolidated basis.

(f) *Ownership or control of 15 percent or*

more of voting securities. The first company controls 15 percent or more of the outstanding securities of any class of voting securities of the second company, and:

(1) A director representative of the first company or of any of its subsidiaries serves as the chair of the board of directors of the second company or any of its subsidiaries;

(2) One or more employees or directors of the first company or any of its subsidiaries serves as a senior management official of the second company or any of its subsidiaries; or

(3) The first company or any of its subsidiaries enters into transactions or has business relationships with the second company or any of its subsidiaries that generate in the aggregate 2 percent or more of the total annual revenues or expenses of the second company, each on a consolidated basis.

(g) *Accounting consolidation.* The first company consolidates the second company on its financial statements prepared under U.S. generally accepted accounting principles.

(h) *Control of an investment fund.*

(1) The first company serves as an investment adviser to the second company, the second company is an investment fund, and the first company, directly or indirectly, or acting through one or more other persons:

(i) Controls 5 percent or more of the outstanding securities of any class of voting securities of the second company; or

(ii) Controls 25 percent or more of the total equity of the second company.

(2) The presumption of control in paragraph (h)(1) of this section does not apply if the first company organized and sponsored the second company within the preceding 12 months.

(i) *Divestiture of control.*

(1) The first company controlled the second company under section 225.2(e)(1)(i) or (ii) of this part at any time during the prior two years and the first company controls 15 percent or more of the outstanding securities of any class of voting securities of the second company.

(2) Notwithstanding paragraph (i)(1) of this section, a first company will not be presumed to control a second company under this paragraph if 50 percent or more of the outstanding securities of each class of voting securities of the second company is controlled by a person that is not a senior management official or director of the first company, or by a company that is not an affiliate of the first company.

(j) *Securities held in a fiduciary capacity.* For purposes of the presumptions of control in this section, the first company does not control securities of the second company that the first company holds in a fiduciary capacity, except that if the second company is a depository institution or a depository institution holding company, this paragraph (j) only applies to securities held in a fiduciary capacity without sole discretionary authority to exercise the voting rights of the securities.

4–051.3

SECTION 225.33—Rebuttable Presumptions of Noncontrol of a Company

(a) In any proceeding under section 225.31(b) or (c) of this part, a first company is presumed not to control a second company if:

(1) The first company controls less than 10 percent of the outstanding securities of each class of voting securities of the second company; and

(2) The first company is not presumed to control the second company under section 225.32 of this part.

(b) In any proceeding under this subpart, or judicial proceeding under the Bank Holding Company Act, other than a proceeding in which the Board has made a preliminary determination that a first company has the power to exercise a controlling influence over the management or policies of a second company, a first company may not be held to have had control over a second company at any given time, unless the first company, at the time in question, controlled 5 percent or more of the outstanding securities of any class of voting securities of the second company, or had already been found to have control on the basis of the existence of a controlling influence relationship.

4–051.4

SECTION 225.34—Total Equity

(a) *General.* For purposes of this subpart, the total equity controlled by a first company in a second company that is organized as a stock corporation and prepares financial statements pursuant to U.S. generally accepted accounting principles will be calculated as described in paragraph (b) of this section. With respect to a second company that is not organized as a stock corporation or that does not prepare financial statements pursuant to U.S. generally accepted accounting principles, the first company's total equity in the second company will be calculated so as to be reasonably consistent with the methodology described in paragraph (b) of this section, while taking into account the legal form of the second company and the accounting system used by the second company to prepare financial statements.

(b) *Calculation of total equity.*

(1) *Total equity.* The first company's total equity in the second company, expressed as a percentage, is equal to:

(i) The sum of Investor Common Equity and, for each class of preferred stock issued by the second company, Investor Preferred Equity, divided by

(ii) Issuer Shareholders' Equity.

(2) *Investor Common Equity* equals the greater of:

(i) Zero, and

(ii) The quotient of the number of shares of common stock of the second company that are controlled by the first company divided by the total number of shares of common stock of the second company that are issued and outstanding, multiplied by the amount of shareholders' equity of the second company not allocated to preferred stock under U.S. generally accepted accounting principles.[1]

(3) *Investor Preferred Equity* equals, for each class of preferred stock issued by the second company, the greater of:

(i) Zero, and

(ii) The quotient of the number of shares of the class of preferred stock of the second company that are controlled by the first company divided by the total number of shares of the class of preferred stock that are issued and outstanding, multiplied by the amount of shareholders' equity of the second company allocated to the class of preferred stock under U.S. generally accepted accounting principles.[2]

(c) *Consideration of debt instruments and other interests in total equity.*

(1) For purposes of the total equity calculation in paragraph (b) of this section, a debt instrument or other interest issued by the second company that is controlled by the first company may be treated as an equity instrument if that debt instrument or other interest is functionally equivalent to equity.

(2) For purposes of paragraph (b)(1) of this section, the principal amount of all debt instruments and the market value of all other interests that are functionally equivalent to equity that are controlled by the first company are added to the sum under paragraph (b)(1)(i) of this section, and the principal amount of all debt instruments and the market value of all other interests that are functionally equivalent to equity that are outstanding are added to Issuer Shareholders' Equity.

(3) For purposes of paragraph (c)(1) of this section, a debt instrument issued by the second company may be considered functionally equivalent to equity if it has equity-like characteristics, such as:

(i) Extremely long-dated maturity;

(ii) Subordination to other debt instruments issued by the second company;

(ii) Qualification as regulatory capital under any regulatory capital rules applicable to the second company;

[1] If the second company has multiple classes of common stock outstanding and different classes of common stock have different economic interests in the second company on a per share basis, the number of shares of common stock must be adjusted for purposes of this calculation so that each share of common stock has the same economic interest in the second company.

[2] If there are different classes of preferred stock with equal seniority (i.e., *pari passu* classes of preferred stock), the *pari passu* shares are treated as a single class. If *pari passu* classes of preferred stock have different economic interests in the second company on a per share basis, the number of shares of preferred stock must be adjusted for purposes of this calculation so that each *pari passu* share of preferred stock has the same economic interest in the second company.

(iii) Qualification as equity under applicable tax law;

(iv) Qualification as equity under U.S. generally accepted accounting principles or other applicable accounting standards;

(v) Inadequacy of the equity capital underlying the debt at the time of the issuance of the debt; or

(vi) Issuance not on market terms.

(4) For purposes of paragraph (c)(1) of this section, an interest that is not a debt instrument issued by the second company may be considered functionally equivalent to equity if it has equity-like characteristics, such as entitling its owner to a share of the profits of the second company.

(d) *Exclusion of certain equity instruments from total equity.*

(1) For purposes of the total equity calculation in paragraph (b) of this section, an equity instrument issued by the second company that is controlled by the first company may be treated as not an equity instrument if the equity instrument is functionally equivalent to debt.

(2) For purposes of paragraph (d)(1) of this section, an equity instrument issued by the second company may be considered functionally equivalent to debt if it has debt-like characteristics, such as protections generally provided to creditors, a limited term, a fixed rate of return or a variable rate of return linked to a reference interest rate, classification as debt for tax purposes, or classification as debt for accounting purposes.

(e) *Frequency of total equity calculation.* The total equity of a first company in a second company is calculated each time the first company acquires control over equity instruments of the second company, including any debt instruments or other interests that are functionally equivalent to equity in accordance with paragraph (c) of this section.

4–051.8

SUBPART E—CHANGE IN BANK CONTROL

SECTION 225.41—Transactions Requiring Prior Notice

(a) *Prior-notice requirement.* Any person acting directly or indirectly, or through or in concert with one or more persons, shall give the Board 60 days' written notice, as specified in section 225.43 of this subpart, before acquiring control of a state member bank or bank holding company, unless the acquisition is exempt under section 225.42.

(b) *Definitions.* For purposes of this subpart:

(1) *Acquisition* includes a purchase, assignment, transfer, or pledge of voting securities, or an increase in percentage ownership of a state member bank or a bank holding company resulting from a redemption of voting securities.

(2) *Acting in concert* includes knowing participation in a joint activity or parallel action towards a common goal of acquiring control of a state member bank or bank holding company whether or not pursuant to an express agreement.

(3) *Immediate family* includes a person's father, mother, stepfather, stepmother, brother, sister, stepbrother, stepsister, son, daughter, stepson, stepdaughter, grandparent, grandson, granddaughter, father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, the spouse of any of the foregoing, and the person's spouse.

4–051.9

(c) *Acquisitions requiring prior notice.*

(1) *Acquisition of control.* The acquisition of voting securities of a state member bank or bank holding company constitutes the acquisition of control under the Bank Control Act,* requiring prior notice to the Board, if, immediately after the transaction, the acquiring person (or persons acting in concert) will own, control, or hold with power to vote 25 percent or more of any class of voting securities of the institution.

(2) *Rebuttable presumption of control.* The Board presumes that an acquisition of voting securities of a state member bank or bank holding company constitutes the ac-

* The Change in Bank Control Act amended section 7(j) of the Federal Deposit Insurance Act (12 USC 1817(j) at 1–344).

quisition of control under the Bank Control Act, requiring prior notice to the Board, if, immediately after the transaction, the acquiring person (or persons acting in concert) will own, control, or hold with power to vote 10 percent or more of any class of voting securities of the institution, and if—

(i) the institution has registered securities under section 12 of the Securities Exchange Act of 1934 (15 USC 78*l*); or

(ii) no other person will own, control, or hold the power to vote a greater percentage of that class of voting securities immediately after the transaction.[1]

4–052

(d) *Rebuttable presumption of concerted action.* The following persons shall be presumed to be acting in concert for purposes of this subpart:

(1) a company and any controlling shareholder, partner, trustee, or management official of the company, if both the company and the person own voting securities of the state member bank or bank holding company;

(2) an individual and the individual's immediate family;

(3) companies under common control;

(4) persons that are parties to any agreement, contract, understanding, relationship, or other arrangement, whether written or otherwise, regarding the acquisition, voting, or transfer of control of voting securities of a state member bank or bank holding company, other than through a revocable proxy as described in section 225.42(a)(5) of this subpart;

(5) persons that have made, or propose to make, a joint filing under sections 13 or 14 of the Securities Exchange Act of 1934 (15 USC 78m or 78n), and the rules promulgated thereunder by the Securities and Exchange Commission; and

(6) a person and any trust for which the person serves as trustee.

[1] If two or more persons, not acting in concert, each propose to acquire simultaneously equal percentages of 10 percent or more of a class of voting securities of the state member bank or bank holding company, each person must file prior notice to the Board.

4–052.01

(e) *Acquisitions of loans in default.* The Board presumes an acquisition of a loan in default that is secured by voting securities of a state member bank or bank holding company to be an acquisition of the underlying securities for purposes of this section.

(f) *Other transactions.* Transactions other than those set forth in paragraph (c) of this section resulting in a person's control of less than 25 percent of a class of voting securities of a state member bank or bank holding company are not deemed by the Board to constitute control for purposes of the Bank Control Act.

(g) *Rebuttal of presumptions.* Prior notice to the Board is not required for any acquisition of voting securities under the presumption of control set forth in this section, if the Board finds that the acquisition will not result in control. The Board shall afford any person seeking to rebut a presumption in this section an opportunity to present views in writing or, if appropriate, orally before its designated representatives at an informal conference.

4–052.1

SECTION 225.42—Transactions Not Requiring Prior Notice

(a) *Exempt transactions.* The following transactions do not require notice to the Board under this subpart:

(1) *Existing control relationships.* The acquisition of additional voting securities of a state member bank or bank holding company by a person who—

(i) continuously since March 9, 1979 (or since the institution commenced business, if later), held power to vote 25 percent or more of any class of voting securities of the institution; or

(ii) is presumed, under section 225.41(c)(2) of this subpart, to have controlled the institution continuously since March 9, 1979, if the aggregate amount of voting securities held does not exceed 25 percent or more of any class of voting securities of the institution or, in other cases, where the Board determines that

the person has controlled the bank continuously since March 9, 1979;

(2) *Increase of previously authorized acquisitions.* Unless the Board or the Reserve Bank otherwise provides in writing, the acquisition of additional shares of a class of voting securities of a state member bank or bank holding company by any person (or persons acting in concert) who has lawfully acquired and maintained control of the institution (for purposes of section 225.41(c) of this subpart), after complying with the procedures and receiving approval to acquire voting securities of the institution under this subpart, or in connection with an application approved under section 3 of the BHC Act (12 USC 1842; section 225.11 of subpart B of this part) or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 USC 1828(c));

(3) *Acquisitions subject to approval under BHC Act or Bank Merger Act.* Any acquisition of voting securities subject to approval under section 3 of the BHC Act (section 225.11 of subpart B), or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 USC 1828(c));

(4) *Transactions exempt under BHC Act.* Any transaction described in sections 2(a)(5), 3(a)(A), or 3(a)(B) of the BHC Act (12 USC 1841(a)(5), 1842(a)(A), 1842(a)(B)), by a person described in those provisions;

4–052.3

(5) *Proxy solicitation.* The acquisition of the power to vote securities of a state member or bank holding company through receipt of a revocable proxy in connection with a proxy solicitation for the purposes of conducting business at a regular or special meeting of the institution, if the proxy terminates within a reasonable period after the meeting;

(6) *Stock dividends.* The receipt of voting securities of a state member bank or bank holding company through a stock dividend or stock split if the proportional interest of the recipient in the institution remains substantially the same; and.

(7) *Acquisition of foreign banking organization.* The acquisition of voting securities of a qualifying foreign banking organization. (This exemption does not extend to the reports and information required under paragraphs 9, 10, and 12 of the Bank Control Act (12 USC 1817(j)(9), (10), and (12)) and section 225.44 of this subpart.

4–052.31

(b) *Prior-notice exemption.*

(1) The following acquisitions of voting securities of a state member bank or bank holding company, which would otherwise require prior notice under this subpart, are not subject to the prior-notice requirements if the acquiring person notifies the appropriate Reserve Bank within 90 calendar days after the acquisition and provides any relevant information requested by the Reserve Bank:

(i) acquisition of voting securities through inheritance;

(ii) acquisition of voting securities as a bona fide gift; and

(iii) acquisition of voting securities in satisfaction of a debt previously contracted (DPC) in good faith.

4–052.32

(2) The following acquisitions of voting securities of a state member bank or bank holding company, which would otherwise require prior notice under this subpart, are not subject to the prior-notice requirements if the acquiring person does not reasonably have advance knowledge of the transaction, and provides the written notice required under section 225.43 to the appropriate Reserve Bank within 90 calendar days after the transaction occurs:

(i) acquisition of voting securities resulting from a redemption of voting securities by the issuing bank or bank holding company; and

(ii) acquisition of voting securities as a result of actions (including the sale of securities) by any third party that is not within the control of the acquiror.

(3) Nothing in paragraphs (b)(1) or (b)(2) of this section limits the authority of the Board to disapprove a notice pursuant to section 225.43(h) of this subpart.

4–052.4

SECTION 225.43—Procedures for Filing, Processing, Publishing, and Acting on Notices

(a) *Filing notice.*

(1) A notice required under this subpart shall be filed with the appropriate Reserve Bank and shall contain all the information required by paragraph 6 of the Bank Control Act (12 USC 1817(j)(6)), or prescribed in the designated Board form.

(2) The Board may waive any of the informational requirements of the notice if the Board determines that it is in the public interest.

(3) A notificant shall notify the appropriate Reserve Bank or the Board immediately of any material changes in a notice submitted to the Reserve Bank, including changes in financial or other conditions.

(4) When the acquiring person is an individual, or group of individuals acting in concert, the requirement to provide personal financial data may be satisfied by a current statement of assets and liabilities and an income summary, as required in the designated Board form, together with a statement of any material changes since the date of the statement or summary. The Reserve Bank or the Board, nevertheless, may request additional information, if appropriate.

(b) *Acceptance of notice.* The 60-day notice period specified in section 225.41 of this subpart begins on the date of receipt of a complete notice. The Reserve Bank shall notify the person or persons submitting a notice under this subpart in writing of the date the notice is or was complete and thereby accepted for processing. The Reserve Bank or the Board may request additional relevant information at any time after the date of acceptance.

4–052.41

(c) *Publication.*

(1) *Newspaper announcement.* Any person(s) filing a notice under this subpart shall publish, in a form prescribed by the Board, an announcement soliciting public comment on the proposed acquisition. The announcement shall be published in a newspaper of general circulation in the community in which the head office of the state member bank to be acquired is located or, in the case of a proposed acquisition of a bank holding company, in the community in which its head office is located and in the community in which the head office of each of its subsidiary banks is located. The announcement shall be published no earlier than 15 calendar days before the filing of the notice with the appropriate Reserve Bank and no later than 10 calendar days after the filing date; and the publisher's affidavit of publication shall be provided to the appropriate Reserve Bank.

(2) *Contents of newspaper announcement.* The newspaper announcement shall state—

(i) the name of each person identified in the notice as a proposed acquiror of the bank or bank holding company;

(ii) the name of the bank or bank holding company to be acquired, including the name of each of the bank holding company's subsidiary banks; and

(iii) a statement that interested persons may submit comments on the notice to the Board or the appropriate Reserve Bank for a period of 20 days, or such shorter period as may be provided, pursuant to paragraph (c)(5) of this section.

(3) *Federal Register announcement.* The Board shall, upon filing of a notice under this subpart, publish announcement in the *Federal Register* of receipt of the notice. The *Federal Register* announcement shall contain the information required under paragraphs (c)(2)(i) and (c)(2)(ii) of this section and a statement that interested persons may submit comments on the proposed acquisition for a period of 15 calendar days, or such shorter period as may be provided, pursuant to paragraph (c)(5) of this section. The Board may waive publication in the *Federal Register*, if the Board determines that such action is appropriate.

(4) *Delay of publication.* The Board may permit delay in the publication required under paragraphs (c)(1) and (c)(3) if the Board determines, for good cause shown, that it is in the public interest to grant such a delay. Requests for delay of publication

may be submitted to the appropriate Reserve Bank.

(5) *Shortening or waiving notice.* The Board may shorten or waive the public-comment or newspaper-publication requirements of this paragraph, or act on a notice before the expiration of a public-comment period, if it determines in writing that an emergency exists, or that disclosure of the notice, solicitation of public comment, or delay until expiration of the public-comment period would seriously threaten the safety or soundness of the bank or bank holding company to be acquired.

4–052.42

(6) *Consideration of public comments.* In acting upon a notice filed under this subpart, the Board shall consider all public comments received in writing within the period specified in the newspaper or *Federal Register* announcement, whichever is later. At the Board's option, comments received after this period may, but need not, be considered.

(7) *Standing.* No person (other than the acquiring person) who submits comments or information on a notice filed under this subpart shall thereby become a party to the proceeding or acquire any standing or right to participate in the Board's consideration of the notice or to appeal or otherwise contest the notice or the Board's action regarding the notice.

4–052.5

(d) *Time period for Board action.*

(1) *Consummation of acquisition.*

(i) The notificants may consummate the proposed acquisition 60 days after submission to the Reserve Bank of a complete notice under paragraph (a) of this section, unless within that period the Board disapproves the proposed acquisition or extends the 60-day period, as provided under paragraph (d)(2) of this section.

(ii) The notificant(s) may consummate the proposed transaction before the expiration of the 60-day period if the Board notifies the notificant(s) in writing of the Board's intention not to disapprove the acquisition.

(2) *Extensions of time period.*

(i) The Board may extend the 60-day period in paragraph (d)(1) of this section for an additional 30 days by notifying the acquiring person(s).

(ii) The Board may further extend the period during which it may disapprove a notice for two additional periods of not more than 45 days each, if the Board determines that—

(A) any acquiring person has not furnished all the information required under paragraph (a) of this section;

(B) any material information submitted is substantially inaccurate;

(C) the Board is unable to complete the investigation of any acquiring person because of inadequate cooperation or delay by that person; or

(D) additional time is needed to investigate and determine that no acquiring person has a record of failing to comply with the requirements of the Bank Secrecy Act, subchapter II of chapter 53 of title 31, United States Code.

(iii) If the Board extends the time period under this paragraph, it shall notify the acquiring person(s) of the reasons therefor and shall include a statement of the information, if any, deemed incomplete or inaccurate.

4–052.51

(e) *Advice to bank supervisory agencies.*

(1) Upon accepting a notice relating to acquisition of securities of a state member bank, the Reserve Bank shall send a copy of the notice to the appropriate state bank supervisor, which shall have 30 calender days from the date the notice is sent in which to submit its views and recommendations to the Board. The Reserve Bank also shall send a copy of any notice to the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

(2) If the Board finds that it must act immediately in order to prevent the probable failure of the bank or bank holding company involved, the Board may dispense

with or modify the requirements for notice to the state supervisor.

4–052.6

(f) *Investigation and report.*

(1) After receiving a notice under this subpart, the Board or the appropriate Reserve Bank shall conduct an investigation of the competence, experience, integrity, and financial ability of each person by and for whom an acquisition is to be made. The Board shall also make an independent determination of the accuracy and completeness of any information required to be contained in a notice under paragraph (a) of this section. In investigating any notice accepted under this subpart, the Board or Reserve Bank may solicit information or views from any person, including any bank or bank holding company involved in the notice, and any appropriate state, federal, or foreign governmental authority.

(2) The Board or the appropriate Reserve Bank shall prepare a written report of its investigation, which shall contain, at a minimum, a summary of the results of the investigation.

(g) *Factors considered in acting on notices.* In reviewing a notice filed under this subpart, the Board shall consider the information in the record, the views and recommendations of the appropriate bank supervisor, and any other relevant information obtained during any investigation of the notice.

4–052.7

(h) *Disapproval and hearing.*

(1) *Disapproval of notice.* The Board may disapprove an acquisition if it finds adverse effects with respect to any of the factors set forth in paragraph 7 of the Bank Control Act (12 USC 1817(j)(7)) (i.e., competitive, financial, managerial, banking, or incompleteness of information).

(2) *Disapproval notification.* Within three days after its decision to issue a notice of intent to disapprove any proposed acquisition, the Board shall notify the acquiring person in writing of the reasons for the action.

(3) *Hearing.* Within 10 calendar days of receipt of the notice of the Board's intent to disapprove, the acquiring person may submit a written request for a hearing. Any hearing conducted under this paragraph shall be in accordance with the Rules of Practice for Formal Hearings (12 CFR 263). At the conclusion of the hearing, the Board shall, by order, approve or disapprove the proposed acquisition on the basis of the record of the hearing. If the acquiring person does not request a hearing, the notice of intent to disapprove becomes final and unappealable.

4–052.71

SECTION 225.44—Reporting of Stock Loans

(a) *Requirements.*

(1) Any foreign bank or affiliate of a foreign bank that has credit outstanding to any person or group of persons, in the aggregate, which is secured, directly or indirectly, by 25 percent or more of any class of voting securities of a state member bank, shall file a consolidated report with the appropriate Reserve Bank for the state member bank.

(2) The foreign bank or its affiliate also shall file a copy of the report with its appropriate federal banking agency.

(3) Any shares of the state member bank held by the foreign bank or any affiliate of the foreign bank as principal must be included in the calculation of the number of shares in which the foreign bank or its affiliate has a security interest for purposes of paragraph (a) of this section.

4–052.72

(b) *Definitions.* For purposes of paragraph (a) of this section:

(1) *Foreign bank* shall have the same meaning as in section 1(b) of the International Banking Act of 1978 (12 USC 3101).

(2) *Credit outstanding* includes any loan or extension of credit; the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit; and any other type of transaction

that extends credit or financing to the person or group of persons.

(3) *Group of persons* includes any number of persons that the foreign bank or any affiliate of a foreign bank has reason to believe—

(i) are acting together, in concert, or with one another to acquire or control shares of the same insured depository institution, including an acquisition of shares of the same depository institution at approximately the same time under substantially the same terms; or

(ii) have made, or propose to make, a joint filing under section 13 or 14 of the Securities Exchange Act of 1934 (15 USC 78m or 78n), and the rules promulgated thereunder by the Securities and Exchange Commission regarding ownership of the shares of the same insured depository institution.

4–052.73

(c) *Exceptions.* Compliance with paragraph (a) of this section is not required if—

(1) the person or group of persons referred to in that paragraph has disclosed the amount borrowed and the security interest therein to the Board or appropriate Reserve Bank in connection with a notice filed under section 225.41 of this subpart, or another application filed with the Board or Reserve Bank as a substitute for a notice under section 225.41 of this subpart, including an application filed under section 3 of the BHC Act (12 USC 1842) or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 USC 1828(c)), or an application for membership in the Federal Reserve System; or

(2) the transaction involves a person or group of persons that has been the owner or owners of record of the stock for a period of one year or more; or, if the transaction involves stock issued by a newly chartered bank, before the bank is opened for business.

4–052.74

(d) *Report requirements.*

(1) The consolidated report shall indicate the number and percentage of shares securing each applicable extension of credit, the identity of the borrower, and the number of shares held as principal by the foreign bank and any affiliate thereof.

(2) A foreign bank, or any affiliate of a foreign bank, shall file the consolidated report in writing within 30 days of the date on which the foreign bank or affiliate first believes that the security for any outstanding credit consists of 25 percent or more of any class of voting securities of a state member bank.

(e) *Other reporting requirements.* A foreign bank, or any affiliate thereof, that is supervised by the System and is required to report credit outstanding that is secured by the shares of an insured depository institution to another federal banking agency also shall file a copy of the report with the appropriate Reserve Bank.

4–052.85

SUBPART F—LIMITATIONS ON NONBANK BANKS

SECTION 225.52—Limitation on Overdrafts

(a) *Definitions.* For purposes of this section—

(1) ''Account'' means a reserve account, clearing account, or deposit account as defined in the Board's Regulation D (12 CFR 204.2(a)(1)(i)), that is maintained at a Federal Reserve Bank or nonbank bank.

(2) ''Cash item'' means (i) a check other than a check classified as a noncash item; or (ii) any other item payable on demand and collectible at par that the Federal Reserve Bank of the District in which the item is payable is willing to accept as a cash item.

(3) ''Discount-window loan'' means any credit extended by a Federal Reserve Bank to a nonbank bank or industrial bank pursuant to the provisions of the Board's Regulation A (12 CFR 201).

(4) ''Industrial bank'' means an institution as defined in section 2(c)(2)(H) of the BHC Act (12 USC 1841(c)(2)(H)).

4–052.86

(5) ''Noncash item'' means an item handled by a Reserve Bank as a noncash item under the Reserve Bank's ''Collection of Noncash Items Operating Circular'' (e.g., a maturing banker's acceptance or a maturing security, or a demand item, such as a check, with special instructions or an item that has not been preprinted or postencoded).

(6) ''Other nonelectronic transactions'' include all other transactions not included as funds transfers, book-entry securities transfers, cash items, noncash items, automated clearinghouse transactions, net-settlement entries, and discount-window loans (e.g., original issue of securities or redemption of securities).

(7) An ''overdraft'' in an account occurs whenever the Federal Reserve Bank, nonbank bank, or industrial bank holding an account posts a transaction to the account of the nonbank bank, industrial bank, or affiliate that exceeds the aggregate balance of the accounts of the nonbank bank, industrial bank, or affiliate, as determined by the posting rules set forth in paragraphs (d) and (e) of this section and continues until the aggregate balance of the account is zero or greater.

(8) ''Transfer item'' means an item as defined in subpart B of Regualtion J (12 CFR 210.25 et seq.).

4–052.87

(b) *Restriction on overdrafts.*

(1) *Affiliates.* Neither a nonbank bank nor an industrial bank shall permit any affiliate to incur any overdraft in its account with the nonbank bank or industrial bank.

(2) *Nonbank banks or industrial banks.*

(i) No nonbank bank or industrial bank shall incur any overdraft in its account at a Federal Reserve Bank on behalf of an affiliate.

(ii) An overdraft by a nonbank bank or industrial bank in its account at a Federal Reserve Bank shall be deemed to be on behalf of an affiliate whenever—

(A) a nonbank bank or industrial bank holds an account for an affiliate from which third-party payments can be made; and

(B) when the posting of an affiliate's transaction to the nonbank bank's or industrial bank's account at a Reserve Bank creates an overdraft in its account at a Federal Reserve Bank or increases the amount of an existing overdraft in its account at a Federal Reserve Bank.

4–052.88

(c) *Permissible overdrafts.* The following are permissible overdrafts not subject to paragraph (b):

(1) *Inadvertent error.* An overdraft in its account by a nonbank bank or its affiliate, or an industrial bank or its affiliate, that results from an inadvertent computer error or inadvertent accounting error, that was not reasonably foreseeable or could not have been prevented through the maintenance of procedures reasonably adopted by the nonbank bank or affiliate to avoid such overdraft; and

(2) *Fully secured primary-dealer affiliate overdrafts.*

(i) An overdraft incurred by an affiliate of a nonbank bank, which affiliate is recognized as a primary dealer by the Federal Reserve Bank of New York, in the affiliate's account at the nonbank bank, or an overdraft incurred by a nonbank bank on behalf of its primary-dealer affiliate in the nonbank bank's account at a Federal Reserve Bank; *provided* the overdraft is fully secured by bonds, notes, or other obligations which are direct obligations of the United States or on which the principal and interest are fully guaranteed by the United States or by securities and obligations eligible for settlement on the Federal Reserve book-entry system.

(ii) An overdraft by a nonbank bank in its account at a Federal Reserve Bank that is on behalf of a primary-dealer affiliate is fully secured when that portion of its overdraft at the Federal Reserve Bank that corresponds to the transaction posted for an affiliate that caused or increased the nonbank bank's overdraft is fully secured in accordance with paragraph (c)(2)(iii).

(iii) An overdraft is fully secured under paragraph (c)(2)(i) when the nonbank bank can demonstrate that the overdraft is secured, at all times, by a perfected security interest in specific, identified obligations described in paragraph (c)(2)(i) with a market value that, in the judgment of the Reserve Bank holding the nonbank bank's account, is sufficiently in excess of the amount of the overdraft to provide a margin of protection in a volatile market or in the event the securities need to be liquidated quickly.

4–052.89

(d) *Posting by Federal Reserve Banks.* For purposes of determining the balance of an account under this section, payments and transfers by nonbank banks and industrial banks processed by the Federal Reserve Banks shall be considered posted to their accounts at Federal Reserve Banks as follows:

(1) *Funds transfers.* Transfer items shall be posted—

(i) to the transferor's account at the time the transfer is actually made by the transferor's Federal Reserve Bank; and

(ii) to the transferee's account at the time the transferee's Reserve Bank sends the transfer item or sends or telephones the advice of credit for the item to the transferee, whichever occurs first.

(2) *Book-entry securities transfers against payment.* A book-entry securities transfer against payment shall be posted—

(i) to the transferor's account at the time the entry is made by the transferor's Reserve Bank; and

(ii) to the transferee's account at the time the entry is made by the transferee's Reserve Bank.

4–052.9

(3) *Discount-window loans.* Credit for a discount-window loan shall be posted to the account of a nonbank bank or industrial bank at the close of business on the day that it is made or such earlier time as may be specifically agreed to by the Federal Reserve Bank and the nonbank bank under the terms of the loan. Debit for repayment of a discount-window loan shall be posted to the account of the nonbank bank or industrial bank as of the close of business on the day of maturity of the loan or such earlier time as may be agreed to by the Federal Reserve Bank and the nonbank bank or required by the Federal Reserve Bank under the terms of the loan.

(4) *Other transactions.* Total aggregate credits for automated clearinghouse transfers, cash items, noncash items, net-settlement entries, and other nonelectronic transactions shall be posted to the account of a nonbank bank or industrial bank as of the opening of business on settlement day. Total aggregate debits for these transactions and entries shall be posted to the account of a nonbank or industrial bank as of the close of business on settlement day.

4–052.91

(e) *Posting by nonbank banks and industrial banks.* For purposes of determining the balance of an affiliate's account under this section, payments and transfers through an affiliate's account at a nonbank bank or industrial bank shall by posted as follows:

(1) *Funds transfers.*

(i) Fedwire transfer items shall be posted—

(A) to the transferor affiliate's account no later than the time the transfer is actually made by the transferor's Federal Reserve Bank; and

(B) to the transferee affiliate's account no earlier than the time the transferee's Reserve Bank sends the transfer item, or sends or telephones the advice of credit for the item to the transferee, whichever occurs first.

(ii) For funds transfers not sent or received through Federal Reserve Banks, debits shall be posted to the transferor affiliate's account not later than the time the nonbank bank or industrial bank becomes obligated on the transfer. Credits shall not be posted to the transferee affiliate's account before the nonbank bank or industrial bank has received actually and finally collected funds for the transfer.

4–052.92

(2) *Book-entry securities transfers against payment.*

(i) A book-entry securities transfer against payment shall be posted—

(A) to the transferor affiliate's account not earlier than the time the entry is made by the transferor's Reserve Bank; and

(B) to the transferee affiliate's account not later than the time the entry is made by the transferee's Reserve Bank.

(ii) For book-entry securities transfers against payment that are not sent or received through Federal Reserve Banks, enteries shall be posted—

(A) to the buyer-affiliate's account not later than the time the nonbank bank or industrial bank becomes obligated on the transfer; and

(B) to the seller-affiliate's account not before the nonbank bank or industrial bank has received actually and finally collected funds for the transfer.

4–052.93

(3) *Other transactions.*

(i) *Credits.* Except as otherwise provided in this paragraph, credits for cash items, noncash items, ACH transfers, net-settlement entries, and all other nonelectronic transactions shall be posted to an affiliate's account on the day of the transaction (i.e., settlement day for ACH transactions or the day of credit for check transactions), but no earlier than the Federal Reserve Bank's opening of business on that day. Credit for cash items that are required by federal or state statute or regulation to be made available to the depositor for withdrawal prior to the posting time set forth in the preceding paragraph shall be posted as of the required availability time.

(ii) *Debits.* Debits for cash items, noncash items, ACH transfers, net-settlement entries, and all other nonelectronic transactions shall be posted to an affiliate's account on the day of the transaction (e.g., settlement day for ACH transactions or the day of presentment for check transactions), but no later than the Federal Reserve Bank's close of business on that day. If a check drawn on an affiliate's account or an ACH debit transfer received by an affiliate is returned timely by the nonbank bank or industrial bank in accordance with applicable law and agreements, no entry need be posted to the affiliate's account for such item.

4–053

SUBPART G—APPRAISAL STANDARDS FOR FEDERALLY RELATED TRANSACTIONS

SECTION 225.61—Authority, Purpose, and Scope

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (the ''Board'') under title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. No. 101-73, 103 Stat. 183 (1989)), 12 U.S.C. 3310, 3331-3351, and section 5(b) of the Bank Holding Company Act, 12 U.S.C. 1844(b).

(b) *Purpose and scope.*

(1) Title XI provides protection for federal financial and public-policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This subpart implements the requirements of title XI, and applies to all federally related transactions entered into by the Board or by institutions regulated by the Board (''regulated institutions'').

(2) This subpart—

(i) identifies which real estate-related financial transactions require the services of an appraiser;

(ii) prescribes which categories of federally related transactions shall be appraised by a state-certified appraiser and which by a state-licensed appraiser; and

(iii) prescribes minimum standards for

the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the Board.

4–053.1

SECTION 225.62—Definitions

(a) *Appraisal* means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(b) *Appraisal Foundation* means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) *Appraisal Subcommittee* means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(d) *Business loan* means a loan or extension of credit to any corporation, general or limited partnership, business trust, joint venture, pool, syndicate, sole proprietorship, or other business entity.

(e) *Commercial real estate transaction* means a real estate-related financial transaction that is not secured by a single 1-to-4 family residential property.

(f) *Complex appraisal for a residential real estate transaction* means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

4–053.2

(g) *Federally related transaction* means any real estate-related financial transaction entered into on or after August 9, 1990, that—

(1) the Board or any regulated institution engages in or contracts for; and

(2) requires the services of an appraiser.

(h) *Market value* means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby—

(1) buyer and seller are typically motivated;

(2) both parties are well informed or well advised, and acting in what they consider their own best interests;

(3) a reasonable time is allowed for exposure in the open market;

(4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

4–053.3

(i) *Real estate* or *real property* means an identified parcel or tract of land, with improvements, and includes easements, rights-of-way, undivided or future interests, or similar rights in a tract of land, but does not include mineral rights, timber rights, growing crops, water rights, or similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

(j) *Real estate-related financial transaction* means any transaction involving—

(1) the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof; or

(2) the refinancing of real property or interests in real property; or

(3) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

(k) *Residential real estate transaction* means a real estate-related financial transaction that is secured by a single 1-to-4 family residential property.

4–053.4

(*l*) *State-certified appraiser* means any individual who has satisfied the requirements for certification in a state or territory whose criteria for certification as a real estate appraiser

currently meet or exceed the minimum criteria for certification issued by the Appraiser Qualifications Board of the Appraisal Foundation. No individual shall be a state-certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a state or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualifications Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of the state or territory are inconsistent with title XI of FIRREA. The Board may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(m) *State-licensed appraiser* means any individual who has satisfied the requirements for licensing in a state or territory where the licensing procedures comply with title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the state or territory are inconsistent with title XI. The Board may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within the Board's jurisdiction.

4–053.5

(n) *Tract development* means a project of five units or more that is constructed or is to be constructed as a single development.

(o) *Transaction value* means—

(1) for loans or other extensions of credit, the amount of the loan or extension of credit;

(2) for sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) for the pooling of loans or interests in real property for resale or purchase, the amount of the loan or the market value of the real property calculated with respect to each such loan or interest in real property.

4–053.6

SECTION 225.63—Appraisals Required; Transactions Requiring a State-Certified or -Licensed Appraiser

(a) *Appraisals required.* An appraisal performed by a state-certified or -licensed appraiser is required for any real estate-related financial transaction except those in which—

(1) the transaction is a residential real estate transaction that has a transaction value of $400,000 or less;

(2) a lien on real estate has been taken as collateral in an abundance of caution;

(3) the transaction is not secured by real estate;

(4) a lien on real estate has been taken for purposes other than the real estate's value;

(5) the transaction is a business loan that—

(i) has a transaction value of $1 million or less; and

(ii) is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment;

(6) a lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(7) the transaction involves an existing extension of credit at the lending institution, provided that—

(i) there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or

(ii) there is no advancement of new monies, other than funds necessary to cover reasonable closing costs;

(8) the transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgaged-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met Board regulatory requirements for appraisals at the time of origination;

(9) the transaction is wholly or partially insured or guaranteed by a United States gov-

ernment agency or United States government-sponsored agency;

(10) the transaction either—

(i) qualifies for sale to a United States government agency or United States government-sponsored agency; or

(ii) involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate;

(11) the regulated institution is acting in a fiduciary capacity and is not required to obtain an appraisal under other law;

(12) the transaction involves underwriting or dealing in mortgage-backed securities;

(13) the Board determines that the services of an appraiser are not necessary in order to protect federal financial and public-policy interests in real estate-related financial transactions or to protect the safety and soundness of the institution;

(14) the transaction is a commercial real estate transaction that has a transaction value of $500,000 or less; or

(15) the transaction is exempted from the appraisal requirement pursuant to the rural residential exemption under 12 U.S.C. 3356.

4–053.61

(b) *Evaluations required.* For a transaction that does not require the services of a State certified or licensed appraiser under paragraphs (a)(1), (5), (7), (14), or (15) of this section, the institution shall obtain an appropriate evaluation of real property collateral that is consistent with safe and sound banking practices.*

(c) *Appraisals to address safety-and-soundness concerns.* The Board reserves the right to require an appraisal under this subpart whenever the agency believes it is necessary to address safety-and-soundness concerns.

4–053.7

(d) *Transactions requiring a state-certified appraiser.*

(1) *All transactions of $1,000,000 or more.* All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a state-certified appraiser.

(2) *Commercial real estate transactions of more than $500,000.* All federally related transactions that are commercial real estate transactions having a transaction value of more than $500,000 shall require an appraisal prepared by a state-certified appraiser.

4–053.8

(3) *Complex appraisals for residential real estate transactions of more than $400,000.* All complex appraisals for residential real estate transactions rendered in connection with federally related transactions shall require a State certified appraiser if the transaction value is more than $400,000. A regulated institution may presume that appraisals for residential real estate transactions are not complex, unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If during the course of the appraisal a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) the regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and co-sign the appraisal; or

(ii) the institution may engage a certified appraiser to complete the appraisal.

(e) *Transactions requiring either a state-certified or -licensed appraiser.* All appraisals for federally related transactions not requiring the services of a state-certified appraiser shall be prepared by either a state-certified appraiser or a state-licensed appraiser.

(f) *Deferrals of appraisals and evaluations for certain residential and commercial transactions.*

(1) *120-day grace period.* The completion of appraisals and evaluations required under

* *See also* 3–1577.

paragraphs (a) and (b) of this section may be deferred up to 120 days from the date of closing.

(2) *Covered transactions.* The deferrals authorized under paragraph (f)(1) of this section apply to all residential and commercial real estate-secured transactions, excluding transactions for the acquisition, development, and construction of real estate which, for purposes of this rule, mean those loans described in paragraphs (f)(2)(i) through (iv) of this section. The term ''construction'' as used in this paragraph (f)(2) includes not only construction of new structures, but also additions or alterations to existing structures and the demolition of existing structures to make way for new structures. The following loan transactions are excluded from the deferrals authorized under paragraph (f)(1) of this section:

(i) Loans secured by real estate made to finance:

(A) Land development (such as the process of improving land—laying sewers, water pipes, etc.) preparatory to erecting new structures; or

(B) The on-site construction of industrial, commercial, residential, or farm buildings;

(ii) Loans secured by vacant land (except land known to be used or usable for agricultural purposes);

(iii) Loans secured by real estate to acquire and improve developed or undeveloped property; and

(iv) Loans made under Title I or Title X of the National Housing Act that:

(A) Conform to the definition of ''construction'' as defined in paragraph (f)(2) of this section; and

(B) Are secured by real estate.

(3) *Sunset.* The appraisal and evaluation deferrals authorized by paragraph (f) of this section will expire for transactions closing after December 31, 2020.

4–053.9

SECTION 225.64—Minimum Appraisal Standards

For federally related transactions, all appraisals shall, at a minimum:

(a) conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation, 1029 Vermont Ave., N.W., Washington, D.C. 20005, unless principles of safe and sound banking require compliance with stricter standards;

(b) be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;

(c) be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice;

(d) analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, nonmarket lease terms, and tract developments with unsold units;

(e) be based upon the definition of market value as set forth in this subpart; and

(f) be performed by state-licensed or -certified appraisers in accordance with requirements set forth in this subpart.

4–054.1

SECTION 225.65—Appraiser Independence

(a) *Staff appraisers.* If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to ensure that the appraisers exercise independent judgment and that the appraisal is adequate. Such steps include, but are not limited to, prohibiting an individual from performing appraisals in connection with federally related transactions in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any

vote or approval involving assets on which they performed an appraisal.

4–054.2

(b) *Fee appraisers.*

(1) If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or transaction.

(2) A regulated institution also may accept an appraisal that was prepared by an appraiser engaged directly by another financial-services institution if—

(i) the appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction; and

(ii) the regulated institution determines that the appraisal conforms to the requirements of this subpart and is otherwise acceptable.

4–054.3

SECTION 225.66—Professional Association Membership; Competency

(a) *Membership in appraisal organizations.* A state-certified appraiser or a state-licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be state-certified or -licensed, as appropriate. However, a state-certified or -licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

4–054.4

SECTION 225.67—Enforcement

Institutions and institution-affiliated parties, including staff appraisers and fee appraisers, may be subject to removal and/or prohibition orders, cease-and-desist orders, and the imposition of civil money penalties pursuant to the Federal Deposit Insurance Act, 12 USC 1811 et seq., as amended, or other applicable law.

4–055

SUBPART H—NOTICE OF ADDITION OR CHANGE OF DIRECTORS AND SENIOR EXECUTIVE OFFICERS

SECTION 225.71—Definitions

(a) *Director* means a person who serves on the board of directors of a regulated institution, except that this term does not include an advisory director who—

(1) is not elected by the shareholders of the regulated institution;

(2) is not authorized to vote on any matters before the board of directors or any committee thereof;

(3) solely provides general policy advice to the board of directors and any committee thereof; and

(4) has not been identified by the Board or Reserve Bank as a person who performs the functions of a director for purposes of this subpart.

(b) *Regulated institution* means a state member bank or a bank holding company.

4–055.1

(c) *Senior executive officer* means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, chief operating officer, chief financial officer, chief lending officer, or chief investment officer. *Senior executive officer* also includes any other person identified by the Board or Reserve Bank, whether or not hired as an employee, with significant influence over, or who participates in, major policymaking decisions of the regulated institution.

(d) *Troubled condition* for a regulated institution means an institution that—

(1) has a composite rating, as determined in its most recent report of examination or inspection, of 4 or 5 under the Uniform Financial Institutions Rating System or under the Federal Reserve Bank Holding Company Rating System;

(2) is subject to a cease-and-desist order or formal written agreement that requires action to improve the financial condition of the institution, unless otherwise informed in writing by the Board or Reserve Bank; or

(3) is informed in writing by the Board or Reserve Bank that it is in troubled condition for purposes of the requirements of this subpart on the basis of the institution's most recent report of condition or report of examination or inspection, or other information available to the Board or Reserve Bank.

4–055.2

SECTION 225.72—Director and Officer Appointments; Prior-Notice Requirement

(a) *Prior notice by regulated institution.* A regulated institution shall give the Board 30 days' written notice, as specified in section 225.73, before adding or replacing any member of its board of directors, employing any person as a senior executive officer of the institution, or changing the responsibilities of any senior executive officer so that the person would assume a different senior executive officer position, if—

(1) the regulated institution is not in compliance with all minimum capital requirements applicable to the institution as determined on the basis of the institution's most recent report of condition or report of examination or inspection;

(2) the regulated institution is in troubled condition; or

(3) the Board determines, in connection with its review of a capital-restoration plan required under section 38 of the Federal Deposit Insurance Act or subpart B of the Board's Regulation H, or otherwise, that such notice is appropriate.

(b) *Prior notice by individual.* The prior notice required by paragraph (a) of this section may be provided by an individual seeking election to the board of directors of a regulated institution.

4–055.4

SECTION 225.73—Procedures for Filing, Processing, and Acting on Notices; Standards for Disapproval; Waiver of Notice

(a) *Filing notice.*

(1) *Content.* The notice required in section 225.72 shall be filed with the appropriate Reserve Bank and shall contain—

(i) the information required by paragraph 6(A) of the Change in Bank Control Act (12 USC 1817(j)(6)(A)) as may be prescribed in the designated Board form;

(ii) additional information consistent with the Federal Financial Institutions Examination Council's joint statement of guidelines on conducting background checks and change in control investigations, as set forth in the designated Board form; and

(iii) such other information as may be required by the Board or Reserve Bank.

(2) *Modification.* The Reserve Bank may modify or accept other information in place of the requirements of section 225.73(a)(1) for a notice filed under this subpart.

(3) *Acceptance and processing of notice.* The 30-day notice period specified in section 225.72 shall begin on the date all information required to be submitted by the notificant pursuant to section 225.73(a)(1) is received by the appropriate Reserve Bank. The Reserve Bank shall notify the regulated institution or individual submitting the notice of the date on which all required information is received and the notice is accepted for processing, and of the date on which the 30-day notice period will expire. The Board or Reserve Bank may extend the 30-day notice period for an additional period of not more than 60 days by notifying the regulated institution or individual filing the notice that the period has been extended and stating the reason for not processing the notice within the 30-day notice period.

4–055.5

(b) *Commencement of service.*

(1) *At expiration of period.* A proposed director or senior executive officer may begin service after the end of the 30-day period and any extension as provided under paragraph (a)(3) of this section, unless the Board or Reserve Bank disapproves the notice before the end of the period.

(2) *Prior to expiration of period.* A proposed director or senior executive officer may begin service before the end of the 30-day period and any extension as provided under paragraph (a)(3) of this section, if the Board or the Reserve Bank notifies in writing the regulated institution or individual submitting the notice of the Board's or Reserve Bank's intention not to disapprove the notice.

4–055.6

(c) *Notice of disapproval.* The Board or Reserve Bank shall disapprove a notice under section 225.72 if the Board or Reserve Bank finds that the competence, experience, character, or integrity of the individual with respect to whom the notice is submitted indicates that it would not be in the best interests of the depositors of the regulated institution or in the best interests of the public to permit the individual to be employed by, or associated with, the regulated institution. The notice of disapproval shall contain a statement of the basis for disapproval and shall be sent to the regulated institution and the disapproved individual.

4–055.7

(d) *Appeal of a notice of disapproval.*

(1) A disapproved individual or a regulated institution that has submitted a notice that is disapproved under this section may appeal the disapproval to the Board within 15 days of the effective date of the notice of disapproval. An appeal shall be in writing and explain the reasons for the appeal and include all facts, documents, and arguments that the appealing party wishes to be considered in the appeal, and state whether the appealing party is requesting an informal hearing.

(2) Written notice of the final decision of the Board shall be sent to the appealing party within 60 days of the receipt of an appeal, unless the appealing party's request for an informal hearing is granted.

(3) The disapproved individual may not serve as a director or senior executive officer of the state member bank or bank holding company while the appeal is pending.

4–055.71

(e) *Informal hearing.*

(1) An individual or regulated institution whose notice under this section has been disapproved may request an informal hearing on the notice. A request for an informal hearing shall be in writing and shall be submitted within 15 days of a notice of disapproval. The Board may, in its sole discretion, order an informal hearing if the Board finds that oral argument is appropriate or necessary to resolve disputes regarding material issues of fact.

(2) An informal hearing shall be held within 30 days of a request, if granted, unless the requesting party agrees to a later date.

(3) Written notice of the final decision of the Board shall be given to the individual and the regulated institution within 60 days of the conclusion of any informal hearing ordered by the Board, unless the requesting party agrees to a later date.

4–055.8

(f) *Waiver of notice.*

(1) *Waiver requests.* The Board or Reserve Bank may permit an individual to serve as a senior executive officer or director before the notice required under this subpart is provided, if the Board or Reserve Bank finds that—

(i) delay would threaten the safety or soundness of the regulated institution or a bank controlled by a bank holding company;

(ii) delay would not be in the public interest; or

(iii) other extraordinary circumstances exist that justify waiver of prior notice.

(2) *Automatic waiver.* An individual may serve as a director upon election to the board of directors of a regulated institution

before the notice required under this subpart is provided if the individual—

(i) is not proposed by the management of the regulated institution;

(ii) is elected as a new member of the board of directors at a meeting of the regulated institution; and

(iii) provides to the appropriate Reserve Bank all the information required in section 225.73(a) within two (2) business days after the individual's election.

(3) *Effect on disapproval authority.* A waiver shall not affect the authority of the Board or Reserve Bank to disapprove a notice within 30 days after a waiver is granted under paragraph (f)(1) of this section or the election of an individual who has filed a notice and is serving pursuant to an automatic waiver under paragraph (f)(2) of this section.

4–056

SUBPART I—FINANCIAL HOLDING COMPANIES

SECTION 225.81—What is a financial holding company?

(a) *Definition.* A financial holding company is a bank holding company that meets the requirements of this section.

(b) *Requirements to be a financial holding company.* In order to be a financial holding company—

(1) all depository institutions controlled by the bank holding company must be and remain well capitalized;

(2) all depository institutions controlled by the bank holding company must be and remain well managed; and

(3) the bank holding company must have made an effective election to become a financial holding company.

(c) *Requirements for foreign banks that are or are owned by bank holding companies.*

(1) *Foreign banks with U.S. branches or agencies that also own U.S. banks.* A foreign bank that is a bank holding company and that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section, section 225.82, and sections 225.90 through 225.92 in order to be a financial holding company. After it becomes a financial holding company, a foreign bank described in this paragraph will be subject to the provisions of sections 225.83, 225.84, 225.93, and 225.94.

(2) *Bank holding companies that own foreign banks with U.S. branches or agencies.* A bank holding company that owns a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section, and sections 225.90 through 225.92 in order to be a financial holding company. After it becomes a financial holding company, a bank holding company described in this paragraph will be subject to the provisions of sections 225.83, 225.84, 225.93, and 225.94.

4–056.1

SECTION 225.82—How does a bank holding company elect to become a financial holding company?

(a) *Filing requirement.* A bank holding company may elect to become a financial holding company by filing a written declaration with the appropriate Reserve Bank. A declaration by a bank holding company is considered to be filed on the date that all information required by paragraph (b) of this section is received by the appropriate Reserve Bank.

(b) *Contents of declaration.* To be deemed complete, a declaration must—

(1) state that the bank holding company elects to be a financial holding company;

(2) provide the name and head-office address of the bank holding company and of each depository institution controlled by the bank holding company;

(3) certify that each depository institution controlled by the bank holding company is well capitalized as of the date the bank holding company submits its declaration;

(4) provide the capital ratios as of the close of the previous quarter for all relevant capital measures, as defined in section 38 of the

Federal Deposit Insurance Act (12 USC 1831o), for each depository institution controlled by the company on the date the company submits its declaration; and

(5) certify that each depository institution controlled by the company is well managed as of the date the company submits its declaration.

4–056.11

(c) *Effectiveness of election.* An election by a bank holding company to become a financial holding company shall not be effective if, during the period provided in paragraph (e) of this section, the Board finds that, as of the date the declaration was filed with the appropriate Reserve Bank—

(1) any insured depository institution controlled by the bank holding company (except an institution excluded under paragraph (d) of this section) has not achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the institution's most recent examination; or

(2) any depository institution controlled by the bank holding company is not both well capitalized and well managed.

(d) *Consideration of the CRA performance of a recently acquired insured depository institution.* Except as provided in paragraph (f) of this section, an insured depository institution will be excluded for purposes of the review of the Community Reinvestment Act rating provisions of paragraph (c)(1) of this section if—

(1) the bank holding company acquired the insured depository institution during the 12-month period preceding the filing of an election under paragraph (a) of this section;

(2) the bank holding company has submitted an affirmative plan to the appropriate federal banking agency for the institution to take actions necessary for the institution to achieve at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the next examination of the institution; and

(3) the appropriate federal banking agency for the institution has accepted the plan described in paragraph (d)(2) of this section.

4–056.12

(e) *Effective date of election.*

(1) *In general.* An election filed by a bank holding company under paragraph (a) of this section is effective on the thirty-first calendar day after the date that a complete declaration was filed with the appropriate Reserve Bank, unless the Board notifies the bank holding company prior to that time that the election is ineffective.

(2) *Earlier notification that an election is effective.* The Board or the appropriate Reserve Bank may notify a bank holding company that its election to become a financial holding company is effective prior to the thirty-first day after the date that a complete declaration was filed with the appropriate Reserve Bank. Such a notification must be in writing.

4–056.13

(f) *Requests to become a financial holding company submitted as part of an application to become a bank holding company.*

(1) *In general.* A company that is not a bank holding company and has applied for the Board's approval to become a bank holding company under section 3(a)(1) of the BHC Act (12 USC 1842(a)(1)) may as part of that application submit a request to become a financial holding company.

(2) *Contents of request.* A request to become a financial holding company submitted as part of an application to become a bank holding company must—

(i) state that the company seeks to become a financial holding company on consummation of its proposal to become a bank holding company; and

(ii) certify that each depository institution that would be controlled by the company on consummation of its proposal to become a bank holding company will be both well capitalized and well managed as of the date the company consummates the proposal.

(3) *Request becomes a declaration and an effective election on date of consummation of bank holding company proposal.* A complete request submitted by a company under this paragraph (f) becomes a complete declaration by a bank holding company for

purposes of section 4(*l*) of the BHC Act and becomes an effective election for purposes of section 225.81(b) on the date that the company lawfully consummates its proposal under section 3 of the BHC Act, unless the Board notifies the company at any time prior to consummation of the proposal and that—

(i) any depository institution that would be controlled by the company on consummation of the proposal will not be both well capitalized and well managed on the date of consummation; or

(ii) any insured depository institution that would be controlled by the company on consummation of the proposal has not achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the institution's most recent examination.

(4) *Limited exclusion for recently acquired institutions not available.* Unless the Board determines otherwise, an insured depository institution that is controlled or would be controlled by the company as part of its proposal to become a bank holding company may not be excluded for purposes of evaluating the Community Reinvestment Act criterion described in this paragraph or in paragraph (d) of this section.

4–056.14

(g) *Board's authority to exercise supervisory authority over a financial holding company.* An effective election to become a financial holding company does not in any way limit the Board's statutory authority under the BHC Act, the Federal Deposit Insurance Act, or any other relevant federal statute to take appropriate action, including imposing supervisory limitations, restrictions, or prohibitions on the activities and acquisitions of a bank holding company that has elected to become a financial holding company, or enforcing compliance with applicable law.

4–056.2

SECTION 225.83—What are the consequences of failing to continue to meet applicable capital and management requirements?

(a) *Notice by the Board.* If the Board finds that a financial holding company controls any depository institution that is not well capitalized or well managed, the Board will notify the company in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the area(s) of noncompliance. The Board may provide this notice at any time before or after receiving notice from the financial holding company under paragraph (b) of this section.

(b) *Notification by a financial holding company required.*

(1) *Notice to Board.* A financial holding company must notify the Board in writing within 15 calendar days of becoming aware that any depository institution controlled by the company has ceased to be well capitalized or well managed. This notification must identify the depository institution involved and the area(s) of noncompliance.

(2) *Triggering events for notice to the Board.*

(i) *Well capitalized.* A company becomes aware that a depository institution it controls is no longer well capitalized upon the occurrence of any material event that would change the category assigned to the institution for purposes of section 38 of the Federal Deposit Insurance Act (12 USC 1831o). See 12 CFR 6.3(b)-(c), 208.42(b)-(c), and 325.102(b)-(c).

(ii) *Well managed.* A company becomes aware that a depository institution it controls is no longer well managed at the time the depository institution receives written notice from the appropriate federal or state banking agency that either its composite rating or its rating for management is not at least satisfactory.

4–056.21

(c) *Execution of agreement acceptable to the Board.*

(1) *Agreement required; time period.* Within 45 days after receiving a notice

from the Board under paragraph (a) of this section, the company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) *Extension of time for executing agreement.* Upon request by a company, the Board may extend the 45-day period under paragraph (c)(1) of this section if the Board determines that granting additional time is appropriate under the circumstances. A request by a company for additional time must include an explanation of why an extension is necessary.

(3) *Agreement requirements.* An agreement required by paragraph (c)(1) of this section to correct a capital or management deficiency must—

(i) explain the specific actions that the company will take to correct all areas of noncompliance;

(ii) provide a schedule within which each action will be taken;

(iii) provide any other information that the Board may require; and

(iv) be acceptable to the Board.

4–056.22

(d) *Limitations during period of noncompliance.* Until the Board determines that a company has corrected the conditions described in a notice under paragraph (a) of this section—

(1) the Board may impose any limitations or conditions on the conduct or activities of the company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the BHC Act; and

(2) the company and its affiliates may not commence any additional activity or acquire control or shares of any company under section 4(k) of the BHC Act without prior approval from the Board.

4–056.23

(e) *Consequences of failure to correct conditions within 180 days.*

(1) *Divestiture of depository institutions.* If a company does not correct the conditions described in a notice under paragraph (a) of this section within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the company to divest ownership or control of any depository institution owned or controlled by the company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) *Alternative method of complying with a divestiture order.* A company may comply with an order issued under paragraph (e)(1) of this section by ceasing to engage (both directly and through any subsidiary that is not a depository institution or a subsidiary of a depository institution) in any activity that may be conducted only under section 4(k), (n), or (o) of the BHC Act. The termination of activities must be completed within the time period referred to in paragraph (e)(1) of this section and in accordance with the terms and conditions acceptable to the Board.

(f) *Consultation with other agencies.* In taking any action under this section, the Board will consult with the relevant federal and state regulatory authorities.

4–056.3

SECTION 225.84—What are the consequences of failing to maintain a satisfactory or better rating under the Community Reinvestment Act at all insured depository institution subsidiaries?

(a) *Limitations on activities.*

(1) *In general.* Upon receiving a notice regarding performance under the Community Reinvestment Act in accordance with paragraph (a)(2) of this section, a financial holding company may not—

(i) commence any additional activity under section 4(k) or 4(n) of the BHC Act; or

(ii) directly or indirectly acquire control, including all or substantially all of the assets, of a company engaged in any activity under section 4(k) or 4(n) of the BHC Act.

(2) *Notification.* A financial holding company receives notice for purposes of this paragraph at the time that the appropriate federal banking agency for any insured depository institution controlled by the com-

pany or the Board provides notice to the institution or company that the institution has received a rating of ''needs to improve record of meeting community credit needs'' or ''substantial noncompliance in meeting community credit needs'' in the institution's most recent examination under the Community Reinvestment Act.

4–056.31

(b) *Exceptions for certain activities.*

(1) *Continuation of investment activities.* The prohibition in paragraph (a) of this section does not prevent a financial holding company from continuing to make investments in the ordinary course of conducting merchant banking activities under section 4(k)(4)(H) of the BHC Act or insurance company investment activities under section 4(k)(4)(I) of the BHC Act if—

(i) the financial holding company lawfully was a financial holding company and commenced the merchant banking activity under section 4(k)(4)(H) of the BHC Act or the insurance company investment activity under section 4(k)(4)(I) of the BHC Act prior to the time that an insured depository institution controlled by the financial holding company received a rating below ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act; and

(ii) the Board has not, in the exercise of its supervisory authority, advised the financial holding company that these activities must be restricted.

(2) *Activities that are closely related to banking.* The prohibition in paragraph (a) of this section does not prevent a financial holding company from commencing any additional activity or acquiring control of a company engaged in any activity under section 4(c) of the BHC Act, if the company complies with the notice, approval, and other requirements of that section and section 4(j) of the BHC Act.

4–056.32

(c) *Duration of prohibitions.* The prohibitions described in paragraph (a) of this section shall continue in effect until such time as each insured depository institution controlled by the financial holding company has achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the most recent examination of the institution.

4–056.4

SECTION 225.85—Is notice to or approval from the Board required prior to engaging in a financial activity?

(a) *No prior approval required generally.*

(1) *In general.* A financial holding company and any subsidiary (other than a depository institution or subsidiary of a depository institution) of the financial holding company may engage in any activity listed in section 225.86, or acquire shares or control of a company engaged exclusively in activities listed in section 225.86, without providing prior notice to or obtaining prior approval from the Board unless required under paragraph (c) of this section.

(2) *Acquisitions by a financial holding company of a company engaged in other permissible activities.* In addition to the activities listed in section 225.86, a company acquired or to be acquired by a financial holding company under paragraph (a)(1) of this section may engage in activities otherwise permissible for a financial holding company under this part in accordance with any applicable notice, approval, or other requirement.

(3) *Acquisition by a financial holding company of a company engaged in limited nonfinancial activities.*

(i) *Mixed acquisitions generally permitted.* A financial holding company may under this subpart acquire more than 5 percent of the outstanding shares of any class of voting securities or control of a company that is not engaged exclusively in activities that are financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) of the BHC Act if—

(A) the company to be acquired is substantially engaged in activities that

are financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) of the BHC Act;

(B) the financial holding company complies with the notice requirements of section 225.87, if applicable; and

(C) the company conforms, terminates, or divests, within two years of the date the financial holding company acquires shares or control of the company, all activities that are not financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) of the BHC Act.

(ii) *Definition of ''substantially engaged.''* Unless the Board determines otherwise, a company will be considered to be ''substantially engaged'' in activities permissible for a financial holding company for purposes of paragraph (a)(3)(A) of this section if at least 85 percent of the company's consolidated total annual gross revenues is derived from and at least 85 percent of the company's consolidated total assets is attributable to the conduct of activities that are financial in nature, incidental to a financial activity, or otherwise permissible for a financial holding company under section 4(c) of the BHC Act.

4–056.41

(b) *Locations in which a financial holding company may conduct financial activities.* A financial holding company may conduct any activity listed in section 225.86 at any location in the United States or at any location outside of the United States subject to the laws of the jurisdiction in which the activity is conducted.

(c) *Circumstances under which prior notice to the Board is required.*

(1) *Acquisition of more than 5 percent of the shares of a savings association.* A financial holding company must obtain Board approval in accordance with section 4(j) of the BHC Act and either section 225.14 or section 225.24, as appropriate, prior to acquiring control or more than 5 percent of the outstanding shares of any class of voting securities of a savings association or of a company that owns, operates, or controls a savings association.

(2) *Supervisory actions.* The Board may, if appropriate in the exercise of its supervisory or other authority, including under section 225.82(g) or section 225.83(d) or other relevant authority, require a financial holding company to provide notice to or obtain approval from the Board prior to engaging in any activity or acquiring shares or control of any company.

4–056.5

SECTION 225.86—What activities are permissible for any financial holding company?

The following activities are financial in nature or incidental to a financial activity:

(a) *Activities determined to be closely related to banking.*

(1) Any activity that the Board had determined by regulation prior to November 12, 1999, to be so closely related to banking as to be a proper incident thereto, subject to the terms and conditions contained in this part, unless modified by the Board. These activities are listed in section 225.28.

(2) Any activity that the Board had determined by an order that was in effect on November 12, 1999, to be so closely related to banking as to be a proper incident thereto, subject to the terms and conditions contained in this part and those in the authorizing orders. These activities are—

(i) providing administrative and other services to mutual funds (*Societe Generale*, 84 *Federal Reserve Bulletin* 680 (1998));

(ii) owning shares of a securities exchange (*J.P. Morgan & Co, Inc., and UBS AG*, 86 *Federal Reserve Bulletin* 61 (2000));

(iii) acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions (*Bayerische Hypo- und Vereinsbank AG, et al.*, 86 *Federal Reserve Bulletin* 56 (2000));

(iv) providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business (*Norwest Corporation*, 81 *Federal Reserve Bulletin* 732 (1995));
(v) check-cashing and wire-transmission services (*Midland Bank, PLC*, 76 *Federal Reserve Bulletin* 860 (1990) (check cashing); *Norwest Corporation*, 81 *Federal Reserve Bulletin* 1130 (1995) (money transmission));
(vi) in connection with offering banking services, providing notary-public services, selling postage stamps and postage-paid envelopes, providing vehicle-registration services, and selling public-transportation tickets and tokens (*Popular, Inc.*, 84 *Federal Reserve Bulletin* 481 (1998)); and
(vii) real estate title abstracting (*The First National Company*, 81 *Federal Reserve Bulletin* 805 (1995)).

4–056.51

(b) *Activities determined to be usual in connection with the transaction of banking abroad.* Any activity that the Board had determined by regulation in effect on November 11, 1999, to be usual in connection with the transaction of banking or other financial operations abroad (see section 211.5(d) of this chapter), subject to the terms and conditions in part 211 and Board interpretations in effect on that date regarding the scope and conduct of the activity. In addition to the activities listed in paragraphs (a) and (c) of this section, these activities are—

(1) providing management consulting services, including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the financial holding company to control the person to which the services are provided;
(2) operating a travel agency in connection with financial services offered by the financial holding company or others; and
(3) organizing, sponsoring, and managing a mutual fund, so long as—
(i) the fund does not exercise managerial control over the entities in which the fund invests; and
(ii) the financial holding company reduces its ownership in the fund, if any, to less than 25 percent of the equity of the fund within one year of sponsoring the fund or such additional period as the Board permits.

4–056.52

(c) *Activities permitted under section 4(k)(4) of the BHC Act.* Any activity defined to be financial in nature under sections 4(k)(4)(A) through (E), (H) and (I) of the BHC Act.

4–056.53

(d) *Activities determined to be financial in nature or incidental to financial activities by the Board.*

(1) *Acting as a finder.* Acting as a finder in bringing together one or more buyers and sellers of any product or service for transactions that the parties themselves negotiate and consummate.
(i) *What is the scope of finder activities?* Acting as a finder includes providing any or all of the following services through any means:
(A) identifying potential parties, making inquiries as to interest, introducing and referring potential parties to each other, and arranging contacts between and meetings of interested parties;
(B) conveying between interested parties expressions of interest, bids, offers, orders and confirmations relating to a transaction; and
(C) transmitting information concerning products and services to potential parties in connection with the activities described in paragraphs (d)(1)(i)(A) and (B) of this section.
(ii) *What are some examples of finder services?* The following are examples of the services that may be provided by a finder when done in accordance with paragraphs (d)(1)(iii) and (iv) of this section. These examples are not exclusive.
(A) Hosting an electronic marketplace on the financial holding company's Internet web site by providing hypertext or similar links to the web sites of third party buyers or sellers.

(B) Hosting on the financial holding company's servers the Internet web site of—

(*1*) a buyer (or seller) that provides information concerning the buyer (or seller) and the products or services it seeks to buy (or sell) and allows sellers (or buyers) to submit expressions of interest, bids, offers, orders and confirmations relating to such products or services; or

(*2*) a government or government agency that provides information concerning the services or benefits made available by the government or government agency, assists persons in completing applications to receive such services or benefits from the government or agency, and allows persons to transmit their applications for services or benefits to the government or agency.

(C) Operating an Internet web site that allows multiple buyers and sellers to exchange information concerning the products and services that they are willing to purchase or sell, locate potential counterparties for transactions, aggregate orders for goods or services with those made by other parties, and enter into transactions between themselves.

(D) Operating a telephone call center that provides permissible finder services.

4–056.54

(iii) *What limitations are applicable to a financial holding company acting as a finder?*

(A) A finder may act only as an intermediary between a buyer and a seller.

(B) A finder may not bind any buyer or seller to the terms of a specific transaction or negotiate the terms of a specific transaction on behalf of a buyer or seller, except that a finder may—

(*1*) arrange for buyers to receive preferred terms from sellers so long as the terms are not negotiated as part of any individual transaction, are provided generally to customers or broad categories of customers, and are made available by the seller (and not by the financial holding company); and

(*2*) establish rules of general applicability governing the use and operation of the finder service, including rules that—

(*i*) govern the submission of bids and offers by buyers and sellers that use the finder service and the circumstances under which the finder service will match bids and offers submitted by buyers and sellers; and

(*ii*) govern the manner in which buyers and sellers may bind themselves to the terms of a specific transaction.

(C) A finder may not—

(*1*) take title to or acquire or hold an ownership interest in any product or service offered or sold through the finder service;

(*2*) provide distribution services for physical products or services offered or sold through the finder service;

(*3*) own or operate any real or personal property that is used for the purpose of manufacturing, storing, transporting, or assembling physical products offered or sold by third parties; or

(*4*) own or operate any real or personal property that serves as a physical location for the physical purchase, sale, or distribution of products or services offered or sold by third parties.

(D) A finder may not engage in any activity that would require the company to register or obtain a license as a real estate agent or broker under applicable law.

(iv) *What disclosures are required?* A finder must distinguish the products and services offered by the financial holding company from those offered by a third party through the finder service.

(2) [Reserved]

4–056.55

(e) *Activities permitted under section 4(k)(5) of the Bank Holding Company Act (12 USC 1843(k)(5)).*

(1) The following types of activities are financial in nature or incidental to a financial activity when conducted pursuant to a determination by the Board under paragraph (e)(2) of this section:

(i) lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

(ii) providing any device or other instrumentality for transferring money or other financial assets; and

(iii) arranging, effecting, or facilitating financial transactions for the account of third parties.

(2) *Review of specific activities.*

(i) *Is a specific request required?* A financial holding company that wishes to engage on the basis of paragraph (e)(1) of this section in an activity that is not otherwise permissible for a financial holding company must obtain a determination from the Board that the activity is permitted under paragraph (e)(1).

(ii) *Consultation with the secretary of the Treasury.* After receiving a request under this section, the Board will provide the secretary of the Treasury with a copy of the request and consult with the secretary in accordance with section 4(k)(2)(A) of the Bank Holding Company Act (12 USC 1843(k)(2)(A)).

(iii) *Board action on requests.* After consultation with the secretary, the Board will promptly make a written determination regarding whether the specific activity described in the request is included in an activity category listed in paragraph (e)(1) of this section and is therefore either financial in nature or incidental to a financial activity.

4–056.56

(3) *What factors will the Board consider?* In evaluating a request made under this section, the Board will take into account the factors listed in section 4(k)(3) of the BHC Act (12 USC 1843(k)(3)) that it must consider when determining whether an activity is financial in nature or incidental to a financial activity.

(4) *What information must the request contain?* Any request by a financial holding company under this section must be in writing and must—

(i) identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted; and

(ii) provide information supporting the requested determination, including information regarding how the proposed activity falls into one of the categories listed in paragraph (e)(1) of this section, and any other information required by the Board concerning the proposed activity.

4–056.6

SECTION 225.87—Is notice to the Board required after engaging in a financial activity?

(a) *Post-transaction notice generally required to engage in a financial activity.* A financial holding company that commences an activity or acquires shares of a company engaged in an activity listed in section 225.86 must notify the appropriate Reserve Bank in writing within 30 calendar days after commencing the activity or consummating the acquisition by using the appropriate form.

4–056.61

(b) *Cases in which notice to the Board is not required.*

(1) *Acquisitions that do not involve control of a company.* A notice under paragraph (a) of this section is not required in connection with the acquisition of shares of a company if, following the acquisition, the financial holding company does not control the company.

(2) *No additional notice required to engage de novo in an activity for which a financial holding company already has provided notice.* After a financial holding company provides the appropriate Reserve Bank with notice that the company is engaged in an activity listed in section 225.86, a financial

holding company may, unless otherwise notified by the Board, commence the activity de novo through any subsidiary that the financial holding company is authorized to control without providing additional notice under paragraph (a) of this section.

(3) *Conduct of certain investment activities.* Unless required by paragraph (b)(4) of this section, a financial holding company is not required to provide notice under paragraph (a) of this section of any individual acquisition of shares of a company as part of the conduct by a financial holding company of securities underwriting, dealing, or market-making activities as described in section 4(k)(4)(E) of the BHC Act (12 U.S.C. 1843(k)(4)(E)), merchant banking activities conducted pursuant to section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)), or insurance company investment activities conducted pursuant to section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I)), if the financial holding company previously has notified the Board under paragraph (a) of this section that the company has commenced the relevant securities, merchant banking, or insurance company investment activities, as relevant.

4–056.62

(4) *Notice of large merchant banking or insurance company investments.* Notwithstanding paragraph (b)(1) or (b)(3) of this section, a financial holding company must provide notice under paragraph (a) of the section if—

(i) as part of a merchant banking activity conducted under section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)), the financial holding company acquires more than 5 percent of the shares, assets, or ownership interests of any company at a total cost that exceeds the lesser of 5 percent of the financial holding company's tier 1 capital or $200 million;

(ii) as part of an insurance company investment activity conducted under section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I)), the financial holding company acquires more than 5 percent of the shares, assets, or ownership interests of any company at a total cost that exceeds the lesser of 5 percent of the financial holding company's tier 1 capital or $200 million; or

(iii) the Board in the exercise of its supervisory authority notifies the financial holding company that a notice is necessary.

(iv) For purposes of this paragraph (b)(4), a financial holding company that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) calculates its tier 1 capital (as defined in section 217.2 of this chapter) in accordance with section 217.12(b) of this chapter.

4–056.7

SECTION 225.88—How to request the Board to determine that an activity is financial in nature or incidental to a financial activity

(a) *Requests regarding activities that may be financial in nature or incidental to a financial activity.* A financial holding company or other interested party may request a determination from the Board that an activity not listed in section 225.86 is financial in nature or incidental to a financial activity.

(b) *Required information.* A request submitted under this section must be in writing and must—

(1) identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted;

(2) explain in detail why the activity should be considered financial in nature or incidental to a financial activity; and

(3) provide information supporting the requested determination and any other information required by the Board concerning the proposed activity.

4–056.71

(c) *Board procedures for reviewing requests.*

(1) *Consultation with the secretary of the Treasury.* Upon receipt of the request, the Board will provide the secretary of the Treasury a copy of the request and consult with the secretary in accordance with section 4(k)(2)(A) of the BHC Act (12 U.S.C. 1843(k)(2)(A)).

(2) *Public notice.* The Board may, as appropriate and after consultation with the secretary, publish a description of the proposal in the *Federal Register* with a request for public comment.

(d) *Board action.* The Board will endeavor to make a decision on any request filed under paragraph (a) of this section within 60 calendar days following the completion of both the consultative process described in paragraph (c)(1) of this section and the public comment period, if any.

4–056.72

(e) *Advisory opinions regarding scope of financial activities.*

(1) *Written request.* A financial holding company or other interested party may request an advisory opinion from the Board about whether a specific proposed activity falls within the scope of an activity listed in section 225.86 as financial in nature or incidental to a financial activity. The request must be submitted in writing and must contain—

(i) a detailed description of the particular activity in which the company proposes to engage or the product or service the company proposes to provide;

(ii) an explanation supporting an interpretation regarding the scope of the permissible financial activity; and

(iii) any additional information requested by the Board regarding the activity.

(2) *Board response.* The Board will provide an advisory opinion within 45 calendar days of receiving a complete written request under paragraph (e)(1) of this section.

4–056.8

SECTION 225.89—How to request approval to engage in an activity that is complementary to a financial activity

(a) *Prior Board approval is required.* A financial holding company that seeks to engage in or acquire more than 5 percent of the outstanding shares of any class of voting securities of a company engaged in an activity that the financial holding company believes is complementary to a financial activity must obtain prior approval from the Board in accordance with section 4(j) of the BHC Act (12 U.S.C. 1843(j)). The notice must be in writing and must—

(1) identify and define the proposed complementary activity, specifically describing what the activity would involve and how the activity would be conducted;

(2) identify the financial activity for which the proposed activity would be complementary and provide detailed information sufficient to support a finding that the proposed activity should be considered complementary to the identified financial activity;

(3) describe the scope and relative size of the proposed activity, as measured by the percentage of the projected financial holding company revenues expected to be derived from and assets associated with conducting the activity;

(4) discuss the risks that conducting the activity may reasonably be expected to pose to the safety and soundness of the subsidiary depository institutions of the financial holding company and to the financial system generally;

(5) describe the potential adverse effects, including potential conflicts of interest, decreased or unfair competition, or other risks, that conducting the activity could raise, and explain the measures the financial holding company proposes to take to address those potential effects;

(6) describe the potential benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that the proposal reasonably can be expected to produce; and

(7) provide any information about the financial and managerial resources of the fi-

nancial holding company and any other information requested by the Board.

4–056.81

(b) *Factors for consideration by the Board.* In evaluating a notice to engage in a complementary activity, the Board must consider whether—

(1) the proposed activity is complementary to a financial activity;

(2) the proposed activity would pose a substantial risk to the safety or soundness of depository institutions or the financial system generally; and

(3) the proposal could be expected to produce benefits to the public that outweigh possible adverse effects.

(c) *Board action.* The Board will inform the financial holding company in writing of the Board's determination regarding the proposed activity within the period described in section 4(j) of the Bank Holding Company Act (12 U.S.C. 1843(j)).

4–056.9

SECTION 225.90—What are the requirements for a foreign bank to be treated as a financial holding company?

(a) *Foreign banks as financial holding companies.* A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, and any company that owns or controls such a foreign bank, will be treated as a financial holding company if—

(1) the foreign bank, any other foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, and any U.S. depository institution subsidiary that is owned or controlled by the foreign bank or company, is and remains well capitalized and well managed; and

(2) the foreign bank, and any company that owns or controls the foreign bank, has made an effective election to be treated as a financial holding company under this subpart.

4–056.91

(b) *Standards for "well capitalized."* A foreign bank will be considered ''well capitalized'' if either—

(1) (i) its home country supervisor, as defined in section 211.21 of the Board's Regulation K (12 CFR 211.21), has adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord);

(ii) the foreign bank maintains a tier 1 capital to total risk-based assets ratio of 6 percent and a total capital to total risk-based assets ratio of 10 percent, as calculated under its home country standard; and

(iii) the foreign bank's capital is comparable to the capital required for a U.S. bank owned by a financial holding company; or

(2) the foreign bank has obtained a determination from the Board under section 225.91(c) that the foreign bank's capital is otherwise comparable to the capital that would be required of a U.S. bank owned by a financial holding company.

4–056.92

(c) *Standards for "well managed."* A foreign bank will be considered ''well managed'' if—

(1) the foreign bank has received at least a satisfactory composite rating of its U.S. branch, agency, and commercial lending company operations at its most recent assessment;

(2) the home country supervisor of the foreign bank consents to the foreign bank expanding its activities in the United States to include activities permissible for a financial holding company; and

(3) the management of the foreign bank meets standards comparable to those required of a U.S. bank owned by a financial holding company.

4–057

SECTION 225.91—How may a foreign bank elect to be treated as a financial holding company?

(a) *Filing requirement.* A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, or a company that owns or controls such a foreign bank, may elect to be treated as a financial holding company by filing a written declaration with the appropriate Reserve Bank.

(b) *Contents of declaration.* The declaration must—

(1) state that the foreign bank or the company elects to be treated as a financial holding company;

(2) provide the risk-based capital ratios and amount of tier 1 capital and total assets of the foreign bank, and of each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, as of the close of the most recent quarter and as of the close of the most recent audited reporting period;

(3) certify that the foreign bank, and each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, meets the standards of well capitalized set out in section 225.90(b)(1)(i) and (ii) or section 225.90(b)(2) as of the date the foreign bank or company files its election;

(4) certify that the foreign bank, and each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, is well managed as defined in section 225.90(c)(1) as of the date the foreign bank or company files its election;

(5) certify that all U.S. depository institution subsidiaries of the foreign bank or company are well capitalized and well managed as of the date the foreign bank or company files its election; and

(6) provide the capital ratios for all relevant capital measures (as defined in section 38 of the Federal Deposit Insurance Act (12 USC 1831o)) as of the close of the previous quarter for each U.S. depository institution subsidiary of the foreign bank or company.

4–057.01

(c) *Pre-clearance process.* Before filing an election to be treated as a financial holding company, a foreign bank or company may file a request for review of its qualifications to be treated as a financial holding company. The Board will endeavor to make a determination on such requests within 30 days of receipt. A foreign bank that has not been found, or that is chartered in a country where no bank from that country has been found, by the Board under the Bank Holding Company Act or the International Banking Act to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor is required to use this process.

4–057.1

SECTION 225.92—How does an election by a foreign bank become effective?

(a) *In general.* An election described in section 225.91 is effective on the thirty-first day after the date that an election was received by the appropriate Federal Reserve Bank, unless the Board notifies the foreign bank or company prior to that time that—

(1) the election is ineffective; or

(2) the period is extended with the consent of the foreign bank or company making the election.

(b) *Earlier notification that an election is effective.* The Board or the appropriate Federal Reserve Bank may notify a foreign bank or company that its election to be treated as a financial holding company is effective prior to the thirty-first day after the election was filed with the appropriate Federal Reserve Bank. Such notification must be in writing.

4–057.11

(c) *Under what circumstances will the Board find an election to be ineffective?* An election to be treated as a financial holding company shall not be effective if, during the period

provided in paragraph (a) of this section, the Board finds that—

(1) the foreign bank certificant, or any foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States and is controlled by a foreign bank or company certificant, is not both well capitalized and well managed;

(2) any U.S. insured depository institution subsidiary of the foreign bank or company (except an institution excluded under paragraph (d) of this section) or any U.S. branch of a foreign bank that is insured by the Federal Deposit Insurance Corporation has not achieved at least a rating of ''satisfactory record of meeting community needs'' under the Community Reinvestment Act at the institution's most recent examination;

(3) any U.S. depository institution subsidiary of the foreign bank or company is not both well capitalized and well managed; or

(4) the Board does not have sufficient information to assess whether the foreign bank or company making the election meets the requirements of this subpart.

(d) *How is CRA performance of recently acquired insured depository institutions considered?* An insured depository institution will be excluded for purposes of the review of CRA ratings described in paragraph (c)(2) of this section consistent with the provisions of section 225.82(d).

4–057.12

(e) *Factors used in the Board's determination regarding comparability of capital and management.*

(1) *In general.* In determining whether a foreign bank is well capitalized and well managed in accordance with comparable capital and management standards, the Board will give due regard to national treatment and equality of competitive opportunity. In this regard, the Board may take into account the foreign bank's composition of capital, tier 1 capital to total assets leverage ratio, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements, the foreign bank's anti-money laundering procedures, whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis, and other factors that may affect analysis of capital and management. The Board will consult with the home-country supervisor for the foreign bank as appropriate.

(2) *Assessment of consolidated supervision.* A foreign bank that is not subject to comprehensive supervision on a consolidated basis by its home-country authorities may not be considered well capitalized and well managed unless—

(i) the home country has made significant progress in establishing arrangements for comprehensive supervision on a consolidated basis; and

(ii) the foreign bank is in strong financial condition as demonstrated, for example, by capital levels that significantly exceed the minimum levels that are required for a well capitalized determination and strong asset quality.

4–057.2

SECTION 225.93—What are the consequences of a foreign bank failing to continue to meet applicable capital and management requirements?

(a) *Notice by the Board.* If a foreign bank or company has made an effective election to be treated as a financial holding company under this subpart and the Board finds that the foreign bank, any foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, or any U.S. depository institution subsidiary controlled by the foreign bank or company, ceases to be well capitalized or well managed, the Board will notify the foreign bank and company, if any, in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the areas of noncompliance.

(b) *Notification by a financial holding company required.*

(1) *Notice to Board.* Promptly upon becoming aware that the foreign bank, any foreign bank that maintains a U.S. branch, agency, or commercial lending company and is con-

trolled by the foreign bank or company, or any U.S. depository institution subsidiary of the foreign bank or company, has ceased to be well capitalized or well managed, the foreign bank and company, if any, must notify the Board and identify the area of noncompliance.

(2) *Triggering events for notice to the Board.*

(i) *Well capitalized.* A foreign bank becomes aware that it is no longer well capitalized at the time that the foreign bank or company is required to file a report of condition (or similar supervisory report) with its home-country supervisor or the appropriate Federal Reserve Bank that indicates that the foreign bank no longer meets the well-capitalized standards.

(ii) *Well managed.* A foreign bank becomes aware that it is no longer well managed at the time that the foreign bank receives written notice from the appropriate Federal Reserve Bank that the composite rating of its U.S. branch, agency, and commercial lending company operations is not at least satisfactory.

4–057.21

(c) *Execution of agreement acceptable to the Board.*

(1) *Agreement required; time period.* Within 45 days after receiving a notice under paragraph (a) of this section, the foreign bank or company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) *Extension of time for executing agreement.* Upon request by the foreign bank or company, the Board may extend the 45-day period under paragraph (c)(1) of this section if the Board determines that granting additional time is appropriate under the circumstances. A request by a foreign bank or company for additional time must include an explanation of why an extension is necessary.

(3) *Agreement requirements.* An agreement required by paragraph (c)(1) of this section to correct a capital or management deficiency must—

(i) explain the specific actions that the foreign bank or company will take to correct all areas of noncompliance;

(ii) provide a schedule within which each action will be taken;

(iii) provide any other information that the Board may require; and

(iv) be acceptable to the Board.

4–057.22

(d) *Limitations during period of noncompliance.* Until the Board determines that a foreign bank or company has corrected the conditions described in a notice under paragraph (a) of this section—

(1) the Board may impose any limitations or conditions on the conduct or the U.S. activities of the foreign bank or company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the Bank Holding Company Act; and

(2) the foreign bank or company and its affiliates may not commence any additional activity in the United States or acquire control or shares of any company under section 4(k) of the Bank Holding Company Act (12 USC 1843(k)) without prior approval from the Board.

(e) *Consequences of failure to correct conditions within 180 days.*

(1) *Termination of offices and divestiture.* If a foreign bank or company does not correct the conditions described in a notice under paragraph (a) of this section within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the foreign bank or company to terminate the foreign bank's U.S. branches and agencies and divest any commercial lending companies owned or controlled by the foreign bank or company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) *Alternative method of complying with a divestiture order.* A foreign bank or company may comply with an order issued under paragraph (e)(1) of this section by ceasing to engage (both directly and through any subsidiary that is not a depository institution or a subsidiary of a depository institution) in any activity that may be con-

ducted only under section 4(k), (n), or (o) of the BHC Act (12 USC 1843(k), (n) and (o)). The termination of activities must be completed within the time period referred to in paragraph (e)(1) of this section and subject to terms and conditions acceptable to the Board.

4–057.23

(f) *Consultation with other agencies.* In taking any action under this section, the Board will consult with the relevant federal and state regulatory authorities and the appropriate home-country supervisor(s) of the foreign bank.

4–057.3

SECTION 225.94—What are the consequences of an insured branch or depository institution failing to maintain a satisfactory or better rating under the Community Reinvestment Act?

(a) *Insured branch as an ''insured depository institution.''* A U.S. branch of a foreign bank that is insured by the Federal Deposit Insurance Corporation shall be treated as an ''insured depository institution'' for purposes of section 225.84.

(b) *Applicability.* The provisions of section 225.84, with the modifications contained in this section, shall apply to a foreign bank that operates an insured branch referred to in paragraph (a) of this section or an insured depository institution in the United States, and any company that owns or controls such a foreign bank, that has made an effective election under section 225.92 in the same manner and to the same extent as they apply to a financial holding company.

4–058

SUBPART J—MERCHANT BANKING INVESTMENTS

SECTION 225.170—What type of investments are permitted by this subpart, and under what conditions may they be made?

(a) *What type of investments are permitted by this subpart?* Section 4(k)(4)(H) of the Bank Holding Company Act (12 USC 1843(k)(4)(H)) and this subpart authorize a financial holding company, directly or indirectly and as principal or on behalf of one or more persons, to acquire or control any amount of shares, assets, or ownership interests of the company or other entity that is engaged in any activity not otherwise authorized for the financial holding company under section 4 of the Bank Holding Company Act. For purposes of this subpart, shares, assets, or ownership interests acquired or controlled under section 4(k)(4)(H) and this subpart are referred to as ''merchant banking investments.'' A financial holding company may not directly or indirectly acquire or control any merchant banking investment except in compliance with the requirements of this subpart.

(b) *Must the investment be a bona fide merchant banking investment?* The acquisition or control of shares, assets, or ownership interests under this subpart is not permitted unless it is part of a bona fide underwriting or merchant or investment banking activity.

(c) *What types of ownership interests may be acquired?* Shares, assets, or ownership interests of a company or other entity include any debt or equity security, warrant, option, partnership interest, trust certificate, or other instrument representing an ownership interest in the company or entity, whether voting or nonvoting.

4–058.1

(d) *Where in a financial holding company may merchant banking investments be made?* A financial holding company and any subsidiary (other than a depository institution or subsidiary of a depository institution) may acquire or control merchant banking investments. A financial holding company and its subsidiaries may not acquire or control merchant banking investments on behalf of a depository institution or subsidiary of a depository institution.

(e) *May assets other than shares be held directly?* A financial holding company may not under this subpart acquire or control assets,

other than debt or equity securities or other ownership interests in a company, unless—

(1) the assets are held by or promptly transferred to a portfolio company;

(2) the portfolio company maintains policies, books and records, accounts, and other indicia of corporate, partnership, or limited-liability organization and operation that are separate from the financial holding company and limit the legal liability of the financial holding company for obligations of the portfolio company; and

(3) the portfolio company has management that is separate from the financial holding company to the extent required by section 225.171.

4–058.11

(f) *What type of affiliate is required for a financial holding company to make merchant banking investments?* A financial holding company may not acquire or control merchant banking investments under this subpart unless the financial holding company qualifies under at least one of the following paragraphs:

(1) *Securities affiliate.* The financial holding company is or has an affiliate that is registered under the Securities Exchange Act of 1934 (15 USC 78c, 78*o*, 78*o*-4) as—

(i) a broker or dealer; or

(ii) a municipal securities dealer, including a separately identifiable department or division of a bank that is registered as a municipal securities dealer.

(2) *Insurance affiliate with an investment adviser affiliate.* The financial holding company controls—

(i) an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance), or providing and issuing annuities; and

(ii) a company that—

(A) is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940 (15 USC 80b-1 et seq.); and

(B) provides investment advice to an insurance company.

4–058.2

SECTION 225.171—What are the limitations on managing or operating a portfolio company held as a merchant banking investment?

(a) *May a financial holding company routinely manage or operate a portfolio company?* Except as permitted in paragraph (e) of this section, a financial holding company may not routinely manage or operate any portfolio company.

(b) *When does a financial holding company routinely manage or operate a company?*

(1) *Examples of routine management or operation.*

(i) *Executive officer interlocks at the portfolio company.* A financial holding company routinely manages or operates a portfolio company if any director, officer, or employee of the financial holding company serves as or has the responsibilities of an executive officer of the portfolio company.

(ii) *Interlocks by executive officers of the financial holding company.*

(A) *Prohibition.* A financial holding company routinely manages or operates a portfolio company if any executive officer of the financial holding company serves as or has the responsibilities of an officer or employee of the portfolio company.

(B) *Definition.* For purposes of paragraph (b)(1)(ii)(A) of this section, the term ''financial holding company'' includes the financial holding company and only the following subsidiaries of the financial holding company:

(*1*) a securities broker or dealer registered under the Securities Exchange Act of 1934;

(*2*) a depository institution;

(*3*) an affiliate that engages in merchant banking activities under this subpart or insurance company investment activities under section 4(k)(4)(I) of the Bank Holding Company Act (12 USC 1843(k)(4)(I));

(*4*) a small-business investment company (as defined in section 302(b) of the Small Business Invest-

ment Act of 1958 (15 USC 682(b)) controlled by the financial holding company or by any depository institution controlled by the financial holding company; and

(*5*) any other affiliate that engages in significant equity investment activities that are subject to a special capital charge under the capital adequacy rules or guidelines of the Board.

(iii) *Covenants regarding ordinary course of business.* A financial holding company routinely manages or operates a portfolio company if any covenant or other contractual arrangement exists between the financial holding company and the portfolio company that would restrict the portfolio company's ability to make routine business decisions, such as entering into transactions in the ordinary course of business or hiring officers or employees other than executive officers.

(2) *Presumptions of routine management or operation.* A financial holding company is presumed to routinely manage or operate a portfolio company if—

(i) any director, officer, or employee of the financial holding company serves as or has the responsibilities of an officer (other than an executive officer) or employee of the portfolio company; or

(ii) any officer or employee of the portfolio company is supervised by any director, officer, or employee of the financial holding company (other than in that individual's capacity as a director of the portfolio company).

4–058.21

(c) *How may a financial holding company rebut a presumption that it is routinely managing or operating a portfolio company?* A financial holding company may rebut a presumption that it is routinely managing or operating a portfolio company under paragraph (b)(2) of this section by presenting information to the Board demonstrating to the Board's satisfaction that the financial holding company is not routinely managing or operating the portfolio company.

(d) *What arrangements do not involve routinely managing or operating a portfolio company?*

(1) *Director representation at portfolio companies.* A financial holding company may select any or all of the directors of a portfolio company or have one or more of its directors, officers, or employees serve as directors of a portfolio company if—

(i) the portfolio company employs officers and employees responsible for routinely managing and operating the company; and

(ii) the financial holding company does not routinely manage or operate the portfolio company, except as permitted in paragraph (e) of this section.

(2) *Covenants or other provisions regarding extraordinary events.* A financial holding company may, by virtue of covenants or other written agreements with a portfolio company, restrict the ability of the portfolio company, or require the portfolio company to consult with or obtain the approval of the financial holding company, to take actions outside of the ordinary course of the business of the portfolio company. Examples of the types of actions that may be subject to these types of covenants or agreements include, but are not limited to, the following:

(i) the acquisition of significant assets or control of another company by the portfolio company or any of its subsidiaries;

(ii) removal or selection of an independent accountant or auditor or investment banker by the portfolio company;

(iii) significant changes to the business plan or accounting methods or policies of the portfolio company;

(iv) removal or replacement of any or all of the executive officers of the portfolio company;

(v) the redemption, authorization or issuance of any equity or debt securities (including options, warrants, or convertible shares) of the portfolio company or any borrowing by the portfolio company outside of the ordinary course of business;

(vi) the amendment of the articles of in-

corporation or bylaws (or similar governing documents) of the portfolio company; and

(vii) the sale, merger, consolidation, spin-off, recapitalization, liquidation, dissolution or sale of substantially all of the assets of the portfolio company or any of its significant subsidiaries.

(3) *Providing advisory and underwriting services to, and having consultations with, a portfolio company.* A financial holding company may—

(i) provide financial, investment, and management consulting advice to a portfolio company in a manner consistent with and subject to any restrictions on such activities contained in section 225.28(b)(6) or 225.86(b)(1) of this part (12 CFR 225.28(b)(6) and 225.86(b)(1));

(ii) provide assistance to a portfolio company in connection with the underwriting or private placement of its securities, including acting as the underwriter or placement agent for such securities; and

(iii) meet with the officers or employees of a portfolio company to monitor or provide advice with respect to the portfolio company's performance or activities.

4–058.22

(e) *When may a financial holding company routinely manage or operate a portfolio company?*

(1) *Special circumstances required.* A financial holding company may routinely manage or operate a portfolio company only when intervention by the financial holding company is necessary or required to obtain a reasonable return on the financial holding company's investment in the portfolio company upon resale or other disposition of the investment, such as to avoid or address a significant operating loss or in connection with a loss of senior management at the portfolio company.

(2) *Duration limited.* A financial holding company may routinely manage or operate a portfolio company only for the period of time as may be necessary to address the cause of the financial holding company's involvement, to obtain suitable alternative management arrangements, to dispose of the investment, or to otherwise obtain a reasonable return upon the resale or disposition of the investment.

(3) *Notice required for extended involvement.* A financial holding company may not routinely manage or operate a portfolio company for a period greater than nine months without prior written notice to the Board.

(4) *Documentation required.* A financial holding company must maintain and make available to the Board upon request a written record describing its involvement in routinely managing or operating a portfolio company.

4–058.23

(f) *May a depository institution or its subsidiary routinely manage or operate a portfolio company?*

(1) *In general.* A depository institution and a subsidiary of a depository institution may not routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this subpart.

(2) *Definition applying provisions governing routine management or operation.* For purposes of this section other than paragraph (e) and for purposes of section 225.173(d), a financial holding company includes a depository institution controlled by the financial holding company and a subsidiary of such a depository institution.

(3) *Exception for certain subsidiaries of depository institutions.* For purposes of paragraph (e) of this section, a financial holding company includes a financial subsidiary held in accordance with section 5136A of the Revised Statutes (12 USC 24a) or section 46 of the Federal Deposit Insurance Act (12 USC 1831w), and a subsidiary that is a small business investment company and that is held in accordance with the Small Business Investment Act (15 USC 661 et seq.), and such a subsidiary may, in accordance with the limitations set forth in this section, routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this subpart.

4–058.3

SECTION 225.172—What are the holding periods permitted for merchant banking investments?

(a) *Must investments be made for resale?* A financial holding company may own or control shares, assets, and ownership interests pursuant to this subpart only for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the financial holding company's merchant banking investment activities.

(b) *What period of time is generally permitted for holding merchant banking investments?*

(1) *In general.* Except as provided in this section or section 225.173, a financial holding company may not, directly or indirectly, own, control, or hold any share, asset, or ownership interest pursuant to this subpart for a period that exceeds 10 years.

(2) *Ownership interests acquired from or transferred to companies held under this subpart.* For purposes of paragraph (b)(1) of this section, shares, assets, or ownership interests—

(i) acquired by a financial holding company from a company in which the financial holding company held an interest under this subpart will be considered to have been acquired by the financial holding company on the date that the share, asset, or ownership interest was acquired by the company; and

(ii) acquired by a company from a financial holding company will be considered to have been acquired by the company on the date that the share, asset, or ownership interest was acquired by the financial holding company if—

(A) the financial holding company held the share, asset, or ownership interest under this subpart; and

(B) the financial holding company holds an interest in the acquiring company under this subpart.

(3) *Interests previously held by a financial holding company under limited authority.* For purposes of paragraph (b)(1) of this section, any shares, assets, or ownership interests previously owned or controlled, directly or indirectly, by a financial holding company under any other provision of the federal banking laws that imposes a limited holding period will be considered to have been acquired by the financial holding company under this subpart on the date the financial holding company first acquired ownership or control of the shares, assets, or ownership interests under such other provision of law. For purposes of this paragraph (b)(3), a financial holding company includes a depository institution controlled by the financial holding company and any subsidiary of such a depository institution.

4–058.31

(4) *Approval required to hold interests held in excess of time limit.* A financial holding company may seek Board approval to own, control, or hold shares, assets, or ownership interests of a company under this subpart for a period that exceeds the period specified in paragraph (b)(1) of this section. A request for approval must—

(i) be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) provide the reasons for the request, including information that addresses the factors in paragraph (b)(5) of this section; and

(iii) explain the financial holding company's plan for divesting the shares, assets, or ownership interests.

(5) *Factors governing Board determinations.* In reviewing any proposal under paragraph (b)(4) of this section, the Board may consider all the facts and circumstances related to the investment, including—

(i) the cost to the financial holding company of disposing of the investment within the applicable period;

(ii) the total exposure of the financial holding company to the company and the risks that disposing of the investment may pose to the financial holding company;

(iii) market conditions;

(iv) the nature of the portfolio company's business;

(v) the extent and history of involvement by the financial holding company in the

management and operations of the company; and

(vi) the average holding period of the financial holding company's merchant banking investments.

4–058.32

(6) *Restrictions applicable to investments held beyond time period.* A financial holding company that directly or indirectly owns, controls, or holds any share, asset, or ownership interest of a company under this subpart for a total period that exceeds the period specified in paragraph (b)(1) of this section must—

(i) For purposes of determining the financial holding company's regulatory capital, apply to the financial holding company's adjusted carrying value of such shares, assets, or ownership interests a capital charge determined by the Board that must be—

(A) higher than the maximum marginal tier 1 capital charge applicable under part 217 to merchant banking investments held by that financial holding company; and

(B) in no event less than 25 percent of the adjusted carrying value of the investment; and

(ii) abide by any other restrictions that the Board may impose in connection with granting approval under paragraph (b)(4) of this section.

4–058.4

SECTION 225.173—How are investments in private equity funds treated under this subpart?

(a) *What is a private equity fund?* For purposes of this subpart, a ''private equity fund'' is any company that—

(1) is formed for the purpose of and is engaged exclusively in the business of investing in shares, assets, and ownership interests of financial and nonfinancial companies for resale or other disposition;

(2) is not an operating company;

(3) no more than 25 percent of the total equity of which is held, owned or controlled, directly or indirectly, by the financial holding company and its directors, officers, employees, and principal shareholders;

(4) has a maximum term of not more than 15 years; and

(5) is not formed or operated for the purpose of making investments inconsistent with the authority granted under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) or evading the limitations governing merchant banking investments contained in this subpart.

4–058.41

(b) *What form may a private equity fund take?* A private equity fund may be a corporation, partnership, limited liability company, or other type of company that issues ownership interests in any form.

(c) *What is the holding period permitted for interests in private equity funds?*

(1) *In general.* A financial holding company may own, control, or hold any interest in a private equity fund under this subpart and any interest in a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this subpart for the duration of the fund, up to a maximum of 15 years.

(2) *Request to hold interest for longer period.* A financial holding company may seek Board approval to own, control, or hold an interest in or held through a private equity fund for a period longer than the duration of the fund in accordance with section 225.172(b) of this subpart.

(3) *Application of rules.* The rules described in section 225.172(b)(2) and (3) governing holding periods of interests acquired, transferred or previously held by a financial holding company apply to interests in, held through, or acquired from a private equity fund.

4–058.42

(d) *How do the restrictions on routine management and operation apply to private equity funds and investments held through a private equity fund?*

(1) *Portfolio companies held through a pri-*

vate equity fund. A financial holding company may not routinely manage or operate a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this subpart, except as permitted under section 225.171(e).

(2) *Private equity funds controlled by a financial holding company.* A private equity fund that is controlled by a financial holding company may not routinely manage or operate a portfolio company, except as permitted under section 225.171(e).

(3) *Private equity funds that are not controlled by a financial holding company.* A private equity fund may routinely manage or operate a portfolio company so long as no financial holding company controls the private equity fund or as permitted under section 225.171(e).

(4) *When does a financial holding company control a private equity fund?* A financial holding company controls a private equity fund for purposes of this subpart if the financial holding company, including any director, officer, employee, or principal shareholder of the financial holding company—

(i) serves as a general partner, managing member, or trustee of the private equity fund (or serves in a similar role with respect to the private equity fund);

(ii) owns or controls 25 percent or more of any class of voting shares or similar interests in the private equity fund;

(iii) in any manner selects, controls, or constitutes a majority of the directors, trustees, or management of the private equity fund; or

(iv) owns or controls more than 5 percent of any class of voting shares or similar interests in the private equity fund and is the investment adviser to the fund.

4–058.5

SECTION 225.174—What aggregate thresholds apply to merchant banking investments?

(a) *In general.* A financial holding company may not, without Board approval, directly or indirectly acquire any additional shares, assets, or ownership interests under this subpart or make any additional capital contribution to any company the shares, assets, or ownership interests of which are held by the financial holding company under this subpart if the aggregate carrying value of all merchant banking investments held by the financial holding company under this subpart exceeds—

(1) 30 percent of the tier 1 capital of the financial holding company; or

(2) after excluding interests in private equity funds, 20 percent of the tier 1 capital of the financial holding company.

(b) *How do these thresholds apply to a private equity fund?* Paragraph (a) of this section applies to the interest acquired or controlled by the financial holding company under this subpart in a private equity fund. Paragraph (a) of this section does not apply to any interest in a company held by a private equity fund or to any interest held by a person that is not affiliated with the financial holding company.

(c) *How long do these thresholds remain in effect?* This section 225.174 shall cease to be effective on the date that a final rule issued by the Board that specifically addresses the appropriate regulatory capital treatment of merchant banking investments becomes effective.

(d) *Qualifying community banking organizations.* For purposes of this section, a financial holding company that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) calculates its tier 1 capital (as defined in section 217.2 of this chapter) in accordance with section 217.12(b) of this chapter.

4–058.6

SECTION 225.175—What risk management, record keeping and reporting policies are required to make merchant banking investments?

(a) *What internal controls and records are necessary?*

(1) *General.* A financial holding company, including a private equity fund controlled

by a financial holding company, that makes investments under this subpart must establish and maintain policies, procedures, records, and systems reasonably designed to conduct, monitor, and manage such investment activities and the risks associated with such investment activities in a safe and sound manner, including policies, procedures, records, and systems reasonably designed to—

(i) monitor and assess the carrying value, market value, and performance of each investment and the aggregate portfolio;

(ii) identify and manage the market, credit, concentration, and other risks associated with such investments;

(iii) identify, monitor, and assess the terms, amounts and risks arising from transactions and relationships (including contingent fees or contingent interests) with each company in which the financial holding company holds an interest under this subpart;

(iv) ensure the maintenance of corporate separateness between the financial holding company and each company in which the financial holding company holds an interest under this subpart and protect the financial holding company and its depository institution subsidiaries from legal liability for the operations conducted and financial obligations of each such company; and

(v) ensure compliance with this part and any other provisions of law governing transactions and relationships with companies in which the financial holding company holds an interest under this subpart (e.g., fiduciary principles or sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c-1), if applicable).

(2) *Availability of records.* A financial holding company must make the policies, procedures, and records required by paragraph (a)(1) of this section available to the Board or the appropriate Reserve Bank upon request.

4–058.61

(b) *What periodic reports must be filed?* A financial holding company must provide reports to the appropriate Reserve Bank in such format and at such times as the Board may prescribe.

(c) *Is notice required for the acquisition of companies?*

(1) *Fulfillment of statutory notice requirement.* Except as required in paragraph (c)(2) of this section, no post-acquisition notice under section 4(k)(6) of the Bank Holding Company Act (12 U.S.C. 1843(k)(6)) is required by a financial holding company in connection with an investment made under this subpart if the financial holding company has previously filed a notice under section 225.87 indicating that it had commenced merchant banking investment activities under this subpart.

(2) *Notice of large individual investments.* A financial holding company must provide written notice to the Board on the appropriate form within 30 days after acquiring more than 5 percent of the voting shares, assets, or ownership interests of any company under this subpart, including an interest in a private equity fund, at a total cost to the financial holding company that exceeds the lesser of 5 percent of the tier 1 capital of the financial holding company or $200 million.

(3) *Qualifying community banking organizations.* For purposes of this paragraph (c), a financial holding company that is a qualifying community banking organization (as defined in section 217.12 of this chapter) that is subject to the community bank leverage ratio framework (as defined in section 217.12 of this chapter) calculates its tier 1 capital (as defined in section 217.2 of this chapter) in accordance with section 217.12(b) of this chapter.

4–058.7

SECTION 225.176—How do the statutory cross-marketing and section 23A and 23B limitations apply to merchant banking investments?

(a) *Are cross-marketing activities prohibited?*

(1) *In general.* A depository institution, including a subsidiary of a depository institution, controlled by a financial holding company may not—

(i) offer or market, directly or through any arrangement, any product or service of any company if more than 5 percent of the company's voting shares, assets, or ownership interests are owned or controlled by the financial holding company pursuant to this subpart; or

(ii) allow any product or service of the depository institution, including any product or service of a subsidiary of the depository institution, to be offered or marketed, directly or through any arrangement, by or through any company described in paragraph (a)(1)(i) of this section.

(2) *How are certain subsidiaries treated?* For purposes of paragraph (a)(1) of this section, a subsidiary of a depository institution does not include a financial subsidiary held in accordance with section 5136A of the Revised Statutes (12 U.S.C. 24a) or section 46 of the Federal Deposit Insurance Act. (12 U.S.C. 1831w), any company held by a company owned in accordance with section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*; 12 U.S.C. 611 *et seq.*), or any company held by a small business investment company owned in accordance with the Small Business Investment Act of 1958 (15 U.S.C. 661 *et seq.*).

(3) *How do the cross marketing restrictions apply to private equity funds?* The restriction contained in paragraph (a)(1) of this section does not apply to—

(i) portfolio companies held by a private equity fund that the financial holding company does not control; or

(ii) the sale, offer, or marketing of any interest in a private equity fund, whether or not controlled by the financial holding company.

4–058.71

(b) *When are companies held under section 4(k)(4)(H) affiliates under sections 23A and 23B?*

(1) *Rebuttable presumption of control.* The following rebuttable presumption of control shall apply for purposes of sections 23A and 23B of the Federal Reserve Act (12 USC 371c, 371c-1): if a financial holding company directly or indirectly owns or controls more than 15 percent of the total equity of a company pursuant to this subpart, the company shall be presumed to be an affiliate of any member bank that is affiliated with the financial holding company.

(2) *Request to rebut presumption.* A financial holding company may rebut this presumption by providing information acceptable to the Board demonstrating that the financial holding company does not control the company.

(3) *Presumptions that control does not exist.* Absent evidence to the contrary, the presumption in paragraph (b)(1) of this section will be considered to have been rebutted without Board approval under paragraph (b)(2) of this section if any one of the following requirements are met:

(i) no officer, director, or employee of the financial holding company serves as a director, trustee, or general partner (or individual exercising similar functions) of the company;

(ii) a person that is not affiliated or associated with the financial holding company owns or controls a greater percentage of the equity capital of the portfolio company than the amount owned or controlled by the financial holding company, and no more than one officer or employee of the holding company serves as a director or trustee (or individual exercising similar functions) of the company; or

(iii) a person that is not affiliated or associated with the financial holding company owns or controls more than 50 percent of the voting shares of the portfolio company, and officers and employees of the holding company do not constitute a majority of the directors or trustees (or individuals exercising similar functions) of the company.

4–058.72

(4) *Convertible instruments.* For purposes of paragraph (b)(1) of this section, equity capital includes options, warrants, and any other instrument convertible into equity capital.

(5) *Application of presumption to private equity funds.* A financial holding company

will not be presumed to own or control the equity capital of a company for purposes of paragraph (b)(1) of this section solely by virtue of an investment made by the financial holding company in a private equity fund that owns or controls the equity capital of the company unless the financial holding company controls the private equity fund as described in section 225.173(d)(4).

(6) *Application of sections 23A and 23B to U.S. branches and agencies of foreign banks.* Sections 23A and 23B of the Federal Reserve Act (12 USC 371c, 371c-1) shall apply to all covered transactions between each U.S. branch and agency of a foreign bank that acquires or controls, or that is affiliated with a company that acquires or controls, merchant banking investments and—

(i) any portfolio company that the foreign bank or affiliated company controls or is presumed to control under paragraph (b)(1) of this section; and

(ii) any company that the foreign bank or affiliated company controls or is presumed to control under paragraph (b)(1) of this section if the company is engaged in acquiring or controlling merchant banking investments and the proceeds of the covered transaction are used for the purpose of funding the company's merchant banking investment activities.

4–058.8

SECTION 225.177—Definitions

(a) *What do references to a financial holding company include?*

(1) Except as otherwise expressly provided, the term ''financial holding company'' as used in this subpart means the financial holding company and all of its subsidiaries, including a private equity fund or other fund controlled by the financial holding company.

(2) Except as otherwise expressly provided, the term ''financial holding company'' does not include a depository institution or subsidiary of a depository institution or any portfolio company controlled directly or indirectly by the financial holding company.

(b) *What do references to a depository institution include?* For purposes of this subpart, the term ''depository institution'' includes a U.S. branch or agency of a foreign bank.

(c) *What is a portfolio company?* A portfolio company is any company or entity—

(1) that is engaged in any activity not authorized for the financial holding company under section 4 of the Bank Holding Company Act (12 USC 1843); and

(2) any shares, assets, or ownership interests of which are held, owned, or controlled directly or indirectly by the financial holding company pursuant to this subpart, including through a private equity fund that the financial holding company controls.

4–058.81

(d) *Who are the executive officers of a company?*

(1) An executive officer of a company is any person who participates or has the authority to participate (other than in the capacity as a director) in major policymaking functions of the company, whether or not the officer has an official title, the title designates the officer as an assistant, or the officer serves without salary or other compensation.

(2) The term ''executive officer'' does not include—

(i) any person, including a person with an official title, who may exercise a certain measure of discretion in the performance of his duties, including the discretion to make decisions in the ordinary course of the company's business, but who does not participate in the determination of major policies of the company and whose decisions are limited by policy standards fixed by senior management of the company; or

(ii) any person who is excluded from participating (other than in the capacity of a director) in major policymaking functions of the company by resolution of the board of directors or by the bylaws of the company and who does not in fact participate in such policymaking functions.

4–058.83

SUBPART K—PROPRIETARY TRADING AND RELATIONSHIPS WITH HEDGE FUNDS AND PRIVATE EQUITY FUNDS

4–058.84

SECTION 225.180—Definitions

For purposes of this subpart:

(a) *Banking entity* means—

(1) Any insured depository institution;

(2) Any company that controls an insured depository institution;

(3) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978; and

(4) Any affiliate or subsidiary of any of the foregoing entities.

(b) *Hedge fund* and *private equity fund* mean an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, as provided in section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)), determine.

(c) *Insured depository institution* has the same meaning as given that term in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), except that for purposes of this subpart the term shall not include an institution that functions solely in a trust or fiduciary capacity if—

(1) All or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity;

(2) No deposits of such institution which are insured by the Federal Deposit Insurance Corporation are offered or marketed by or through an affiliate of such institution;

(3) Such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and

(4) Such institution does not—

(i) Obtain payment or payment related services from any Federal Reserve bank, including any service referred to in section 11A of the Federal Reserve Act (12 U.S.C. 248a); or

(ii) Exercise discount or borrowing privileges pursuant to section 19(b)(7) of the Federal Reserve Act (12 U.S.C. 416(b)(7)).

(d) *Nonbank financial company supervised by the Board* means a nonbank financial company supervised by the Board of Governors, as defined in section 102 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5311).

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *Illiquid fund* means a hedge fund or private equity fund that:

(1) As of May 1, 2010—

(i) Was principally invested in illiquid assets; or

(ii) Was invested in, and contractually committed to principally invest in, illiquid assets; and

(2) Makes all investments pursuant to, and consistent with, an investment strategy to principally invest in illiquid assets.

(g) *Illiquid assets* means any real property, security, obligation, or other asset that—

(1) Is not a liquid asset;

(2) Because of statutory or regulatory restrictions applicable to the hedge fund, private equity fund or asset, cannot be offered, sold, or otherwise transferred by the hedge fund or private equity fund to a person that is unaffiliated with the relevant banking entity; or

(3) Because of contractual restrictions applicable to the hedge fund, private equity fund or asset, cannot be offered, sold, or otherwise transferred by the hedge fund or private equity fund for a period of 3 years or more to a person that is unaffiliated with the relevant banking entity.

(h) *Liquid asset* means:

(1) Cash or cash equivalents;

(2) An asset that is traded on a recognized, established exchange, trading facility or other market on which there exist independent, bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for the particular asset almost instantaneously;

(3) An asset for which there are bona fide, competitive bid and offer quotations in a recognized inter-dealer quotation system or similar system or for which multiple dealers furnish bona fide, competitive bid and offer quotations to other brokers and dealers on request;

(4) An asset the price of which is quoted routinely in a widely disseminated publication that is readily available to the general public or through an electronic service that provides indicative data from real-time financial networks;

(5) An asset with an initial term of one year or less and the payments on which at maturity may be settled, closed-out, or paid in cash or one or more other liquid assets described in paragraphs (h)(1), (2), (3), or (4); and

(6) Any other asset that the Board determines, based on all the facts and circumstances, is a liquid asset.

(i) *Principally invested* and related definitions. A hedge fund or private equity fund:

(1) Is *principally invested* in illiquid assets if at least 75 percent of the fund's consolidated total assets are—

(i) Illiquid assets; or

(ii) Risk-mitigating hedges entered into in connection with and related to individual or aggregated positions in, or holdings of, illiquid assets;

(2) Is *contractually committed to principally invest* in illiquid assets if the fund's organizational documents, other documents that constitute a contractual obligation of the fund, or written representations contained in the fund's offering materials distributed to potential investors provide for the fund to be principally invested in assets described in paragraph (i)(1) at all times other than during temporary periods, such as the period prior to the initial receipt of capital contributions from investors or the period during which the fund's investments are being liquidated and capital and profits are being returned to investors; and

(3) Has an *investment strategy to principally invest* in illiquid assets if the fund—

(i) Markets or holds itself out to investors as intending to principally invest in assets described in paragraph (i)(1) of this section; or

(ii) Has a documented investment policy of principally investing in assets described in paragraph (i)(1) of this section.

4–058.85

SECTION 225.181—Conformance Period for Banking Entities Engaged in Prohibited Proprietary Trading or Private Fund Activities

(a) *Conformance period.*

(1) *In general.* Except as provided in paragraph (b)(2) or (3) of this section, a banking entity shall bring its activities and investments into compliance with the requirements of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart no later than 2 years after the earlier of:

(i) July 21, 2012; or

(ii) Twelve months after the date on which final rules adopted under section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)) are published in the *Federal Register*.

(2) *New banking entities.* A company that was not a banking entity, or a subsidiary or affiliate of a banking entity, as of July 21, 2010, and becomes a banking entity, or a subsidiary or affiliate of a banking entity, after that date shall bring its activities and investments into compliance with the requirements of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart before the later of—

(i) The conformance date determined in accordance with paragraph (a)(1) of this section; or

(ii) Two years after the date on which

the company becomes a banking entity or a subsidiary or affiliate of a banking entity.

(3) *Extended conformance period.* The Board may extend the two-year period under paragraph (a)(1) or (2) of this section by not more than three separate one-year periods, if, in the judgment of the Board, each such one-year extension is consistent with the purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart and would not be detrimental to the public interest.

(b) *Illiquid funds.*

(1) *Extended transition period.* The Board may further extend the period provided by paragraph (a) of this section during which a banking entity may acquire or retain an equity, partnership, or other ownership interest in, or otherwise provide additional capital to, a private equity fund or hedge fund if—

(i) The fund is an illiquid fund; and

(ii) The acquisition or retention of such interest, or provision of additional capital, is necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.

(2) *Duration limited.* The Board may grant a banking entity only one extension under paragraph (b)(1) of this section and such extension—

(i) May not exceed 5 years beyond any conformance period granted under paragraph (a)(3) of this section; and

(ii) Shall terminate automatically on the date during any such extension on which the banking entity is no longer under a contractual obligation described in paragraph (b)(1)(ii).

(3) *Contractual obligation.* For purposes of this paragraph (b)—

(i) A banking entity has a contractual obligation to take or retain an equity, partnership, or other ownership interest in an illiquid fund if the banking entity is prohibited from redeeming all of its equity, partnership, or other ownership interests in the fund, and from selling or otherwise transferring all such ownership interests to a person that is not an affiliate of the banking entity—

(A) Under the terms of the banking entity's equity, partnership, or other ownership interest in the fund or the banking entity's other contractual arrangements with the fund or unaffiliated investors in the fund; or

(B) If the banking entity is the sponsor of the fund, under the terms of a written representation made by the banking entity in the fund's offering materials distributed to potential investors;

(ii) A banking entity has a contractual obligation to provide additional capital to an illiquid fund if the banking entity is required to provide additional capital to such fund—

(A) Under the terms of its equity, partnership or other ownership interest in the fund or the banking entity's other contractual arrangements with the fund or unaffiliated investors in the fund; or

(B) If the banking entity is the sponsor of the fund, under the terms of a written representation made by the banking entity in the fund's offering materials distributed to potential investors; and

(iii) A banking entity shall be considered to have a contractual obligation for purposes of paragraph (b)(3)(i) or (ii) of this section only if—

(A) The obligation may not be terminated by the banking entity or any of its subsidiaries or affiliates under the terms of its agreement with the fund; and

(B) In the case of an obligation that may be terminated with the consent of other persons, the banking entity and its subsidiaries and affiliates have used their reasonable best efforts to obtain such consent and such consent has been denied.

(c) *Approval required to hold interests in excess of time limit.* The conformance period in paragraph (a) of this section may be extended in accordance with paragraph (a)(3) or (b) of this section only with the approval of the Board. A banking entity that seeks the Board's approval for an extension of the conformance period under paragraph (a)(3) or for an ex-

tended transition period under paragraph (b)(1) must—

(1) Submit a request in writing to the Board at least 180 days prior to the expiration of the applicable time period;

(2) Provide the reasons why the banking entity believes the extension should be granted, including information that addresses the factors in paragraph (d)(1) of this section; and

(3) Provide a detailed explanation of the banking entity's plan for divesting or conforming the activity or investment(s).

(d) *Factors governing Board determinations.*

(1) *Extension requests generally.* In reviewing any application by a specific company for an extension under paragraph (a)(3) or (b)(1) of this section, the Board may consider all the facts and circumstances related to the activity, investment, or fund, including, to the extent relevant—

(i) Whether the activity or investment—

(A) Involves or results in material conflicts of interest between the banking entity and its clients, customers or counterparties;

(B) Would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(C) Would pose a threat to the safety and soundness of the banking entity; or

(D) Would pose a threat to the financial stability of the United States;

(ii) Market conditions;

(iii) The nature of the activity or investment;

(iv) The date that the banking entity's contractual obligation to make or retain an investment in the fund was incurred and when it expires;

(v) The contractual terms governing the banking entity's interest in the fund;

(vi) The degree of control held by the banking entity over investment decisions of the fund;

(vii) The types of assets held by the fund, including whether any assets that were illiquid when first acquired by the fund have become liquid assets, such as, for example, because any statutory, regulatory, or contractual restrictions on the offer, sale, or transfer of such assets have expired;

(viii) The date on which the fund is expected to wind up its activities and liquidate, or its investments may be redeemed or sold;

(ix) The total exposure of the banking entity to the activity or investment and the risks that disposing of, or maintaining, the investment or activity may pose to the banking entity or the financial stability of the United States;

(x) The cost to the banking entity of divesting or disposing of the activity or investment within the applicable period;

(xi) Whether the divestiture or conformance of the activity or investment would involve or result in a material conflict of interest between the banking entity and unaffiliated clients, customers or counterparties to which it owes a duty;

(xii) The banking entity's prior efforts to divest or conform the activity or investment(s), including, with respect to an illiquid fund, the extent to which the banking entity has made efforts to terminate or obtain a waiver of its contractual obligation to take or retain an equity, partnership, or other ownership interest in, or provide additional capital to, the illiquid fund; and

(xiii) Any other factor that the Board believes appropriate.

(2) *Timing of Board review.* The Board will seek to act on any request for an extension under paragraph (a)(3) or (b)(1) of this section no later than 90 calendar days after the receipt of a complete record with respect to such request.

(3) *Consultation.* In the case of a banking entity that is primarily supervised by another Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, the Board will consult with such agency prior to the approval of a request by the banking entity for an extension under paragraph (a)(3) or (b)(1) of this section.

(e) *Authority to impose restrictions on activities or investments during any extension pe-*

riod.

(1) *In general.* The Board may impose such conditions on any extension approved under paragraph (a)(3) or (b)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart.

(2) *Consultation.* In the case of a banking entity that is primarily supervised by another Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, the Board will consult with such agency prior to imposing conditions on the approval of a request by the banking entity for an extension under paragraph (a)(3) or (b)(1) of this section.

4–058.86

SECTION 225.182—Conformance Period for Nonbank Financial Companies Supervised by the Board Engaged in Proprietary Trading or Private Fund Activities

(a) *Divestiture requirement.* A nonbank financial company supervised by the Board shall come into compliance with all applicable requirements of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart, including any capital requirements or quantitative limitations adopted there under and applicable to the company, not later than 2 years after the date the company becomes a nonbank financial company supervised by the Board.

(b) *Extensions.* The Board may, by rule or order, extend the two-year period under paragraph (a) by not more than three separate one-year periods, if, in the judgment of the Board, each such one-year extension is consistent with the purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart and would not be detrimental to the public interest.

(c) *Approval required to hold interests in excess of time limit.* A nonbank financial company supervised by the Board that seeks the Board's approval for an extension of the conformance period under paragraph (b) of this section must—

(1) Submit a request in writing to the Board at least 180 days prior to the expiration of the applicable time period;

(2) Provide the reasons why the nonbank financial company supervised by the Board believes the extension should be granted; and

(3) Provide a detailed explanation of the company's plan for conforming the activity or investment(s) to any applicable requirements established under section 13(a)(2) or (f)(4) of the Bank Holding Company Act (12 U.S.C. 1851(a)(2) and (f)(4)).

(d) *Factors governing Board determinations.*

(1) *In general.* In reviewing any application for an extension under paragraph (b) of this section, the Board may consider all the facts and circumstances related to the nonbank financial company and the request including, to the extent determined relevant by the Board, the factors described in section 225.181(d)(1).

(2) *Timing.* The Board will seek to act on any request for an extension under paragraph (b) of this section no later than 90 calendar days after the receipt of a complete record with respect to such request.

(e) *Authority to impose restrictions on activities or investments during any extension period.* The Board may impose conditions on any extension approved under paragraph (b) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the nonbank financial company or the financial stability of the United States, address material conflicts of interest or other unsound practices, or otherwise further the purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart.

4–058.87

SUBPART L—CONDITIONS TO ORDERS

4–058.88

SECTION 225.200—Conditions to Board's Section 20 Orders

(a) *Introduction.* Under section 20 of the Glass-Steagall Act (12 U.S.C. 377) and section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), a nonbank subsidiary of a bank holding company may to a limited extent underwrite and deal in securities for which underwriting and dealing by a member bank is prohibited. Pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, these so-called section 20 subsidiaries are required to register with the SEC as broker-dealers and are subject to all the financial reporting, anti-fraud, and financial-responsibility rules applicable to broker-dealers. In addition, transactions between insured depository institutions and their section 20 affiliates are restricted by sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c-1). The Board expects a section 20 subsidiary, like any other subsidiary of a bank holding company, to be operated prudently. Doing so would include observing corporate formalities (such as the maintenance of separate accounting and corporate records), and instituting appropriate risk management, including independent trading and exposure limits consistent with parent-company guidelines.

(b) *Conditions.* As a condition of each order approving establishment of a section 20 subsidiary, a bank holding company shall comply with the following conditions.

(1) *Capital.*

(i) A bank holding company shall maintain adequate capital on a fully consolidated basis. If operating a section 20 authorized to underwrite and deal in all types of debt and equity securities, a bank holding company shall maintain strong capital on a fully consolidated basis.

(ii) In the event that a bank or thrift affiliate of a section 20 subsidiary shall become less than well capitalized (as defined in section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o), and the bank holding company shall fail to restore it promptly to the well-capitalized level, the Board may, in its discretion, reimpose the funding, credit-extension, and credit-enhancement firewalls contained in its 1989 order allowing underwriting and dealing in bank-ineligible securities,[1] or order the bank holding company to divest the section 20 subsidiary.

(iii) A foreign bank that operates a branch or agency in the United States shall maintain strong capital on a fully consolidated basis at levels above the minimum levels required by the Basle Capital Accord. In the event that the Board determines that the foreign bank's capital has fallen below these levels and the foreign bank fails to restore its capital position promptly, the Board may, in its discretion, reimpose the funding, credit extension, and credit enhancement firewalls contained in its 1990 order allowing foreign banks to underwrite and deal in bank-ineligible securities,[2] or order the foreign bank to divest the section 20 subsidiary.

(2) *Internal controls.*

(i) Each bank holding company or foreign bank shall cause its subsidiary banks, thrifts, branches, or agencies[3] to adopt policies and procedures, including appropriate limits on exposure, to govern their participation in transactions underwritten or arranged by a section 20 affiliate.

(ii) Each bank holding company or foreign bank shall ensure that an independent and thorough credit evaluation has been undertaken in connection with par-

[1] Firewalls 5-8, 19, 21, and 22 of *J.P. Morgan & Co., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 1989 *Fed. Res. Bull.* 192, 214-16. 192, 214-16.

[2] Firewalls 5-8, 19, 21, and 22 of *Canadian Imperial Bank of Commerce, The Royal Bank of Canada, Barclays PLC, and Barclays Bank PLC*, 1990 *Fed. Res. Bull.* 158. 158.

[3] The terms ''branch'' and ''agency'' refer to a U.S. branch and agency of a foreign bank.

ticipation by a bank, thrift, or branch or agency in such transactions, and that adequate documentation of that evaluation is maintained for review by examiners of the appropriate federal bank agency and the Federal Reserve.

(3) *Interlocks restriction.*

(i) Directors, officers, or employees of a bank or thrift subsidiary of a bank holding company, or a bank or thrift subsidiary or branch or agency of a foreign bank, shall not serve as a majority of the board of directors or the chief executive officer of an affiliated section 20 subsidiary.

(ii) Directors, officers, or employees of a section 20 subsidiary shall not serve as a majority of the board of directors or the chief executive officer of an affiliated bank or thrift subsidiary or branch or agency, except that the manager of a branch or agency may act as a director of the underwriting subsidiary.

(iii) For purposes of this standard, the manager of a branch or agency of a foreign bank generally will be considered to be the chief executive officer of the branch or agency.

(4) *Customer disclosure.*

(i) *Disclosure to section 20 customers.* A section 20 subsidiary shall provide, in writing, to each of its retail customers,[4] at the time an investment account is opened, the same minimum disclosures, and obtain the same customer acknowledgement, described in the Interagency Statement on Retail Sales of Nondeposit Investment Products (statement) as applicable in such situations. These disclosures must be provided regardless of whether the section 20 subsidiary is itself engaged in activities through arrangements with a bank that are covered by the statement.

(ii) *Disclosures accompanying investment advice.* A director, officer, or employee of a bank, thrift, branch, or agency may not express an opinion on the value or the advisability of the purchase or the sale of a bank-ineligible security that he or she knows is being underwritten or dealt in by a section 20 affiliate unless he or she notifies the customer of the affiliate's role.

(5) *Intraday credit.* Any intraday extension of credit to a section 20 subsidiary by an affiliated bank, thrift, branch, or agency shall be on market terms consistent with section 23B of the Federal Reserve Act.

(6) *Restriction on funding purchases of securities during underwriting period.* No bank, thrift, branch, or agency shall knowingly extend credit to a customer secured by, or for the purpose of purchasing, any bank-ineligible security that a section 20 affiliate is underwriting or has underwritten within the past 30 days, unless—

(i) the extension of credit is made pursuant to, and consistent with any conditions imposed in a preexisting line of credit that was not established in contemplation of the underwriting; or

(ii) the extension of credit is made in connection with clearing transactions for the section 20 affiliate.

(7) *Reporting requirement.*

(i) Each bank holding company or foreign bank shall submit quarterly to the appropriate Federal Reserve Bank any FOCUS report filed with the NASD or other self-regulatory organizations, and any information required by the Board to monitor compliance with these operating standards and section 20 of the Glass Steagall Act, on forms provided by the Board.

(ii) In the event that a section 20 subsidiary is required to furnish notice concerning its capitalization to the Securities and Exchange Commission pursuant to 17 CFR 240.17a-11, a copy of the notice shall be filed concurrently with the appropriate Federal Reserve Bank.

(8) *Foreign banks.* A foreign bank shall ensure that any extension of credit by its branch or agency to a section 20 affiliate, and any purchase of such branch or agency, as principal or fiduciary, of securities for which a section 20 affiliate is a principal underwriter, conforms to sections 23A and 23B of the Federal Reserve Act, and that its

[4] For purposes of this operating standard, a retail customer is any customer that is not an ''accredited investor'' as defined in 17 CFR 230.501(a).

branches and agencies not advertise or suggest that they are responsible for the obligations of a section 20 affiliate, consistent with section 23B(c) of the Federal Reserve Act.

4–058.89

SUBPART M—MINIMUM REQUIREMENTS FOR APPRAISAL MANAGEMENT COMPANIES

SECTION 225.190—Authority, Purpose, and Scope

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. 101-73, 103 Stat. 183 (1989)), 12 U.S.C. 3310, 3331-3351, section 1473 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. 3353, and section 5(b) of the Bank Holding Company Act, 12 U.S.C. 1844(b).

(b) *Purpose and scope.*

(1) The purpose of this subpart is to implement sections 1109, 1117, 1121, and 1124 of FIRREA Title XI, 12 U.S.C. 3338, 3346, 3350, and 3353. Title XI provides protection for Federal financial and public policy interests in real estate related transactions by requiring real estate appraisals used in connection with Federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This subpart implements the requirements of title XI as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act and applies to all Federally related transactions and to States and to appraisal management companies (AMCs) performing appraisal management services in connection with consumer credit transactions secured by a consumer's principal dwelling or securitizations of those transactions.

(2) This subpart:

(i) Identifies which real estate related financial transactions require the services of an appraiser.

(ii) Prescribes which categories of Federally related transactions shall be appraised by a State-certified appraiser and which by a State-licensed appraiser;

(iii) Prescribes minimum standards for the performance of real estate appraisals in connection with Federal related transactions under the jurisdiction of the Board;

(iv) Prescribes minimum requirements to be applied by participating States in the registration and supervision of AMCs; and

(v) Prescribes minimum requirements to be applied by participating States to report certain information concerning AMCs registered with the States to a national registry of AMCs.

(c) *Rule of construction.* Nothing in this subpart should be construed to prevent a State from establishing requirements in addition to those in this subpart. In addition, nothing in this subpart should be construed to alter guidance in, and applicability of, the Interagency Appraisal and Evaluation Guidelines[1] or other relevant agency guidance that cautions banks and bank holding companies, that each organization is accountable for overseeing the activities of third-party service providers and ensuring that any services provided by a third party comply with applicable laws, regulations, and supervisory guidance applicable directly to the creditor.

4–058.891

SECTION 225.191—Definitions

For purposes of this subpart:

(a) *Affiliate* has the meaning provided in 12 U.S.C. 1841.

(b) *AMC National Registry* means the registry of State-registered AMCs and Federally regulated AMCs maintained by the Appraisal Subcommittee.

[1] *See*, Agencies issue final appraisal and evaluation guidelines, http://www.federalreserve.gov/newsevents/press/bcreg/20101202a.htm.

(c) *Appraisal Foundation* means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(d) (1) *Appraisal management company (AMC)* means a person that:

(i) Provides appraisal management services to creditors or to secondary mortgage market participants, including affiliates;

(ii) Provides such services in connection with valuing a consumer's principal dwelling as security for a consumer credit transaction or incorporating such transactions into securitizations; and

(iii) Within a 12-month period, as defined in section 225.192(d), oversees an appraiser panel of more than 15 State-certified or State-licensed appraisers in a State or 25 or more State-certified or State-licensed appraisers in two or more States, as described in section 225.192;

(2) An AMC does not include a department or division of an entity that provides appraisal management services only to that entity.

(e) *Appraisal management services* means one or more of the following:

(1) Recruiting, selecting, and retaining appraisers;

(2) Contracting with State-certified or State-licensed appraisers to perform appraisal assignments;

(3) Managing the process of having an appraisal performed, including providing administrative services such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and secondary market participants, collecting fees from creditors and secondary market participants for services provided, and paying appraisers for services performed; and

(4) Reviewing and verifying the work of appraisers.

(f) *Appraiser panel* means a network, list or roster of licensed or certified appraisers approved by an AMC to perform appraisals as independent contractors for the AMC. Appraisers on an AMC's ''appraiser panel'' under this part include both appraisers accepted by the AMC for consideration for future appraisal assignments in covered transactions or for secondary mortgage market participants in connection with covered transactions and appraisers engaged by the AMC to perform one or more appraisals in covered transactions or for secondary mortgage market participants in connection with covered transactions. An appraiser is an independent contractor for purposes of this part if the appraiser is treated as an independent contractor by the AMC for purposes of Federal income taxation.

(g) *Consumer credit* means credit offered or extended to a consumer primarily for personal, family, or household purposes.

(h) *Covered transaction* means any consumer credit transaction secured by the consumer's principal dwelling.

(i) *Creditor* means:

(1) A person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract.

(2) A person regularly extends consumer credit if the person extended credit (other than credit subject to the requirements of 12 CFR 1026.32) more than 5 times for transactions secured by a dwelling in the preceding calendar year. If a person did not meet these numerical standards in the preceding calendar year, the numerical standards shall be applied to the current calendar year. A person regularly extends consumer credit if, in any 12-month period, the person originates more than one credit extension that is subject to the requirements of 12 CFR 1026.32 or one or more such credit extensions through a mortgage broker.

(j) *Dwelling* means:

(1) A residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence.

(2) A consumer can have only one ''principal'' dwelling at a time. Thus, a vacation or other second home would not be a principal dwelling. However, if a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within a year or upon the completion of construction, the new dwelling is considered the principal dwelling for purposes of this section.

(k) *Federally regulated AMC* means an AMC that is owned and controlled by an insured depository institution, as defined in 12 U.S.C. 1813 and regulated by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation.

(*l*) *Federally related transaction regulations* means regulations established by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the National Credit Union Administration, pursuant to sections 1112, 1113, and 1114 of FIRREA Title XI, 12 U.S.C. 3341-3343.

(m) *Person* means a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit.

(n) *Secondary mortgage market participant* means a guarantor or insurer of mortgage-backed securities, or an underwriter or issuer of mortgage-backed securities. Secondary mortgage market participant only includes an individual investor in a mortgage-backed security if that investor also serves in the capacity of a guarantor, insurer, underwriter, or issuer for the mortgage-backed security.

(o) *States* mean the 50 States and the District of Columbia and the territories of Guam, Mariana Islands, Puerto Rico, and the U.S. Virgin Islands.

(p) *Uniform Standards of Professional Appraisal Practice (USPAP)* means the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation.

4–058.892

SECTION 225.192—Appraiser Panel—Annual Size Calculation

For purposes of determining whether, within a 12-month period, an AMC oversees an appraiser panel of more than 15 State-certified or State-licensed appraisers in a State or 25 or more State-certified or State-licensed appraisers in two or more States pursuant to section 225.191(d)(1)(iii)—

(a) An appraiser is deemed part of the AMC's appraiser panel as of the earliest date on which the AMC:

(1) Accepts the appraiser for the AMC's consideration for future appraisal assignments in covered transactions or for secondary mortgage market participants in connection with covered transactions; or

(2) Engages the appraiser to perform one or more appraisals on behalf of a creditor for a covered transaction or secondary mortgage market participant in connection with a covered transaction.

(b) An appraiser who is deemed part of the AMC's appraiser panel pursuant to paragraph (a) of this section is deemed to remain on the panel until the date on which the AMC:

(1) Sends written notice to the appraiser removing the appraiser from the appraiser panel, with an explanation of its action; or

(2) Receives written notice from the appraiser asking to be removed from the appraiser panel or notice of the death or incapacity of the appraiser.

(c) If an appraiser is removed from an AMC's appraiser panel pursuant to paragraph (b) of this section, but the AMC subsequently accepts the appraiser for consideration for future assignments or engages the appraiser at any time during the twelve months after the AMC's removal, the removal will be deemed not to have occurred, and the appraiser will be deemed to have been part of the AMC's appraiser panel without interruption.

(d) The period for purposes of counting appraisers on an AMC's appraiser panel may be the calendar year or a 12-month period established by law or rule of each State with which the AMC is required to register.

4–058.893

SECTION 225.193—Appraisal Management Company Registration

Each State electing to register AMCs pursuant to paragraph (b)(1) of this section must:

(a) Establish and maintain within the State appraiser certifying and licensing agency a licensing program that is subject to the limitations set forth in section 225.194 and with the legal authority and mechanisms to:

(1) Review and approve or deny an AMC's application for initial registration;

(2) Review and renew or review and deny an AMC's registration periodically;

(3) Examine the books and records of an AMC operating in the State and require the AMC to submit reports, information, and documents;

(4) Verify that the appraisers on the AMC's appraiser panel hold valid State certifications or licenses, as applicable;

(5) Conduct investigations of AMCs to assess potential violations of applicable appraisal-related laws, regulations, or orders;

(6) Discipline, suspend, terminate, or deny renewal of the registration of an AMC that violates applicable appraisal-related laws, regulations, or orders; and

(7) Report an AMC's violation of applicable appraisal-related laws, regulations, or orders, as well as disciplinary and enforcement actions and other relevant information about an AMC's operations, to the Appraisal Subcommittee.

(b) Impose requirements on AMCs that are not owned and controlled by an insured depository institution and not regulated by a Federal financial institutions regulatory agency to:

(1) Register with and be subject to supervision by the State appraiser certifying and licensing agency;

(2) Engage only State-certified or State-licensed appraisers for Federally related transactions in conformity with any Federally related transaction regulations;

(3) Establish and comply with processes and controls reasonably designed to ensure that the AMC, in engaging an appraiser, selects an appraiser who is independent of the transaction and who has the requisite education, expertise, and experience necessary to competently complete the appraisal assignment for the particular market and property type;

(4) Direct the appraiser to perform the assignment in accordance with USPAP; and

(5) Establish and comply with processes and controls reasonably designed to ensure that the AMC conducts its appraisal management services in accordance with the requirements of section 129E(a)-(i) of the Truth in Lending Act, 15 U.S.C. 1639e(a)-(i), and regulations thereunder.

4–058.894

SECTION 225.194—Ownership Limitations for State-Registered Appraisal Management Companies

(a) *Appraiser certification or licensing of owners.*

(1) An AMC subject to State registration pursuant to section 225.193 shall not be registered by a State or included on the AMC National Registry if such AMC, in whole or in part, directly or indirectly, is owned by any person who has had an appraiser license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any State for a substantive cause, as determined by the appropriate State appraiser certifying and licensing agency.

(2) An AMC subject to State registration pursuant to section 225.193 is not barred by paragraph (a)(1) of this section from being registered by a State or included on the AMC National Registry if the license or certificate of the appraiser with an ownership interest was not revoked for a substantive cause and has been reinstated by the State or States in which the appraiser was licensed or certified.

(b) *Good moral character of owners.* An AMC shall not be registered by a State if any person that owns more than 10 percent of the AMC—

(1) Is determined by the State appraiser

certifying and licensing agency not to have good moral character; or

(2) Fails to submit to a background investigation carried out by the State appraiser certifying and licensing agency.

4–058.895

SECTION 225.195—Requirements for Federally Regulated Appraisal Management Companies

(a) *Requirements in providing services.* To provide appraisal management services for a creditor or secondary mortgage market participant relating to a covered transaction, a Federally regulated AMC must comply with the requirements in section 225.193(b)(2) through (5).

(b) *Ownership limitations.*

(1) A Federally regulated AMC shall not be included on the AMC National Registry if such AMC, in whole or in part, directly or indirectly, is owned by any person who has had an appraiser license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any State for a substantive cause, as determined by the ASC.

(2) A Federally regulated AMC is not barred by this paragraph (b) from being included on the AMC National Registry if the license or certificate of the appraiser with an ownership interest was not revoked for a substantive cause and has been reinstated by the State or States in which the appraiser was licensed or certified.

(c) *Reporting information for the AMC National Registry.* A Federally regulated AMC must report to the State or States in which it operates the information required to be submitted by the State to the Appraisal Subcommittee pursuant to the Appraisal Subcommittee's policies regarding the determination of the AMC National Registry fee, including but not necessarily limited to the collection of information related to the limitations set forth in this section.

4–058.896

SECTION 225.196—Information to Be Presented to the Appraisal Subcommittee by Participating States

Each State electing to register AMCs for purposes of permitting AMCs to provide appraisal management services relating to covered transactions in the State must submit to the Appraisal Subcommittee the information required to be submitted by Appraisal Subcommittee regulations or guidance concerning AMCs that operate in the State.

4–058.897

SUBPART N—COMPUTER-SECURITY INCIDENT NOTIFICATION

SECTION 225.300—Authority, Purpose, and Scope

(a) *Authority.* This subpart is issued under the authority of 12 U.S.C. 1, 321-338a, 1467a(g), 1818(b), 1844(b), 1861-1867, and 3101 *et seq*.

(b) *Purpose.* This subpart promotes the timely notification of computer-security incidents that may materially and adversely affect Board-supervised entities.

(c) *Scope.* This subpart applies to all U.S. bank holding companies and savings and loan holding companies; state member banks; the U.S. operations of foreign banking organizations; and Edge and agreement corporations. This subpart also applies to their bank service providers, as defined in section 225.301(b)(2).

4–058.898

SECTION 225.301—Definitions

(a) Except as modified in this subpart, or unless the context otherwise requires, the terms used in this subpart have the same meanings as set forth in 12 U.S.C. 1813.

(b) For purposes of this subpart, the following definitions apply.

(1) *Banking organization* means a U.S. bank holding company; U.S. savings and loan holding company; state member bank; the U.S. operations of foreign banking organizations; and an Edge or agreement corpo-

ration; provided, however, that no designated financial market utility shall be considered a banking organization.

(2) *Bank service provider* means a bank service company or other person that performs covered services; provided, however, that no designated financial market utility shall be considered a bank service provider.

(3) *Business line* means a product or service offered by a banking organization to serve its customers or support other business needs.

(4) *Computer-security incident* is an occurrence that results in actual harm to the confidentiality, integrity, or availability of an information system or the information that the system processes, stores, or transmits.

(5) *Covered services* are services performed, by a person, that are subject to the Bank Service Company Act (12 U.S.C. 1861-1867).

(6) *Designated financial market utility* has the same meaning as set forth at 12 U.S.C. 5462(4).

(7) *Notification incident* is a computer-security incident that has materially disrupted or degraded, or is reasonably likely to materially disrupt or degrade, a banking organization's—

(i) Ability to carry out banking operations, activities, or processes, or deliver banking products and services to a material portion of its customer base, in the ordinary course of business;

(ii) Business line(s), including associated operations, services, functions, and support, that upon failure would result in a material loss of revenue, profit, or franchise value; or

(iii) Operations, including associated services, functions and support, as applicable, the failure or discontinuance of which would pose a threat to the financial stability of the United States.

(8) *Person* has the same meaning as set forth at 12 U.S.C. 1817(j)(8)(A).

4–058.899

SECTION 225.302—Notification

A banking organization must notify the appropriate Board-designated point of contact about a notification incident through email, telephone, or other similar methods that the Board may prescribe. The Board must receive this notification from the banking organization as soon as possible and no later than 36 hours after the banking organization determines that a notification incident has occurred.

SECTION 225.303—Bank Service Provider Notification

(a) A bank service provider is required to notify at least one bank-designated point of contact at each affected banking organization customer as soon as possible when the bank service provider determines that it has experienced a computer-security incident that has materially disrupted or degraded, or is reasonably likely to materially disrupt or degrade, covered services provided to such banking organization for four or more hours.

(1) A bank-designated point of contact is an email address, phone number, or any other contact(s), previously provided to the bank service provider by the banking organization customer.

(2) If the banking organization customer has not previously provided a bank-designated point of contact, such notification shall be made to the chief executive officer and chief information officer of the banking organization customer, or two individuals of comparable responsibilities, through any reasonable means.

(b) The notification requirement in paragraph (a) of this section does not apply to any scheduled maintenance, testing, or software update previously communicated to a banking organization customer.

4–058.9

APPENDIX A—Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure*

* Regulation Q—Capital Adequacy of Bank Holding Companies, Savings and Loan Holding Companies, and State Member Banks, revised the Board's risk-based and leverage capital requirements for banking organizations into a harmonized integrated regulatory framework. *See* Regulation Q (12 CFR 217) at 3–2100.

I. Overview

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of bank holding companies (''banking organizations'').[1] The principal objectives of this measure are to (i) make regulatory capital requirements more sensitive to differences in risk profiles among banking organizations; (ii) factor off-balance-sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banking organizations throughout the world.[2]

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted-risk assets by assigning assets and off-balance-sheet items to broad risk categories. An institution's risk-based capital ratio is calculated by dividing its qualifying capital (the numerator of the ratio) by its weighted-risk assets (the denominator).[3] The definition of ''qualifying capital'' is outlined below in section II, and the procedures for calculating weighted-risk assets are discussed in section III. Attachment I illustrates a sample calculation of weighted-risk assets and the risk-based capital ratio.

In addition, when certain organizations that engage in trading activities calculate their risk-based capital ratio under this appendix A, they must also refer to appendix E of this part, which incorporates capital charges for certain market risks into the risk-based capital ratio. When calculating their risk-based capital ratio under this appendix A, such organizations are required to refer to appendix E of this part for supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market-risk-equivalent assets, and calculate risk-based capital ratios adjusted for market risk.

The risk-based capital guidelines also establish a schedule for achieving a minimum supervisory standard for the ratio of qualifying capital to weighted-risk assets and provide for transitional arrangements during a phase-in period to facilitate adoption and implementation of the measure at the end of 1992. These interim standards and transitional arrangements are set forth in section IV.

The risk-based guidelines apply on a consolidated basis to any bank holding company with consolidated assets of $500 million or more. The risk-based guidelines also apply on a consolidated basis to any bank holding company with consolidated assets of less than $500 million if the holding company (i) is engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) conducts significant off-balance-sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary; or (iii) has a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission (SEC). The Federal Reserve may apply the risk-based guidelines at its discretion to any bank holding company, regardless of asset size, if such action is warranted for supervisory purposes.[4]

The risk-based guidelines are to be used in the inspection and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. Thus, in considering an application filed by a bank holding company, the Federal Reserve will take into account the organization's risk-based capital ratio, the reasonableness of its capital plans, and the degree of progress it has demonstrated toward meeting the interim and final risk-based capital standards.

The risk-based capital ratio focuses princi-

[1] Supervisory ratios that relate capital to total assets for bank holding companies are outlined in appendixes B and D of this part.

[2] The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Regulations and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the BSC entitled ''International Convergence of Capital Measurement,'' July 1988.

[3] Banking organizations will initially be expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banking organizations have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

[4] [Reserved]

pally on broad categories of credit risk, although the framework for assigning assets and off-balance-sheet items to risk categories does incorporate elements of transfer risk, as well as limited instances of interest-rate and market risk. The risk-based ratio does not, however, incorporate other factors that can affect an organization's financial condition. These factors include overall interest-rate exposure; liquidity, funding, and market risks; the quality and level of earnings; investment or loan-portfolio concentrations; the quality of loans and investments; the effectiveness of loan and investment policies; and management's ability to monitor and control financial and operating risks.

In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of these other factors, including, in particular, the level and severity of problem and classified assets. For this reason, the final supervisory judgment on an organization's capital adequacy may differ significantly from conclusions that might be drawn solely from the level of the organization's risk-based capital ratio.

The risk-based capital guidelines establish *minimum* ratios of capital to weighted-risk assets. In light of the considerations just discussed, banking organizations generally are expected to operate well above the minimum risk-based ratios. In particular, banking organizations contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Institutions with high or inordinate levels of risk are also expected to operate above minimum capital standards. In all cases, institutions should hold capital commensurate with the level and nature of the risks to which they are exposed. Banking organizations that do not meet the minimum risk-based standard, or that are otherwise considered to be inadequately capitalized, are expected to develop and implement plans acceptable to the Federal Reserve for achieving adequate levels of capital within a reasonable period of time.

The Federal Reserve may determine that the regulatory capital treatment for a banking organization's exposure or other relationship to an entity not consolidated on the banking organization's balance sheet is not commensurate with the actual risk relationship of the banking organization to the entity. In making this determination, the Federal Reserve may require the banking organization to treat the entity as if it were consolidated onto the balance sheet of the banking organization for risk-based capital purposes and calculate the appropriate risk-based capital ratios accordingly, all as specified by the Federal Reserve.

The Board will monitor the implementation and effect of these guidelines in relation to domestic and international developments in the banking industry. When necessary and appropriate, the Board will consider the need to modify the guidelines in light of any significant changes in the economy, financial markets, banking practices, or other relevant factors.

4–058.91

II. Definition of Qualifying Capital for the Risk-Based Capital Ratio

(i) A banking organization's qualifying total capital consists of two types of capital components: ''core capital elements'' (tier 1 capital elements) and ''supplementary capital elements'' (tier 2 capital elements). These capital elements and the various limits, restrictions, and deductions to which they are subject, are discussed below. To qualify as an element of tier 1 or tier 2 capital, an instrument must be fully paid up and effectively unsecured. Accordingly, if a banking organization has purchased, or has directly or indirectly funded the purchase of, its own capital instrument, that instrument generally is disqualified from inclusion in regulatory capital. A qualifying tier 1 or tier 2 capital instrument must be subordinated to all senior indebtedness of the organization. If issued by a bank, it also must be subordinated to claims of depositors. In addition, the instrument must not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

(ii) On a case-by-case basis, the Federal Reserve may determine whether, and to what

extent, any instrument that does not fit wholly within the terms of a capital element set forth below, or that does not have the characteristics or the ability to absorb losses commensurate with the capital treatment specified below, will qualify as an element of tier 1 or tier 2 capital. In making such a determination, the Federal Reserve will consider the similarity of the instrument to instruments explicitly addressed in the guidelines; the ability of the instrument to absorb losses, particularly while the organization operates as a going concern; the maturity and redemption features of the instrument; and other relevant terms and factors.

(iii) The redemption of capital instruments before stated maturity could have a significant impact on an organization's overall capital structure. Consequently, an organization should consult with the Federal Reserve before redeeming any equity or other capital instrument included in tier 1 or tier 2 capital prior to stated maturity if such redemption could have a material effect on the level or composition of the organization's capital base. Such consultation generally would not be necessary when the instrument is to be redeemed with the proceeds of, or replaced by, a like amount of a capital instrument that is of equal or higher quality with regard to terms and maturity and the Federal Reserve considers the organization's capital position to be fully sufficient.

A. The Definition and Components of Qualifying Capital

1. *Tier 1 capital.* Tier 1 capital generally is defined as the sum of core capital elements less any amounts of goodwill, other intangible assets, interest-only strips receivables, deferred tax assets, nonfinancial equity investments, and other items that are required to be deducted in accordance with section II.B. of this appendix. Tier 1 capital must represent at least 50 percent of qualifying total capital.

a. *Core capital elements (tier 1 capital elements).* The elements qualifying for inclusion in the tier 1 component of a banking organization's qualifying total capital are—

i. qualifying common stockholders' equity;

ii. qualifying noncumulative perpetual preferred stock, including related surplus, and senior perpetual preferred stock issued to the United States Department of the Treasury (Treasury) under the Troubled Asset Relief Program (TARP), established by the Emergency Economic Stabilization Act of 2008 (EESA), Division A of Public Law 110-343 (which for purposes of this appendix shall be considered qualifying noncumulative perpetual preferred stock), including related surplus;

iii. minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (class A minority interest); and

iv. restricted core capital elements. The aggregate of these items is limited within tier 1 capital as set forth in section II.A.1.b. of this appendix. These elements are defined to include—

(1) qualifying cumulative perpetual preferred stock (including related surplus);

(2) minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (class B minority interest);

(3) minority interest related to qualifying common stockholders' equity or perpetual preferred stock issued by a consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank (class C minority interest);

(4) qualifying trust preferred securities; and

(5) subordinated debentures issued prior to October 4, 2010, to the Treasury under the TARP (TARP Subordinated Securities) established by the EESA by a bank holding company that has made a valid election to be taxed under

Subchapter S of Chapter 1 of the U.S. Internal Revenue Code (S-Corp BHC) or by a bank holding company organized in mutual form (Mutual BHC).

b. *Limits on restricted core capital elements.*

i. *Limits.*

(1) The aggregate amount of restricted core capital elements that may be included in the tier 1 capital of a banking organization must not exceed 25 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Stated differently, the aggregate amount of restricted core capital elements is limited to one-third of the sum of core capital elements, excluding restricted core capital elements, net of goodwill less any associated deferred tax liability. Notwithstanding the foregoing, the full amount of TARP Subordinated Securities issued by an S-Corp BHC or Mutual BHC may be included in its tier 1 capital, provided that the banking organization must include the TARP Subordinated Securities in restricted core capital elements for the purposes of determining the aggregate amount of other restricted core capital elements that may be included in tier 1 capital in accordance with this section.

(2) In addition, the aggregate amount of restricted core capital elements (other than qualifying mandatory convertible preferred securities[5]) that may be included in the tier 1 capital of an internationally active banking organization[6] must not exceed 15 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability.

(3) Amounts of restricted core capital elements in excess of this limit generally may be included in tier 2 capital. The excess amounts of restricted core capital elements that are in the form of class C minority interest and qualifying trust preferred securities are subject to further limitation within tier 2 capital in accordance with section II.A.2.d.iv. of this appendix. A banking organization may attribute excess amounts of restricted core capital elements first to any qualifying cumulative perpetual preferred stock or to class B minority interest, and second to qualifying trust preferred securities or to class C minority interest, which are subject to a tier 2 sublimit.

ii. *Transition.*

(1) The quantitative limits for restricted core capital elements set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix become effective on March 31, 2011. Prior to that time, a banking organization with restricted core capital elements in amounts that cause it to exceed these limits must consult with the Federal Reserve on a plan for ensuring that the banking organization is not unduly relying on these elements in its capital base and, where appropriate, for reducing such reliance to ensure that the organization complies with these limits as of March 31, 2011.

(2) Until March 31, 2011, the aggregate amount of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities that a banking organization may include in tier 1 capital is

[5] Qualifying mandatory convertible preferred securities generally consist of the joint issuance by a bank holding company to investors of trust preferred securities and a forward-purchase contract, which the investors fully collateralize with the securities, that obligates the investors to purchase a fixed amount of the bank holding company's common stock, generally in three years. A bank holding company wishing to issue mandatorily convertible preferred securities and include them in tier 1 capital must consult with the Federal Reserve prior to issuance to ensure that the securities' terms are consistent with tier 1 capital treatment.

[6] For this purpose, an internationally active banking organization is a banking organization that (1) as of its most recent year-end FR Y-9C reports total consolidated assets equal to $250 billion or more or (2) on a consolidated basis, reports total on-balance-sheet foreign exposure of $10 billion or more on its filings of the most recent year-end FFIEC 009 Country Exposure Report.

limited to 25 percent of the sum of the following core capital elements: qualifying common stockholders' equity, qualifying noncumulative and cumulative perpetual preferred stock (including related surplus), qualifying minority interest in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities. Amounts of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities in excess of this limit may be included in tier 2 capital.

(3) Until March 31, 2011, internationally active banking organizations generally are expected to limit the amount of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities included in tier 1 capital to 15 percent of the sum of core capital elements set forth in section II.A.1.b.ii.2. of this appendix.

c. *Definitions and requirements for core capital elements.*

i. *Qualifying common stockholders' equity.*

(1) *Definition.* Qualifying common stockholders' equity is limited to common stock; related surplus; and retained earnings, including capital reserves and adjustments for the cumulative effect of foreign-currency translation, net of any treasury stock, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values. For this purpose, net unrealized holding gains on such equity securities and net unrealized holding gains (losses) on available-for-sale debt securities are not included in qualifying common stockholders' equity.

(2) *Restrictions on terms and features.* A capital instrument that has a stated maturity date or that has a preference with regard to liquidation or the payment of dividends is not deemed to be a component of qualifying common stockholders' equity, regardless of whether or not it is called common equity. Terms or features that grant other preferences also may call into question whether the capital instrument would be deemed to be qualifying common stockholders' equity. Features that require, or provide significant incentives for, the issuer to redeem the instrument for cash or cash equivalents will render the instrument ineligible as a component of qualifying common stockholders' equity.

(3) *Reliance on voting common stockholders' equity.* Although section II.A.1. of this appendix allows for the inclusion of elements other than common stockholders' equity within tier 1 capital, voting common stockholders' equity, which is the most desirable capital element from a supervisory standpoint, generally should be the dominant element within tier 1 capital. Thus, banking organizations should avoid overreliance on preferred stock and nonvoting elements within tier 1 capital. Such nonvoting elements can include portions of common stockholders' equity where, for example, a banking organization has a class of nonvoting common equity, or a class of voting common equity that has substantially fewer voting rights per share than another class of voting common equity. Where a banking organization relies excessively on nonvoting elements within tier 1 capital, the Federal Reserve generally will require the banking organization to allocate a portion of the nonvoting elements to tier 2 capital.

ii. *Qualifying perpetual preferred stock.*

(1) *Qualifying requirements.* Perpetual preferred stock qualifying for inclusion in tier 1 capital has no maturity date and cannot be redeemed at the option of the holder. Perpetual preferred stock will qualify for inclusion in tier 1 capital only if it can absorb losses while the issuer operates as a going concern.

(2) *Restrictions on terms and features.* Perpetual preferred stock included in tier 1 capital may not have any provisions restricting the banking organiza-

tion's ability or legal right to defer or waive dividends, other than provisions requiring prior or concurrent deferral or waiver of payments on more-junior instruments, which the Federal Reserve generally expects in such instruments consistent with the notion that the most-junior capital elements should absorb losses first. Dividend deferrals or waivers for preferred stock, which the Federal Reserve expects will occur either voluntarily or at its direction when an organization is in a weakened condition, must not be subject to arrangements that would diminish the ability of the deferral to shore up the banking organization's resources. Any perpetual preferred stock with a feature permit ting redemption at the option of the issuer may qualify as tier 1 capital only if the redemption is subject to prior approval of the Federal Reserve. Features that require, or create significant incentives for the issuer to redeem the instrument for cash or cash equivalents will render the instrument ineligible for inclusion in tier 1 capital. For example, perpetual preferred stock that has a credit-sensitive dividend feature—that is, a dividend rate that is reset periodically based, in whole or in part, on the banking organization's current credit standing—generally does not qualify for inclusion in tier 1 capital.[7] Similarly, perpetual preferred stock that has a dividend-rate step-up or a market-value conversion feature—that is, a feature whereby the holder must or can convert the preferred stock into common stock at the market price prevailing at the time of conversion—generally does not qualify for inclusion in tier 1 capital.[8]

(3) *Noncumulative and cumulative features.* Perpetual preferred stock that is noncumulative generally may not permit the accumulation or payment of unpaid dividends in any form, including in the form of common stock. Perpetual preferred stock that provides for the accumulation or future payment of unpaid dividends is deemed to be cumulative, regardless of whether or not it is called noncumulative.

iii. *Qualifying minority interest.* Minority interest in the common and preferred stockholders' equity accounts of a consolidated subsidiary (minority interest) represents stockholders' equity associated with common or preferred equity instruments issued by a banking organization's consolidated subsidiary that are held by investors other than the banking organization. Minority interest is included in tier 1 capital because, as a general rule, it represents equity that is freely available to absorb losses in the issuing subsidiary. Nonetheless, minority interest typically is not available to absorb losses in the banking organization as a whole, a feature that is a particular concern when the minority interest is issued by a subsidiary that is neither a U.S. depository institution nor a foreign bank. For this reason, this appendix distinguishes among three types of qualifying minority interest. Class A minority interest is minority interest related to qualifying common and noncumulative perpetual preferred equity instruments issued directly (that is, not through a subsidiary) by a consolidated U.S. depository institution[9] or foreign

[7] Traditional floating-rate or adjustable-rate perpetual preferred stock (that is, perpetual preferred stock in which the dividend rate is not affected by the issuer's credit standing or financial condition but is adjusted periodically in relation to an independent index based solely on general market interest rates), however, generally qualifies for inclusion in tier 1 capital provided all other requirements are met.

[8] Notwithstanding this provision, senior perpetual preferred stock issued to the Treasury under the TARP, established by the EESA, may be included in tier 1 capital. In addition, traditional convertible perpetual preferred stock, which the holder must or can convert into a fixed number of common shares at a preset price, generally qualifies for inclusion in tier 1 capital provided all other requirements are met.

[9] U.S. depository institutions are defined to include branches (foreign and domestic) of federally insured banksand depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, and international banking facilities of domestic banks.

Continued

bank[10] subsidiary of a banking organization. Class A minority interest is not subject to a formal limitation within tier 1 capital. Class B minority interest is minority interest related to qualifying cumulative perpetual preferred equity instruments issued directly by a consolidated U.S. depository institution or foreign bank subsidiary of a banking organization. Class B minority interest is a restricted core capital element subject to the limitations set forth in section II.A.1.b.i. of this appendix, but is not subject to a tier 2 sublimit. Class C minority interest is minority interest related to qualifying common or perpetual preferred stock issued by a banking organization's consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank. Class C minority interest is eligible for inclusion in tier 1 capital as a restricted core capital element and is subject to the limitations set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix. Minority interest in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix), and subsidiaries engaged in nonfinancial activities are not included in the banking organization's tier 1 or total capital if the banking organization's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. of this appendix.

iv. *Qualifying trust preferred securities.*

(1) A banking organization that wishes to issue trust preferred securities and include them in tier 1 capital must first consult with the Federal Reserve. Trust preferred securities are defined as undated preferred securities issued by a trust or similar entity sponsored (but generally not consolidated) by a banking organization that is the sole common equity holder of the trust. Qualifying trust preferred securities must allow for dividends to be deferred for at least 20 consecutive quarters without an event of default, unless an event of default leading to acceleration permitted under section II.A.1.c.iv.(2) has occurred. The required notification period for such deferral must be reasonably short, no more than 15 business days prior to the payment date. Qualifying trust preferred securities are otherwise subject to the same restrictions on terms and features as qualifying perpetual preferred stock under section II.A.1.c.ii.(2) of this appendix.

(2) The sole asset of the trust must be a junior subordinated note issued by the sponsoring banking organization that has a minimum maturity of 30 years, is subordinated with regard to both liquidation and priority of periodic payments to all senior and subordinated debt of the sponsoring banking organization (other than other junior subordinated notes underlying trust preferred securities). Otherwise the terms of a junior subordinated note must mirror those of the preferred securities issued by the trust.[11] The note must comply with section II.A.2.d. of this appendix and the Federal Re-

[10] For this purpose, a foreign bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

[11] Under generally accepted accounting principles, the trust issuing the preferred securities generally is not consolidated on the banking organization's balance sheet; rather the underlying subordinated note is recorded as a liability on the organization's balance sheet. Only the amount of the trust preferred securities issued, which generally is equal to the amount of the underlying subordinated note less the amount of the sponsoring banking organization's common equity investment in the trust (which is recorded as an asset on the banking organization's consolidated balance sheet), may be included in tier 1 capital. Because this calculation method effectively deducts the banking organization's common stock investment in the trust in computing the numerator of the capital ratio, the common equity investment in the trust should be excluded from the calculation of risk-weighted assets in accordance with footnote 17 of this appendix. Where a banking organization has issued trust preferred securities as part of a pooled issuance, the organization generally must not buy back a security issued from the pool. Where a banking organization does hold such a security (for example, as a result of an acquisition of another banking organization), the amount of the trust preferred securities includable in regulatory capital must, consistent with section II.(i) of this appendix, be reduced by the notional amount of the banking organization's investment in the security issued by the pooling entity.

serve's subordinated debt policy statement set forth in 12 CFR 250.166[12] except that the note may provide for an event of default and the acceleration of principal and accrued interest upon (a) nonpayment of interest for 20 or more consecutive quarters or (b) termination of the trust without redemption of the trust preferred securities, distribution of the notes to investors, or assumption of the obligation by a successor to the banking organization.

(3) In the last five years before the maturity of the note, the outstanding amount of the associated trust preferred securities is excluded from tier 1 capital and included in tier 2 capital, where the trust preferred securities are subject to the amortization provisions and quantitative restrictions set forth in sections II.A.2.d.iii. and iv. of this appendix as if the trust preferred securities were limited-life preferred stock.

2. *Supplementary capital elements (tier 2 capital elements).* The tier 2 component of an institution's qualifying capital may consist of the following items that are defined as supplementary capital elements:

i. allowance for loan and lease losses (subject to limitations discussed below)
ii. perpetual preferred stock and related surplus (subject to conditions discussed below)
iii. hybrid capital instruments (as defined below), perpetual debt, and mandatory convertible debt securities
iv. term subordinated debt and intermediate-term preferred stock, including related surplus (subject to limitations discussed below)
v. unrealized holding gains on equity securities (subject to limitations discussed in section II.A.2.e. of this appendix.

The maximum amount of tier 2 capital that may be included in an institution's qualifying total capital is limited to 100 percent of tier 1 capital (net of goodwill, other intangible assets, interest-only strips receivables, and nonfinancial equity investments that are required to be deducted in accordance with section II.B. of this appendix A).

The elements of supplementary capital are discussed in greater detail below.

a. *Allowance for loan and lease losses.* Allowances for loan and lease losses are reserves that have been established through a charge against earnings to absorb future losses on loans or lease-financing receivables. Allowances for loan and lease losses exclude ''allocated transfer-risk reserves,''[13] and reserves created against identified losses.

During the transition period, the risk-based capital guidelines provide for reducing the amount of this allowance that may be included in an institution's total capital. Initially, it is unlimited. However, by year-end 1990, the amount of the allowance for loan and lease losses that will qualify as capital will be limited to 1.5 percent of an institution's weighted-risk assets. By the end of the transition period, the amount of the allowance qualifying for inclusion in tier 2 capital may not exceed 1.25 percent of weighted-risk assets.[14]

b. *Perpetual preferred stock.* Perpetual preferred stock (and related surplus) that meets the requirements set forth in section

[12] Trust preferred securities issued before April 15, 2005, generally would be includable in tier 1 capital despite noncompliance with sections II.A.1.c.iv. or II.A.2.d. of this appendix or 12 CFR 250.166 provided the noncomplying terms of the instrument (i) have been commonly used by banking organizations, (ii) do not provide an unreasonably high degree of protection to the holder in circumstances other than bankruptcy of the banking organization, and (iii) do not effectively allow a holder in due course of the note to stand ahead of senior or subordinated debt holders in the event of bankruptcy of the banking organization.

[13] Allocated transfer-risk reserves are reserves that have been established in accordance with section 905(a) of the International Lending Supervision Act of 1983, 12 U.S.C. 3904(a), against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer-risk problems.

[14] The amount of the allowance for loan and lease losses that may be included in tier 2 capital is based on a percentage of gross weighted-risk assets. A banking organization may deduct reserves for loan and lease losses in excess of the amount permitted to be included in tier 2 capital, as well as allocated transfer-risk reserves, from the sum of gross weighted-risk assets and use the resulting net sum of weighted-risk assets in computing the denominator of the risk-based capital ratio.

II.A.1.c.ii.(1) of this appendix is eligible for inclusion in tier 2 capital without limit.[15]

c. *Hybrid capital instruments, perpetual debt, and mandatory convertible debt securities.* Hybrid capital instruments include instruments that are essentially permanent in nature and that have certain characteristics of both equity and debt. Such instruments may be included in tier 2 without limit. The general criteria hybrid capital instruments must meet in order to qualify for inclusion in tier 2 capital are listed below:

1. The instrument must be unsecured; fully paid up; and subordinated to general creditors. If issued by a bank, it must also be subordinated to claims of depositors.
2. The instrument must not be redeemable at the option of the holder prior to maturity, except with the prior approval of the Federal Reserve. (Consistent with the Board's criteria for perpetual debt and mandatory convertible securities, this requirement implies that holders of such instruments may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.)
3. The instrument must be available to participate in losses while the issuer is operating as a going concern. (Term subordinated debt would not meet this requirement.) To satisfy this requirement, the instrument must convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.
4. The instrument must provide the option for the issuer to defer interest payments if (a) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters) *and* (b) the issuer eliminates cash dividends on common and preferred stock.

Perpetual debt and mandatory convertible debt securities that meet the criteria set forth in 12 CFR 225, appendix B, also qualify as unlimited elements of tier 2 capital for bank holdingcompanies.

d. *Subordinated debt and intermediate-term preferred stock.*

i. *Five-year minimum maturity.* Subordinated debt and intermediate-term preferred stock must have an original weighted average maturity of at least five years to qualify as tier 2 capital. If the holder has the option to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing banking organization.

ii. *Other restrictions on subordinated debt.* Subordinated debt included in tier 2 capital must comply with the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166.[16] Accordingly, such subordinated debt must meet the following requirements:

(1) The subordinated debt must be unsecured.
(2) The subordinated debt must clearly state on its face that it is not a deposit and is not insured by a federal agency.
(3) The subordinated debt must not have

[15] Long-term preferred stock with an original maturity of 20 years or more (including related surplus) will also qualify in this category as an element of tier 2. If the holder of such an instrument has a right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined for risk-based capital purposes as the earliest possible date on which the holder can put the instrument back to the issuing banking organization. In the last five years before the maturity of the stock, it must be treated as limited-life preferred stock, subject to the amortization provisions and quantitative restrictions set forth in sections II.A.2.d.iii. and iv. of this appendix.

[16] The subordinated debt policy statement set forth in 12 CFR 250.166 notes that certain terms found in subordinated debt may provide protection to investors without adversely affecting the overall benefits of the instrument to the issuing banking organization and, thus, would be acceptable for subordinated debt included in capital. For example, a provision that prohibits a bank holding company from merging, consolidating, or selling substantially all of its assets unless the new entity redeems or assumes the subordinated debt or that designates the failure to pay principal and interest on a timely basis as an event of default would be acceptable, so long as the occurrence of such events does not allow the debt holders to accelerate the payment of principal or interest on the debt.

credit-sensitive features or other provisions that are inconsistent with safe and sound banking practice.

(4) Subordinated debt issued by a subsidiary U.S. depository institution or foreign bank of a bank holding company must be subordinated in right of payment to the claims of all the institution's general creditors and depositors, and generally must not contain provisions permitting debt holders to accelerate payment of principal or interest upon the occurrence of any event other than receivership of the institution. Subordinated debt issued by a bank holding company or its subsidiaries that are neither U.S. depository institutions nor foreign banks must be subordinated to all senior indebtedness of the issuer; that is, the debt must be subordinated at a minimum to all borrowed money, similar obligations arising from off-balance-sheet guarantees and direct-credit substitutes, and obligations associated with derivative products such as interest rate and foreign-exchange contracts, commodity contracts, and similar arrangements. Subordinated debt issued by a bank holding company or any of its subsidiaries that is not a U.S. depository institution or foreign bank must not contain provisions permitting debt holders to accelerate the payment of principal or interest upon the occurrence of any event other than the bankruptcy of the bank holding company or the receivership of a major subsidiary depository institution. Thus, a provision permitting acceleration in the event that any other affiliate of the bank holding company issuer enters into bankruptcy or receivership makes the instrument ineligible for inclusion in tier 2 capital.

iii. *Discounting in last five years.* As a limited-life capital instrument approaches maturity, it begins to take on characteristics of a short-term obligation. For this reason, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in tier 2 capital is reduced, or discounted, as these instruments approach maturity: one-fifth of the outstanding amount is excluded each year during the instrument's last five years before maturity. When remaining maturity is less than one year, the instrument is excluded from tier 2 capital.

iv. *Limits.* The aggregate amount of term subordinated debt (excluding mandatory convertible debt) and limited-life preferred stock as well as, beginning March 31, 2011, qualifying trust preferred securities and class C minority interest in excess of the limits set forth in section II.A.1.b.i. of this appendix that may be included in tier 2 capital is limited to 50 percent of tier 1 capital (net of goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix). Amounts of these instruments in excess of this limit, although not included in tier 2 capital, will be taken into account by the Federal Reserve in its overall assessment of a banking organization's funding and financial condition.

e. *Unrealized gains on equity securities and unrealized gains (losses) on other assets.* Up to 45 percent of pretax net unrealized holding gains (that is, the excess, if any, of the fair value over historical cost) on available-for-sale equity securities with readily determinable fair values may be included in supplementary capital. However, the Federal Reserve may exclude all or a portion of these unrealized gains from tier 2 capital if the Federal Reserve determines that the equity securities are not prudently valued. Unrealized gains (losses) on other types of assets, such as bank premises and available-for-sale debt securities, are not included in supplementary capital, but the Federal Reserve may take these unrealized gains (losses) into account as additional factors when assessing an institution's overall capital adequacy.

f. *Revaluation reserves.*

i. Such reserves reflect the formal balance-sheet restatement or revaluation

for capital purposes of asset carrying values to reflect current market values. The Federal Reserve generally has not included unrealized asset appreciation in capital-ratio calculations, although it has long taken such values into account as a separate factor in assessing the overall financial strength of a banking organization.

ii. Consistent with long-standing supervisory practice, the excess of market values over book values for assets held by bank holding companies will generally not be recognized in supplementary capital or in the calculation of the risk-based capital ratio. However, all bank holding companies are encouraged to disclose their equivalent of premises (building) and security revaluation reserves. The Federal Reserve will consider any appreciation, as well as depreciation, in specific asset values as additional considerations in assessing overall capital strength and financial condition.

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B. Deductions from Capital and Other Adjustments

Certain assets are deducted from an organization's capital for the purpose of calculating the risk-based capital ratio.[17] These assets include:

i. a. Goodwill—deducted from the sum of core capital elements
   b. Certain identifiable intangible assets, that is, intangible assets other than goodwill—deducted from the sum of core capital elements in accordance with section II.B.1.b. of this appendix
   c. Certain credit-enhancing interest-only strips receivables—deducted from the sum of core capital elements in accordance with sections II.B.1.c. through e. of this appendix

ii. Investments in banking and finance subsidiaries that are not consolidated for accounting or supervisory purposes, and investments in other designated subsidiaries or associated companies at the discretion of the Federal Reserve—deducted from total capital components (as described in greater detail below)

iii. Reciprocal holdings of capital instruments of banking organizations—deducted from total capital components

iv. Deferred tax assets—portions are deducted from the sum of core capital elements in accordance with section II.B.4. of this appendix A

v. Nonfinancial equity investments—portions are deducted from the sum of core capital elements in accordance with section II.B.5. of this appendix A

1. *Goodwill, other intangible assets, and residual interests.*

a. *Goodwill.* Goodwill is an intangible asset that represents the excess of the purchase price over the fair market value of identifiable assets acquired less liabilities assumed in acquisitions accounted for under the purchase method of accounting. Any goodwill carried on the balance sheet of a bank holding company after December 31, 1992, will be deducted from the sum of core capital elements in determining tier 1 capital for ratio-calculation purposes. Any goodwill in existence before March 12, 1988, is grandfathered during the transition period and is not deducted from core capital elements until after December 31, 1992. However, bank holding company goodwill acquired as a result of a merger or acquisition that was consummated on or after March 12, 1988, is deducted immediately.

b. *Other intangible assets.*

i. All servicing assets, including servicing assets on assets other than mortgages (i.e., nonmortgage-servicing assets) are included in this appendix as identifiable intangible assets. The only types of identifiable intangible assets that may be included in, that is, not deducted from, an organization's capital are readily marketable mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships. The total amount of these assets that may be included in capital is subject to the limita-

[17] Any assets deducted from capital in computing the numerator of the ratio are not included in weighted-risk assets in computing the denominator of the ratio.

tions described below in sections II.B.1.d. and e. of this appendix.

c. *Credit-enhancing interest-only strips receivables (I/Os).*

i. Credit-enhancing I/Os are on-balance-sheet assets that, in form or in substance, represent a contractual right to receive some or all of the interest due on transferred assets and expose the bank holding company to credit risk directly or indirectly associated with transferred assets that exceeds a pro rata share of the bank holding company's claim on the assets, whether through subordination provisions or other credit-enhancement techniques. Such I/Os, whether purchased or retained, including other similar ''spread'' assets, may be included in, that is, not deducted from, a bank holding company's capital subject to the limitations described below in sections II.B.1.d. and e. of this appendix.

ii. Both purchased and retained credit-enhancing I/Os, on a non-tax-adjusted basis, are included in the total amount that is used for purposes of determining whether a bank holding company exceeds the tier 1 limitation described below in this section. In determining whether an I/O or other types of spread assets serve as a credit enhancement, the Federal Reserve will look to the economic substance of the transaction.

d. *Fair-value limitation.* The amount of mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships that a bank holding company may include in capital shall be the lesser of 90 percent of their fair value, as determined in accordance with section II.B.1.f. of this appendix, or 100 percent of their book value, as adjusted for capital purposes in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C Report). The amount of credit-enhancing I/Os that a bank holding company may include in capital shall be its fair value. If both the application of the limits on mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships and the adjustment of the balance-sheet amount for these assets would result in an amount being deducted from capital, the bank holding company would deduct only the greater of the two amounts from its core capital elements in determining tier 1 capital.

e. *Tier 1 capital limitation.*

i. The total amount of mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships that may be included in capital, in the aggregate, cannot exceed 100 percent of tier 1 capital. Nonmortgage-servicing assets and purchased credit-card relationships are subject, in the aggregate, to a separate sublimit of 25 percent of tier 1 capital. In addition, the total amount of credit-enhancing I/Os (both purchased and retained) that may be included in capital cannot exceed 25 percent of tier 1 capital.[18]

ii. For purposes of calculating these limitations on mortgage-servicing assets, nonmortgage-servicing assets, purchased credit-card relationships, and credit-enhancing I/Os, tier 1 capital is defined as the sum of core capital elements, net of goodwill, and net of all identifiable intangible assets other than mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships, prior to the deduction of any disallowed mortgage-servicing assets, any disallowed nonmortgage-servicing assets, any disallowed purchased credit-card relationships, any disallowed credit-enhancing I/Os (both purchased and retained), any disallowed deferred tax assets, and any nonfinancial equity investments.

iii. Bank holding companies may elect to deduct disallowed mortgage-servicing assets, disallowed nonmortgage-servicing

[18] Amounts of servicing assets, purchased credit-card relationships, and credit-enhancing I/Os (both retained and purchased) in excess of these limitations, as well as all other identifiable intangible assets, including core deposit intangibles and favorable leaseholds, are to be deducted from a bank holding company's core capital elements in determining tier 1 capital. However, identifiable intangible assets (other than mortgage-servicing assets and purchased credit-card relationships) acquired on or before February 19, 1992, generally will not be deducted from capital for supervisory purposes, although they will continue to be deducted for applications purposes.

assets, and disallowed credit-enhancing I/Os (both purchased and retained) on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income.

f. *Valuation.* Bank holding companies must review the book value of all intangible assets at least quarterly and make adjustments to these values as necessary. The fair value of mortgage-servicing assets, nonmortgage-servicing assets, purchased credit-card relationships, and credit-enhancing I/Os also must be determined at least quarterly. This determination shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or account-attrition rates. Examiners will review both the book value and the fair value assigned to these assets, together with supporting documentation, during the inspection process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of a bank holding company's intangible assets or credit-enhancing I/Os.

g. *Growing organizations.* Consistent with long-standing Board policy, banking organizations experiencing substantial growth, whether internally or by acquisition, are expected to maintain strong capital positions substantially above minimum supervisory levels, without significant reliance on intangible assets or credit-enhancing I/Os.

2. *Investments in certain subsidiaries.*

a. *Unconsolidated banking or finance subsidiaries.* The aggregate amount of investments in banking or finance subsidiaries[19] whose financial statements are not consolidated for accounting or regulatory reporting purposes, regardless of whether the investment is made by the parent bank holding company or its direct or indirect subsidiaries, will be deducted from the consolidated parent banking organization's total capital components.[20] Generally, investments for this purpose are defined as equity and debt capital investments and any other instruments that are deemed to be capital in the particular subsidiary.

Advances (that is, loans, extensions of credit, guarantees, commitments, or any other forms of credit exposure) to the subsidiary that are not deemed to be capital will generally not be deducted from an organization's capital. Rather, such advances generally will be included in the parent banking organization's consolidated assets and be assigned to the 100 percent risk category, unless such obligations are backed by recognized collateral or guarantees, in which case they will be assigned to the risk category appropriate to such collateral or guarantees. These advances may, however, also be deducted from the consolidated parent banking organization's capital if, in the judgment of the Federal Reserve, the risks stemming from such advances are comparable to the risks associated with capital investments or if the advances involve other risk factors that warrant such an adjustment to capital for supervisory purposes. These other factors could include, for example, the absence of collateral support.

Inasmuch as the assets of unconsolidated banking and finance subsidiaries are not fully reflected in a banking organization's consolidated total assets, such assets may be viewed as the equivalent of off-balance-sheet exposures since the operations of an unconsolidated subsidiary could expose the parent organization and its affiliates to considerable risk. For this reason, it is generally appropriate to view the capital resources invested in these unconsolidated entities as primarily supporting the risks inherent in these off-balance-sheet assets, and

[19] For this purpose, a banking and finance subsidiary generally is defined as any company engaged in banking or finance in which the parent institution holds directly or indirectly more than 50 percent of the outstanding voting stock, or which is otherwise controlled or capable of being controlled by the parent institution. For purposes of this section, the definition of *banking and finance subsidiary* does not include a trust or other special-purpose entity used to issue trust preferred securities.

[20] An exception to this deduction would be made in the case of shares acquired in the regular course of securing or collecting a debt previously contracted in good faith. The requirements for consolidation are spelled out in the instructions to the FR Y-9C Report.

not generally available to support risks or absorb losses elsewhere in the organization.

b. *Other subsidiaries and investments.* The deduction of investments, regardless of whether they are made by the parent bank holding company or by its direct or indirect subsidiaries, from a consolidated banking organization's capital will also be applied in the case of any subsidiaries, that, while consolidated for accounting purposes, are not consolidated for certain specified supervisory or regulatory purposes, such as to facilitate functional regulation. For this purpose, aggregate capital investments (that is, the sum of any equity or debt instruments that are deemed to be capital) in these subsidiaries will be deducted from the consolidated parent banking organization's total capital components.[21]

Advances (that is, loans, extensions of credit, guarantees, commitments, or any other forms of credit exposure) to such subsidiaries that are not deemed to be capital will generally not be deducted from capital. Rather, such advances will normally be included in the parent banking organization's consolidated assets and assigned to the 100 percent risk category, unless such obligations are backed by recognized collateral or guarantees, in which case they will be assigned to the risk category appropriate to such collateral or guarantees. These advances may, however, be deducted from the consolidated parent banking organization's capital if, in the judgment of the Federal Reserve, the risks stemming from such advances are comparable to the risks associated with capital investments or if such advances involve other risk factors that warrant such an adjustment to capital for supervisory purposes. These other factors could include, for example, the absence of collateral support.[22]

In general, when investments in a consolidated subsidiary are deducted from a consolidated parent banking organization's capital, the subsidiary's assets will also be excluded from the consolidated assets of the parent banking organization in order to assess the latter's capital adequacy.[23]

The Federal Reserve may also deduct from a banking organization's capital, on a case-by-case basis, investments in certain other subsidiaries in order to determine if the consolidated banking organization meets minimum supervisory capital requirements without reliance on the resources invested in such subsidiaries.

The Federal Reserve will not automatically deduct investments in other unconsolidated subsidiaries or investments in joint ventures and associated companies.[24] Nonetheless, the resources invested in these entities, like investments in unconsolidated banking and finance subsidiaries, support assets not consolidated with the rest of the banking organization's activities and, therefore, may not be generally available to support additional leverage or absorb losses elsewhere in the banking organization. Moreover, experience has shown that banking organizations stand behind the losses of affiliated institutions, such as joint ventures and associated companies, in order to protect the reputation of the organization as a whole. In some cases, this has led to losses that have exceeded the investments in such organizations.

For this reason, the Federal Reserve will

[21] Investments in unconsolidated subsidiaries will be deducted from both tier 1 and tier 2 capital. As a general rule, one-half (50 percent) of the aggregate amount of capital investments will be deducted from the bank holding company's tier 1 capital and one-half (50 percent) from its tier 2 capital. However, the Federal Reserve may, on a case-by-case basis, deduct a proportionately greater amount from tier 1 if the risks associated with the subsidiary so warrant. If the amount deductible from tier 2 capital exceeds actual tier 2 capital, the excess would be deducted from tier 1 capital. Bank holding companies' risk-based capital ratios, net of these deductions, must exceed the minimum standards set forth in section IV.

[22] In assessing the overall capital adequacy of a banking organization, the Federal Reserve may also consider the organization's fully consolidated capital position.

[23] If the subsidiary's assets are consolidated with the parent banking organization for financial-reporting purposes, this adjustment will involve excluding the subsidiary's assets on a line-by-line basis from the consolidated parent organization's assets. The parent banking organization's capital ratio will then be calculated on a consolidated basis with the exception that the assets of the excluded subsidiary will not be consolidated with the remainder of the parent banking organization.

[24] The definition of such entities is contained in the instructions to the Consolidated Financial Statements for Bank Holding Companies. Under regulatory-reporting procedures, associated companies and joint ventures generally are defined as companies in which the banking organization owns 20 to 50 percent of the voting stock.

monitor the level and nature of such investments for individual banking organizations and may, on a case-by-case basis, deduct such investments from total capital components, apply an appropriate risk-weighted capital charge against the organization's proportionate share of the assets of its associated companies, require a line-by-line consolidation of the entity (in the event that the parent's control over the entity makes it the functional equivalent of a subsidiary), or otherwise require the organization to operate with a risk-based capital ratio above the minimum.

In considering the appropriateness of such adjustments or actions, the Federal Reserve will generally take into account whether—

1. the parent banking organization has significant influence over the financial or managerial policies or operations of the subsidiary, joint venture, or associated company;
2. the banking organization is the largest investor in the affiliated company; or
3. other circumstances prevail that appear to closely tie the activities of the affiliated company to the parent banking organization.

3. *Reciprocal holdings of banking organizations' capital instruments.* Reciprocal holdings of banking organizations' capital instruments (that is, instruments that qualify as tier 1 or tier 2 capital) will be deducted from an organization's total capital components for the purpose of determining the numerator of the risk-based capital ratio.

Reciprocal holdings are cross-holdings resulting from formal or informal arrangements in which two or more banking organizations swap, exchange, or otherwise agree to hold each other's capital instruments. Generally, deductions will be limited to intentional cross-holdings. At present, the Board does not intend to require banking organizations to deduct nonreciprocal holdings of such capital instruments.[25]

4. *Deferred tax assets.*

a. The amount of deferred tax assets that is dependent upon future taxable income, net of the valuation allowance for deferred tax assets, that may be included in, that is, not deducted from, a bank holding company's capital may not exceed the lesser of—

i. the amount of these deferred tax assets that the bank holding company is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year,[26] or
ii. 10 percent of tier 1 capital.

b. The reported amount of deferred tax assets, net of any valuation allowance for deferred tax assets, in excess of the lesser of these two amounts is to be deducted from a banking organization's core capital elements in determining tier 1 capital. For purposes of calculating the 10 percent limitation, tier 1 capital is defined as the sum of core capital elements, net of goodwill and net of all identifiable intangible assets other than mortgage-servicing assets, nonmortgage-servicing assets, and purchased credit-card relationships, but prior to the deduction of any disallowed mortgage-servicing assets, any disallowed nonmortgage-servicing assets, any disallowed purchased credit-card

[25] Deductions of holdings of capital securities also would not be made in the case of interstate ''stake out'' invest

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ments that comply with the Board's policy statement on nonvoting equity investments, 12 CFR 225.143 (at 4–172.1). In addition, holdings of capital instruments issued by other banking organizations but taken in satisfaction of debts previously contracted would be exempt from any deduction from capital. The Board intends to monitor nonreciprocal holdings of other banking organizations' capital instruments and to provide information on such holdings to the Basle Supervisors' Committee as called for under the Basle capital framework.

[26] To determine the amount of expected deferred tax assets realizable in the next 12 months, an institution should assume that all existing temporary differences fully reverse as of the report date. Projected future taxable income should not include net operating loss carry-forwards to be used during that year or the amount of existing temporary differences a bank holding company expects to reverse within the year. Such projections should include the estimated effect of tax-planning strategies that the organization expects to implement to realize net operating losses or tax-credit carry-forwards that would otherwise expire during the year. Institutions do not have to prepare a new 12-month projection each quarter. Rather, on interim report dates, institutions may use the future-taxable-income projections for their current fiscal year, adjusted for any significant changes that have occurred or are expected to occur.

relationships, any disallowed credit-enhancing I/Os, any disallowed deferred tax assets, and any nonfinancial equity investments. There generally is no limit in tier 1 capital on the amount of deferred tax assets that can be realized from taxes paid in prior carry-back years or from future reversals of existing taxable temporary differences.

5. *Nonfinancial equity investments.*

a. *General.* A bank holding company must deduct from its core capital elements the sum of the appropriate percentages (as determined below) of the adjusted carrying value of all nonfinancial equity investments held by the parent bank holding company or by its direct or indirect subsidiaries. For purposes of this section II.B.5, investments held by a bank holding company include all investments held directly or indirectly by the bank holding company or any of its subsidiaries.

b. *Scope of nonfinancial equity investments.* A nonfinancial equity investment means any equity investment held by the bank holding company under the merchant banking authority of section 4(k)(4)(H) of the BHC Act and subpart J of the Board's Regulation Y (12 CFR 225.175 *et seq.*); under section 4(c)(6) or 4(c)(7) of BHC Act in a nonfinancial company or in a company that makes investments in nonfinancial companies; in a nonfinancial company through a small business investment company (SBIC) under section 302(b) of the Small Business Investment Act of 1958;[27] in a nonfinancial company under the portfolio investment provisions of the Board's Regulation K (12 CFR 211.8(c)(3)); or in a nonfinancial company under section 24 of the Federal Deposit Insurance Act (other than section 24(f)).[28] A nonfinancial company is an entity that engages in any activity that has not been determined to be financial in nature or incidental to financial activities under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1843(k)).

c. *Amount of deduction from core capital.*

i. The bank holding company must deduct from its core capital elements the sum of the appropriate percentages, as set forth in table 1, of the adjusted carrying value of all nonfinancial equity investments held by the bank holding company. The amount of the percentage deduction increases as the aggregate amount of nonfinancial equity investments held by the bank holding company increases as a percentage of the bank holding company's tier 1 capital.

Table 1—Deduction for Nonfinancial Equity Investments

Aggregate adjusted carrying value of all nonfinancial equity investments held directly or indirectly by the bank holding company (as a percentage of the tier 1 capital of the parent banking organization)[1]	*Deduction from core capital elements (as a percentage of the adjusted carrying value of the investment)*
Less than 15 percent	8 percent
15 percent to 24.99 percent	12 percent
25 percent and above	25 percent

[1] For purposes of calculating the adjusted carrying value of nonfinancial equity investments as a percentage of tier 1 capital, tier 1 capital is defined as the sum of core capital elements net of goodwill and net of all identifiable intangible assets other than mortgage-servicing assets, nonmortgage-servicing assets and purchased credit-card relationships, but prior to the deduction for any disallowed mortgage-servicing assets, any disallowed nonmortgage-servicing assets, any disallowed purchased credit-card relationships, any disallowed credit-enhancing I/Os (both purchased and retained), any disallowed deferred tax assets, and any nonfinancial equity investments.

ii. These deductions are applied on a marginal basis to the portions of the adjusted carrying value of nonfinancial eq-

[27] An equity investment made under section 302(b) of the Small Business Investment Act of 1958 in an SBIC that is not consolidated with the parent banking organization is treated as a nonfinancial equity investment.

[28] See 12 U.S.C. 1843(c)(6), (c)(7) and (k)(4)(H); 15 USC 682(b); 12 CFR 211.5(b)(1)(iii); and 12 U.S.C. 1831a. In a case in which the board of directors of the FDIC, acting directly in exceptional cases and after a review of the proposed activity, has permitted a lesser capital deduction for an investment approved by the board of directors under section 24 of the Federal Deposit Insurance Act, such deduction shall also apply to the consolidated bank holding company capital calculation so long as the bank's investments under section 24 and SBIC investments represent, in the aggregate, less than 15 percent of the tier 1 capital of the bank.

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uity investments that fall within the specified ranges of the parent holding company's tier 1 capital. For example, if the adjusted carrying value of all nonfinancial equity investments held by a bank holding company equals 20 percent of the tier 1 capital of the bank holding company, then the amount of the deduction would be 8 percent of the adjusted carrying value of all investments up to 15 percent of the company's tier 1 capital, and 12 percent of the adjusted carrying value of all investments in excess of 15 percent of the company's tier 1 capital.

iii. The total adjusted carrying value of any nonfinancial equity investment that is subject to deduction under this paragraph is excluded from the bank holding company's risk-weighted assets for purposes of computing the denominator of the company's risk-based capital ratio.[29]

iv. As noted in section I, this appendix establishes *minimum* risk-based capital ratios, and banking organizations are at all times expected to maintain capital commensurate with the level and nature of the risks to which they are exposed. The risk to a banking organization from nonfinancial equity investments increases with its concentration in such investments, and strong capital levels above the minimum requirements are particularly important when a banking organization has a high degree of concentration in nonfinancial equity investments (e.g., in excess of 50 percent of tier 1 capital). The Federal Reserve intends to monitor banking organizations and apply heightened supervision to equity investment activities as appropriate, including where the banking organization has a high degree of concentration in nonfinancial equity investments, to ensure that each organization maintains capital levels that are appropriate in light of its equity investment activities. The Federal Reserve also reserves authority to impose a higher capital charge in any case where the circumstances, such as the level of risk of the particular investment or portfolio of investments, the risk-management systems of the banking organization, or other information, indicate that a higher minimum capital requirement is appropriate.

d. *SBIC investments.*

i. No deduction is required for nonfinancial equity investments that are held by a bank holding company through one or more SBICs that are consolidated with the bank holding company or in one or more SBICs that are not consolidated with the bank holding company to the extent that all such investments, in the aggregate, do not exceed 15 percent of the aggregate of the bank holding company's pro rata interests in the tier 1 capital of its subsidiary banks. Any nonfinancial equity investment that is held through or in an SBIC and not required to be deducted from tier 1 capital under this section II.B.5.d. will be assigned a 100 percent risk weight and included in the parent holding company's consolidated risk-weighted assets.[30]

ii. To the extent the adjusted carrying value of all nonfinancial equity investments that a bank holding company holds through one or more SBICs that are consolidated with the bank holding company

[29] For example, if 8 percent of the adjusted carrying value of a nonfinancial equity investment is deducted from tier 1 capital, the entire adjusted carrying value of the investment will be excluded from risk-weighted assets in calculating the denominator for the risk-based capital ratio.

[30] If a bank holding company has an investment in an SBIC that is consolidated for accounting purposes but that is not wholly owned by the bank holding company, the adjusted carrying value of the bank holding company's nonfinancial equity investments through the SBIC is equal to the holding company's proportionate share of the adjusted carrying value of the SBIC's equity investments in nonfinancial companies. The remainder of the SBIC's adjusted carrying value (i.e. the minority interest holders' proportionate share) is excluded from the risk-weighted assets of the bank holding company. If a bank holding company has an investment in a SBIC that is not consolidated for accounting purposes and has current information that identifies the percentage of the SBIC's assets that are equity investments in nonfinancial companies, the bank holding company may reduce the adjusted carrying value of its investment in the SBIC proportionately to reflect the percentage of the adjusted carrying value of the SBIC's assets that are not equity investments in nonfinancial companies. If a bank holding company reduces the adjusted carrying value of its investment in a nonconsolidated SBIC to reflect financial investments of the SBIC, the amount of the adjustment will be risk weighted at 100 percent and included in the bank's risk-weighted assets.

or in one or more SBICs that are not consolidated with the bank holding company exceeds, in the aggregate, 15 percent of the aggregate tier 1 capital of the company's subsidiary banks, the appropriate percentage of such amounts (as set forth in table 1) must be deducted from the bank holding company's core capital elements. In addition, the aggregate adjusted carrying value of *all* nonfinancial equity investments held through a consolidated SBIC and in a nonconsolidated SBIC (including any investments for which no deduction is required) must be included in determining, for purposes of table 1, the total amount of nonfinancial equity investments held by the bank holding company in relation to its tier 1 capital.

e. *Transition provisions.* No deduction under this section II.B.5 is required to be made with respect to the adjusted carrying value of any nonfinancial equity investment (or portion of such an investment) that was made by the bank holding company prior to March 13, 2000, or that was made after such date pursuant to a binding written commitment[31] entered into by the bank holding company prior to March 13, 2000, provided that in either case the bank holding company has continuously held the investment since the relevant investment date.[32] For purposes of this section II.B.5.e., a nonfinancial equity investment made prior to March 13, 2000, includes any shares or other interests received by the bank holding company through a stock split or stock dividend on an investment made prior to March 13, 2000, provided the bank holding company provides no consideration for the shares or interests received and the transaction does not materially increase the bank holding company's proportional interest in the company. The exercise on or after March 13, 2000, of options or warrants acquired prior to March 13, 2000, is *not* considered to be an investment made prior to March 13, 2000, if the bank holding company provides any consideration for the shares or interests received upon exercise of the options or warrants. Any nonfinancial equity investment (or portion thereof) that is not required to be deducted from tier 1 capital under this section II.B.5.e. must be included in determining the total amount of nonfinancial equity investments held by the bank holding company in relation to its tier 1 capital for purposes of table 1. In addition, any nonfinancial equity investment (or portion thereof) that is not required to be deducted from tier 1 capital under this section II.B.5.e. will be assigned a 100 percent risk weight and included in the bank holding company's consolidated risk-weighted assets.

f. *Adjusted carrying value.*

i. For purposes of this section II.B.5., the ''adjusted carrying value'' of investments is the aggregate value at which the investments are carried on the balance sheet of the consolidated bank holding company reduced by any unrealized gains on those investments that are reflected in such carrying value but excluded from the bank holding company's tier 1 capital and associated deferred tax liabilities. For example, for investments held as available-for-sale (AFS), the adjusted carrying value of the investments would be

[31] A *binding written commitment* means a legally binding written agreement that requires the banking organization to acquire shares or other equity of the company, or make a capital contribution to the company, under terms and conditions set forth in the agreement. Options, warrants, and other agreements that give a banking organization the right to acquire equity or make an investment, but do not require the banking organization to take such actions, are not considered a binding written commitment for purposes of this section II.B.5.

[32] For example, if a bank holding company made an equity investment in 100 shares of a nonfinancial company prior to March 13, 2000, that investment would not be subject to a deduction under this section II.B.5. However, if the bank holding company made any additional equity investment in the company after March 13, 2000, such as by purchasing additional shares of the company (including through the exercise of options or warrants acquired before or after March 13, 2000) or by making a capital contribution to the company, and such investment was not made pursuant to a binding written commitment entered into before March 13, 2000, the adjusted carrying value of the additional investment would be subject to a deduction under this section II.B.5. In addition, if the bank holding company sold and repurchased shares of the company after March 13, 2000, the adjusted carrying value of the reacquired shares would be subject to a deduction under this section II.B.5.

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the aggregate carrying value of the investments (as reflected on the consolidated balance sheet of the bank holding company) *less* any unrealized gains on those investments that are included in other comprehensive income and not reflected in tier 1 capital, and associated deferred tax liabilities.[33]

ii. As discussed above with respect to consolidated SBICs, some equity investments may be in companies that are consolidated for accounting purposes. For investments in a nonfinancial company that is consolidated for accounting purposes under generally accepted accounting principles, the parent banking organization's adjusted carrying value of the investment is determined under the equity method of accounting (net of any intangibles associated with the investment that are deducted from the consolidated bank holding company's core capital in accordance with section II.B.1 of this appendix). Even though the assets of the nonfinancial company are consolidated for accounting purposes, these assets (as well as the credit equivalent amounts of the company's off-balance-sheet items) should be excluded from the banking organization's risk-weighted assets for regulatory capital purposes.

g. *Equity investments.* For purposes of this section II.B.5, an equity investment means any equity instrument (including common stock, preferred stock, partnership interests, interests in limited liability companies, trust certificates and warrants and call options that give the holder the right to purchase an equity instrument), any equity feature of a debt instrument (such as a warrant or call option), and any debt instrument that is convertible into equity where the instrument or feature is held under one of the legal authorities listed in section II.B.5.b. of this appendix A. An investment in any other instrument (including subordinated debt) may be treated as an equity investment if, in the judgment of the Federal Reserve, the instrument is the functional equivalent of equity or exposes the state member bank to essentially the same risks as an equity instrument.

[33] Unrealized gains on AFS investments may be included in supplementary capital to the extent permitted under section II.A.2.e of this appendix A. In addition, the unrealized losses on AFS equity investments are deducted from tier 1 capital in accordance with section II.A.1.a of this appendix A.

4–058.912

III. Procedures for Computing Weighted-Risk Assets and Off-Balance-Sheet Items

A. Procedures

Assets and credit-equivalent amounts of off-balance-sheet items of bank holding companies are assigned to one of several broad risk categories, according to the obligor, or, if relevant, the guarantor or the nature of the collateral. The aggregate dollar value of the amount in each category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are added together, and this sum is the banking organization's total weighted-risk assets that comprise the denominator of the risk-based capital ratio. Attachment I provides a sample calculation.

Risk weights for all off-balance-sheet items are determined by a two-step process. First, the ''credit equivalent amount'' of off-balance-sheet items is determined, in most cases, by multiplying the off-balance-sheet item by a credit-conversion factor. Second, the credit-equivalent amount is treated like any balance-sheet asset and generally is assigned to the appropriate risk category according to the obligor, or, if relevant, the guarantor or the nature of the collateral.

In general, if a particular item qualifies for placement in more than one risk category, it is assigned to the category that has the lowest risk weight. A holding of a U.S. municipal revenue bond that is fully guaranteed by a U.S. bank, for example, would be assigned the 20 percent risk weight appropriate to claims guaranteed by U.S. banks, rather than the 50 percent risk weight appropriate to U.S. municipal revenue bonds.[34]

[34] An investment in shares of a fund whose portfolio

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The Federal Reserve will, on a case-by-case basis, determine the appropriate risk weight for any asset or credit-equivalent amount of an off-balance-sheet item that does not fit wholly within the terms of one of the risk-weight categories set forth below or that imposes risks on a bank holding company that are incommensurate with the risk weight otherwise specified below for the asset or off-balance-sheet item. In addition, the Federal Reserve will, on a case-by-case basis, determine the appropriate credit-conversion factor for any off-balance-sheet item that does not fit wholly within the terms of one of the credit-conversion factors set forth below or that imposes risks on a banking organization that are incommensurate with the credit-conversion factors otherwise specified below for the off-balance-sheet item. In making such a determination, the Federal Reserve will consider the similarity of the asset or off-balance-sheet item to assets or off-balance-sheet items explicitly treated in the guidelines, as well as other relevant factors.

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consists primarily of various securities or money market instruments that, if held separately, would be assigned to different risk categories, generally is assigned to the risk category appropriate the highest risk-weighted asset that the fund is permitted to hold in accordance with the stated investment objectives set forth in the prospectus. An organization may, at its option, assign a fund investment on a pro rata basis to different risk categories according to the investment limits in the fund's prospectus. In no case will an investment in shares in any fund be assigned to a total risk weight of less than 20 percent. If an organization chooses to assign a fund investment on a pro rata basis, and the sum of the investment limits of assets in the fund's prospectus exceeds 100 percent, the organization must assign risk weights in descending order. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its assets in short-term, highly liquid securities of superior credit quality that do not qualify for a preferential risk weight, such securities generally will be disregarded when determining the risk category into which the organization's holding in the overall fund should be assigned. The prudent use of hedging instruments by a fund to reduce the risk of its assets will not increase the risk weighting of the fund investment. For example, the use of hedging instruments by a fund to reduce the interest-rate risk of its government bond portfolio will not increase the risk weight of that fund above the 20 percent category. Nonetheless, if a fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk weighting assigned to the fund's assets, holdings in the fund will be assigned to the 100 percent risk category.

4–058.913

B. Collateral, Guarantees, and Other Considerations

1. *Collateral.* The only forms of collateral that are formally recognized by the risk-based capital framework are cash on deposit in a subsidiary lending institution; securities issued or guaranteed by the central governments of the OECD-based group of countries,[35] U.S. government agencies, or U.S. government-sponsored agencies; and securities issued by multilateral lending institutions or regional development banks. Claims fully secured by such collateral generally are assigned to the 20 percent risk category. Collateralized transactions meeting all the conditions described in section III.C.1. may be assigned a zero percent risk weight.

With regard to collateralized claims that may be assigned to the 20 percent risk-weight category, the extent to which qualifying securities are recognized as collateral is determined by their current market value. If such a claim is only partially secured, that is, the market value of the pledged securities is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the portion that is covered by the market value of the qualifying collateral is assigned to the 20 percent risk category, and the portion of the claim that is not covered by collateral in the form of cash or a qualifying security is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor. For example, to the extent that a claim on a private-sector obligor is collateralized by the current market value of U.S. government securities, it would be placed in the 20 percent risk category and the balance would be assigned to the 100 percent risk category.

[35] The OECD-based group of countries comprises all full members of the Organization for Economic Cooperation and Development (OECD), as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow. The OECD includes the following countries: Australia, Austria, Belgium, Canada, Denmark, the Federal Republic of Germany, Finland, France, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. Saudi Arabia has concluded special lending arrangements with the IMF associated with the Fund's General Arrangements to Borrow.

2. *Guarantees.* Guarantees of the OECD and non-OECD central governments, U.S. government agencies, U.S. government-sponsored agencies, state and local governments of the OECD-based group of countries, multilateral lending institutions and regional development banks, U.S. depository institutions, and foreign banks are also recognized. If a claim is partially guaranteed, that is, coverage of the guarantee is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the portion that is not fully covered by the guarantee is assigned to the risk category appropriate to the obligor or, if relevant, to any collateral. The face amount of a claim covered by two types of guarantees that have different risk weights, such as a U.S. government guarantee and a state guarantee, is to be apportioned between the two risk categories appropriate to the guarantors.

The existence of other forms of collateral or guarantees that the risk-based capital framework does not formally recognize may be taken into consideration in evaluating the risks inherent in an organization's loan portfolio—which, in turn, would affect the overall supervisory assessment of the organization's capital adequacy.

3. *Recourse obligations, direct-credit substitutes, residual interests, and asset- and mortgage-backed securities.* Direct-credit substitutes, assets transferred with recourse, and securities issued in connection with asset securitizations and structured financings are treated as described below. The term *asset securitizations* or *securitizations* in this rule includes structured financings, as well as asset-securitization transactions.

a. *Definitions.*

i. *Credit derivative* means a contract that allows one party (the protection purchaser) to transfer the credit risk of an asset or off-balance-sheet credit exposure to another party (the protection provider). The value of a credit derivative is dependent, at least in part, on the credit performance of the ''reference asset.''

ii. *Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan-servicing assets) and that obligate the bank holding company to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include—

1. early-default clauses and similar warranties that permit the return of, or premium-refund clauses covering, one-to four-family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within one year of the date of transfer;

2. premium-refund clauses that cover assets guaranteed, in whole or in part, by the U.S. government, a U.S. government agency or a government-sponsored enterprise, provided the premium-refund clauses are for a period not to exceed 120 days from the date of transfer; or

3. warranties that permit the return of assets in instances of misrepresentation, fraud, or incomplete documentation.

iii. *Direct-credit substitute* means an arrangement in which a bank holding company assumes, in form or in substance, credit risk associated with an on- or off-balance-sheet credit exposure that was not previously owned by the bank holding company (third-party asset) and the risk assumed by the bank holding company exceeds the pro rata share of the bank holding company's interest in the third-party asset. If the bank holding company has no claim on the third-party asset, then the bank holding company's assumption of any credit risk with respect to the third-party asset is a direct-credit substitute. Direct-credit substitutes include, but are not limited to—

1. financial standby letters of credit that support financial claims on a third party that exceed a bank holding company's pro rata share of losses in the financial claim;
2. guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank holding company's pro rata share in the financial claim;
3. purchased subordinated interests or securities that absorb more than their pro rata share of losses from the underlying assets;
4. credit-derivative contracts under which the bank holding company assumes more than its pro rata share of credit risk on a third-party exposure;
5. loans or lines of credit that provide credit enhancement for the financial obligations of an account party;
6. purchased loan-servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced (mortgage-servicer cash advances that meet the conditions of section III.B.3.a.x. of this appendix are not direct-credit substitutes);
7. cleanup calls on third-party assets (cleanup calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank holding company are not direct-credit substitutes); and
8. liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

iv. *Eligible ABCP liquidity facility* means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset-quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. In addition, if the assets that an eligible ABCP liquidity facility is required to fund against are externally rated assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

v. *Externally rated* means that an instrument or obligation has received a credit rating from a nationally recognized statistical rating organization.

vi. *Face amount* means the notional principal, or face value, amount of an off-balance-sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

vii. *Financial asset* means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

viii. *Financial standby letter of credit* means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary—

1. to repay money borrowed by, or advanced to, or for the account of, a second party (the account party), or
2. to make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

ix. *Liquidity facility* means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

x. *Mortgage-servicer cash advance* means funds that a residential mortgage loan servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely

collection of the loan. A mortgage-servicer cash advance is not a recourse obligation or a direct-credit substitute if—

1. the servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or
2. for any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal balance of that loan.

xi. *Nationally recognized statistical rating organization (NRSRO)* means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor division) (commission) as a nationally recognized statistical rating organization for various purposes, including the commission's uniform net capital requirements for brokers and dealers.

xii. *Recourse* means the retention, by a bank holding company, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred and sold that exceeds a pro rata share of the banking organization's claim on the asset. If a banking organization has no claim on a transferred asset, then the retention of any risk of credit loss is recourse. A recourse obligation typically arises when a bank holding company transfers assets and retains an explicit obligation to repurchase the assets or absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if a bank holding company provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

1. credit-enhancing representations and warranties made on the transferred assets
2. loan-servicing assets retained pursuant to an agreement under which the bank holding company will be responsible for credit losses associated with the loans being serviced (mortgage-servicer cash advances that meet the conditions of section III.B.3.a.x. of this appendix are not recourse arrangements)
3. retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets
4. assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet
5. loan strips sold without contractual recourse where the maturity of the transferred loan is shorter than the maturity of the commitment under which the loan is drawn
6. credit derivatives issued that absorb more than the bank holding company's pro rata share of losses from the transferred assets
7. cleanup calls at inception that are greater than 10 percent of the balance of the original pool of transferred loans (cleanup calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank holding company are not recourse arrangements)
8. liquidity facilities that provide support to ABCP (other than ABCP liquidity facilities)

xiii. *Residual interest* means any on-balance-sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes the bank holding company to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank holding company's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread ac-

counts, cash-collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank holding company to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests for purposes of this appendix.

xiv. *Risk participation* means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct-credit substitute) notwithstanding that another party has acquired a participation in that obligation.

xv. *Securitization* means the pooling and repackaging by a special-purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit-risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

xvi. *Sponsor* means a bank holding company that establishes an ABCP program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

xvii. *Structured finance program* means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special-purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

xviii. *Traded position* means a position that is externally rated, and is retained, assumed, or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

b. *Credit-equivalent amounts and risk weight of recourse obligations and direct-credit substitutes.*

i. *Credit-equivalent amount.* Except as otherwise provided in sections III.B.3.c. through f. and III.B.5. of this appendix, the credit-equivalent amount for a recourse obligation or direct-credit substitute is the full amount of the credit-enhanced assets for which the bank holding company directly or indirectly retains or assumes credit risk multiplied by a 100 percent conversion factor.

ii. *Risk-weight factor.* To determine the bank holding company's risk-weight factor for off-balance-sheet recourse obligations and direct-credit substitutes, the credit-equivalent amount is assigned to the risk category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. For a direct-credit substitute that is an on-balance-sheet asset (e.g., a purchased subordinated security), a bank holding company must calculate risk-weighted assets using the amount of the direct-credit substitute and the full amount of the assets it supports, i.e., all the more senior positions in the structure. The treatment of direct-credit substitutes that have been syndicated or in which risk participations have been conveyed or acquired is set forth in section III.D.1 of this appendix.

c. *Externally rated positions: credit-equivalent amounts and risk weights of recourse obligations, direct-credit substitutes, residual interests, and asset- and mortgage-backed securities (including asset-backed commercial paper).*

i. *Traded positions.* With respect to a recourse obligation, direct-credit substitute,

residual interest (other than a credit-enhancing I/Ostrip) or asset- and mortgage-backed security (including asset-backed commercial paper) that is a traded position and that has received an external rating on a long-term position that is one grade below investment grade or better or a short-term rating that is investment grade, the bank holding company may multiply the face amount of the position by the appropriate risk weight, determined in accordance with the tables below. Stripped mortgage-backed securities and other similar instruments, such as interest-only or principal-only strips that are not credit enhancements, must be assigned to the 100 percent risk category. If a traded position has received more than one external rating, the lowest single rating will apply.

Long-term rating category	*Examples*	*Risk weight*
Highest or second-highest investment grade	AAA, AA	20 percent
Third-highest investment grade	A	50 percent
Lowest investment grade	BBB	100 percent
One category below investment grade	BB	200 percent

Short-term rating	*Examples*	*Risk weight*
Highest investment grade	A-1, P-1	20 percent
Second-highest investment grade	A-2, P-2	50 percent
Lowest investment grade	A-3, P-3	100 percent

ii. *Nontraded positions.* A recourse obligation, direct-credit substitute, or residual interest (but not a credit-enhancing I/O strip) extended in connection with a securitization that is not a traded position may be assigned a risk weight in accordance with section III.B.3.c.i.of this appendix if—

1. it has been externally rated by more than one NRSRO;
2. it has received an external rating on a long-term position that is one grade below investment grade or better or on a short-term position that is investment grade by all NRSROs providing a rating;
3. the ratings are publicly available; and
4. the ratings are based on the same criteria used to rate traded positions.

If the ratings are different, the lowest rating will determine the risk category to which the recourse obligation, direct-credit substitute, or residual interest will be assigned.

d. *Senior positions not externally rated.* For a recourse obligation, direct-credit substitute, residual interest, or asset- or mortgage-backed security that is not externally rated but is senior or preferred in all features to a traded position (including collateralization and maturity), a bank holding company may apply a risk weight to the face amount of the senior position in accordance with section III.B.3.c.i. of this appendix, based on the traded position, subject to any current or prospective supervisory guidance and the bank holding company satisfying the Federal Reserve that this treatment is appropriate. This section will apply only if the traded subordinated position provides substantive credit support to the unrated position until the unrated position matures.

e. *Capital requirement for residual interests.*

i. *Capital requirement for credit-enhancing I/O strips.* After applying the concentration limit to credit-enhancing I/O strips (both purchased and retained) in accordance with sections II.B.2.c. through e. of this appendix, a bank holding company must maintain risk-based capital for a credit-enhancing I/O strip (both purchased and retained), regardless of the external rating on that position,

equal to the remaining amount of the credit-enhancing I/O (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing I/O strip will be treated as if the credit-enhancing I/O strip was retained by the bank holding company and not transferred.

ii. *Capital requirement for other residual interests.*

1. If a residual interest does not meet the requirements of sections III.B.3.c. or d. of this appendix, a bank holding must maintain risk-based capital equal to the remaining amount of the residual interest that is retained on the balance sheet (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred residual interest will be treated as if the residual interest was retained by the bank holding company and not transferred.

2. Where the aggregate capital requirement for residual interests and other recourse obligations in connection with the same transfer of assets exceed the full risk-based capital requirement for those assets, a bank holding company must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under section III.B.3.e.ii.*1.* of this appendix or the full risk-based capital requirement for the assets transferred.

f. *Positions that are not rated by an NRSRO.* A position (but not a residual interest) maintained in connection with a securitization and that is not rated by a NRSRO may be risk-weighted based on the bank holding company's determination of the credit rating of the position, as specified in the table below, multiplied by the face amount of the position. In order to obtain this treatment, the bank holding company's system for determining the credit rating of the position must meet one of the three alternative standards set out in sections III.B.3.f.i. through III.B.3.f.iii. of this appendix.

Rating category	*Examples*	*Risk weight*
Highest or second-highest investment grade	AAA, AA	100 percent
Third-highest investment grade	A	100 percent
Lowest investment grade	BBB	100 percent
One category below investment grade	BB	200 percent

i. *Internal risk rating used for asset-backed programs.* A direct-credit substitute (other than a purchased credit-enhancing I/O) is assumed in connection with an asset-backed commercial paper program sponsored by the bank holding company and the bank holding company is able to demonstrate to the satisfaction of the Federal Reserve, prior to relying upon its use, that the bank holding company's internal credit-risk rating system is adequate. Adequate internal credit-risk rating systems usually contain the following criteria:

1. the internal credit-risk system is an integral part of the bank holding company's risk-management system, which explicitly incorporates the full range of risks arising from a bank holding company's participation in securitization activities;

2. internal credit ratings are linked to measurable outcomes, such as the probability that the position will experience any loss, the position's expected loss given default, and the degree of variance in losses given

default on that position;

3. the bank holding company's internal credit-risk system must separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of a particular securitization transaction;
4. the bank holding company's internal credit-risk system must identify gradations of risk among ''pass'' assets and other risk positions;
5. the bank holding company must have clear, explicit criteria that are used to classify assets into each internal risk grade, including subjective factors;
6. the bank holding company must have independent credit-risk management or loan-review personnel assigning or reviewing the credit-risk ratings;
7. the bank holding company must have an internal-audit procedure that periodically verifies that the internal credit-risk ratings are assigned in accordance with the established criteria;
8. the bank holding company must monitor the performance of the internal credit-risk ratings assigned to nonrated, nontraded direct-credit substitutes over time to determine the appropriateness of the initial credit-risk rating assignment and adjust individual credit-risk ratings, or the overall internal credit-risk ratings system, as needed; and
9. the internal credit-risk system must make credit-risk rating assumptions that are consistent with, or more conservative than, the credit-risk rating assumptions and methodologies of NRSROs.

ii. *Program ratings.* A direct-credit substitute or recourse obligation (other than a residual interest) is assumed or retained in connection with a structured finance program and a NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the bank holding company may apply the rating category that corresponds to the bank holding company's position. In order to rely on a program rating, the bank holding company must demonstrate to the Federal Reserve's satisfaction that the credit-risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The bank holding company must also demonstrate to the Federal Reserve's satisfaction that the criteria underlying the NRSRO's assignment of ratings for the program are satisfied for the particular position. If a bank holding company participates in a securitization sponsored by another party, the Federal Reserve may authorize the bank holding company to use this approach based on a programmatic rating obtained by the sponsor of the program.

iii. *Computer program.* The bank holding company is using an acceptable credit assessment computer program to determine the rating of a direct-credit substitute or recourse obligation (but not residual interest) issued in connection with a structured finance program. A NRSRO must have developed the computer program, and the bank holding company must demonstrate to the Federal Reserve's satisfaction that ratings under the program correspond credibly and reliably with the rating of traded positions.

g. *Limitations on risk-based capital requirements.*

i. *Low-level exposure.* If the maximum contractual exposure to loss retained or assumed by a bank holding company in connection with a recourse obligation or a direct-credit substitute is less than the effective risk-based capital requirement for the enhanced assets, the risk-based capital requirement is limited to the maximum contractual exposure, less any liability account established in accordance with generally accepted accounting principles. This limitation does not apply when a bank holding company provides

credit enhancement beyond any contractual obligation to support assets it has sold.

ii. *Mortgage-related securities or participation certificates retained in a mortgage loan swap.* If a bank holding company holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, capital is required to support the recourse obligation plus the percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of capital required for the on-balance-sheet asset and the recourse obligation, however, is limited to the capital requirement for the underlying loans, calculated as if the organization continued to hold these loans as on-balance-sheet assets.

iii. *Related on-balance-sheet assets.* If a recourse obligation or direct-credit substitute subject to section III.B.3. of this appendix also appears as a balance-sheet asset, the balance-sheet asset is not included in an organization's risk-weighted assets to the extent the value of the balance-sheet asset is already included in the off-balance-sheet credit-equivalent amount for the recourse obligation or direct-credit substitute, except in the case of loan-servicing assets and similar arrangements with embedded recourse obligations or direct-credit substitutes. In that case, both the on-balance-sheet assets and the related recourse obligations and direct-credit substitutes are incorporated into the risk-based capital calculation.

4. *Maturity.* Maturity is generally not a factor in assigning items to risk categories with the exception of claims on non-OECD banks, commitments, and interest-rate and foreign-exchange-rate contracts. Except for commitments, short-term is defined as one year or less *remaining* maturity and long-term is defined as over one year *remaining* maturity. In the case of commitments, short-term is defined as one year or less *original* maturity and long-term is defined as over one year *original* maturity.

5. *Small-business loans and leases on personal property transferred with recourse.*

a. Notwithstanding other provisions of this appendix A, a qualifying banking organization that has transferred small-business loans and leases on personal property (small-business obligations) with recourse shall include in weighted-risk assets only the amount of retained recourse, provided two conditions are met. First, the transaction must be treated as a sale under GAAP and, second, the banking organization must establish pursuant to GAAP a noncapital reserve sufficient to meet the organization's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small-business concern established by the Small Business Administration under section 3(a) of the Small Business Act are eligible for this capital treatment.

b. For purposes of this appendix A, a banking organization is qualifying if it meets the criteria for well capitalized or, by order of the Board, adequately capitalized, as those criteria are set forth in the Board's prompt-corrective-action regulation for state member banks (12 CFR 208.40). For purposes of determining whether an organization meets these criteria, its capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in section III.B.5.a. of this appendix A. The total outstanding amount of recourse retained by a qualifying banking organization on transfers of small-business obligations receiving the preferential capital treatment cannot exceed 15 percent of the organization's total risk-based capital. By order, the Board may approve a higher limit.

c. If a bank holding company ceases to be qualifying or exceeds the 15 percent capital limitation, the preferential capital treatment will continue to apply to any transfers of small-business obligations with recourse that were consummated during the time that the organization was qualifying and did not exceed the capital limit.

6. *Asset-backed commercial paper programs.*

a. An asset-backed commercial paper (ABCP) program means a program that pri-

marily issues externally rated commercial paper backed by assets or exposures held in a bankruptcy-remote, special-purpose entity.
b. If a bank holding company has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank holding company is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank holding company should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

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C. Risk Weights

Attachment III contains a listing of the risk categories, a summary of the types of assets assigned to each category and the risk weight associated with each category, that is, 0 percent, 20 percent, 50 percent, and 100 percent. A brief explanation of the components of each category follows.

1. *Category 1: zero percent.* This category includes cash (domestic and foreign) owned and held in all offices of subsidiary depository institutions or in transit and gold bullion held in either a subsidiary depository institution's own vaults or in another's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities.[36] The category also includes all direct claims (including securities, loans, and leases) on, and the portions of claims that are directly and unconditionally guaranteed by, the central governments[37] of the OECD countries and U.S. government agencies,[38] as well as all direct local currency claims on, and the portions of local currency claims that are directly and unconditionally guaranteed by, the central governments of non-OECD countries, to the extent that subsidiary depository institutions have liabilities booked in that currency. A claim is not considered to be unconditionally guaranteed by a central government if the validity of the guarantee is dependent upon some affirmative action by the holder or a third party. Generally, securities guaranteed by the U.S. government or its agencies that are actively traded in financial markets, such as GNMA securities, are considered to be unconditionally guaranteed.

This category also includes claims collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the banking organization's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

This category also includes ABCP (i) purchased by a bank holding company on or after September 19, 2008, from an SEC-registered open-end investment company that holds itself out as a money market mutual fund under SEC Rule 2a-7 (17 CFR 270.2a-7) and (ii) pledged by a bank holding company to a Federal Reserve Bank to secure financing from the ABCP lending facility (AMLF) established by the Board on September 19, 2008.

2. *Category 2: 20 percent.*

[36] All other holdings of bullion are assigned to the 100 percent risk category.

[37] A central government is defined to include departments and ministries, including the central bank, of the central government. The U.S. central bank includes the 12 Federal Reserve Banks, and stock held in these banks as a condition of membership is assigned to the zero percent risk category. The definition of ''central government'' does not include state, provincial, or local governments; or commercial enterprises owned by the central government. In addition, it does not include local government entities or commercial enterprises whose obligations are guaranteed by the central government, although any claims on such entities guaranteed by central governments are placed in the same general risk category as other claims guaranteed by central governments. OECD central governments are defined as central governments of the OECD-based group of countries; non-OECD central governments are defined as central governments of countries that do not belong to the OECD-based group of countries.

[38] A U.S. government agency is defined as an instrumentality of the U.S. government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government. Such agencies include the Government National Mortgage Association (GNMA), the Veterans Administration (VA), the Federal Housing Administration (FHA), the Export-Import Bank (Exim Bank), the Overseas Private Investment Corporation (OPIC), the Commodity Credit Corporation (CCC), and the Small Business Administration (SBA).

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a. This category includes cash items in the process of collection, both foreign and domestic; short-term claims (including demand deposits) on, and the portions of short-term claims that are guaranteed by,[39] U.S. depository institutions[40] and foreign banks;[41] and long-term claims on, and the portions of long-term claims that are guaranteed by, U.S. depository institutions and OECD banks.[42]

b. This category also includes the portions of claims that are conditionally guaranteed by OECD central governments and U.S. government agencies, as well as the portions of local currency claims that are conditionally guaranteed by non-OECD central governments, to the extent that subsidiary depository institutions have liabilities booked in that currency. In addition, this category also includes claims on, and the portions of claims that are guaranteed by, U.S. government-sponsored agencies[43] and claims on, and the portions of claims guaranteed by, the International Bank for Reconstruction and Development (World Bank), the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, and other multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member. General obligation claims on, or portions of claims guaranteed by the full faith and credit of, states or other political subdivisions of the United States or other countries of the OECD-based group are also assigned to this category.[44]

c. This category also includes the portions of claims (including repurchase transactions) collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies that do not qualify for the zero percent risk-weight category; collateralized by securities issued or guaranteed by U.S. government-sponsored agencies; or collateralized by securities issued by multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member.

d. This category also includes claims[45] on, or guaranteed by, a qualifying securities firm[46] incorporated in the United States or

[39] Claims guaranteed by U.S. depository institutions and foreign banks include risk participations in both banker's acceptances and standby letters of credit, as well as participations in commitments, that are conveyed to U.S. depository institutions or foreign banks.

[40] See footnote 9 of this appendix for the definition of a *U.S. depository institution*. For this purpose, the definition also includes U.S.-chartered depository institutions owned by foreigners. However, branches and agencies of foreign banks located in the U.S., as well as all bank holding companies, are excluded.

[41] See footnote 10 of this appendix for the definition of a *foreign bank*. Foreign banks are distinguished as either OECD banks or non-OECD banks. OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries (other than the United States) that belong to the OECD-based group of countries. Non-OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries that do not belong to the OECD-based group of countries

[42] Long-term claims on, or guaranteed by, non-OECD banks and all claims on bank holding companies are assigned to the 100 percent risk category, as are holdings of bank-issued securities that qualify as capital of the issuing banks.

[43] For this purpose, U.S. government-sponsored agencies are defined as agencies originally established or chartered by the federal government to serve public purposes specified by the U.S. Congress but whose obligations are *not explicitly* guaranteed by the full faith and credit of the U.S. government. These agencies include the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), the Farm Credit System, the Federal Home Loan Bank System, and the Student Loan Marketing Association (SLMA). Claims on U.S. government-sponsored agencies include capital stock in a Federal Home Loan Bank that is held as a condition of membership in that Bank

[44] Claims on, or guaranteed by, states or other political subdivisions of countries that do not belong to the OECD-based group of countries are placed in the 100 percent risk category.

[45] Claims on a qualifying securities firm that are instruments the firm, or its parent company, uses to satisfy its applicable capital requirements are not eligible for this risk weight.

[46] With regard to securities firms incorporated in the United States, qualifying securities firms are those securities firms that are broker-dealers registered with the Securities and Exchange Commission (SEC) and are in compliance with the SEC's net capital rule, 17 CFR 240.15c3-1. With regard to securities firms incorporated in other countries in the OECD-based group of countries, qualifying securities firms are those securities firms that a banking organization is able to demonstrate are subject to consolidated supervision and regulation (covering their direct and indirect subsidiaries, but not necessarily their parent organizations) comparable to that imposed on banks in OECD countries. Such regulation must include risk-based capital

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other member of the OECD-based group of countries provided that: the qualifying securities firm has a long-term issuer credit rating, or a rating on at least one issue of long-term debt, in one of the three highest investment-grade rating categories from a nationally recognized statistical rating organization; or the claim is guaranteed by the firm's parent company and the parent company has such a rating. If ratings are available from more than one rating agency, the lowest rating will be used to determine whether the rating requirement has been met. This category also includes a collateralized claim on a qualifying securities firm in such a country, without regard to satisfaction of the rating standard, provided the claim arises under a contract that—

1. is a reverse-repurchase/repurchase agreement or securities-lending/borrowing transaction executed using standard industry documentation;
2. is collateralized by debt or equity securities that are liquid and readily marketable;
3. is marked to market daily;
4. is subject to a daily margin-maintenance requirement under the standard industry documentation; and
5. can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided, under applicable law of the relevant jurisdiction.[47]

3. *Category 3: 50 percent.* This category includes loans fully secured by first liens[48] on 1- to 4-family residential properties, either owner-occupied or rented, or on multifamily residential properties,[49] that meet certain criteria.[50] Loans included in this category must have been made in accordance with prudent underwriting standards;[51] be performing in accordance with their original terms; and not be 90 days or more past due or carried in nonaccrual status. For purposes of this 50 percent risk weight category, a loan modified on a permanent or trial basis solely pursuant to the U.S. Department of Treasury's Home Affordable Mortgage Program will be considered to be performing in accordance with its original terms. The following additional criteria must also be applied to a loan secured by a multifamily residential property that is included in this category: all principal and interest payments on the loan must have been

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requirements comparable to those applied to banks under the Accord on International Convergence of Capital Measurement and Capital Standards (1988, as amended in 1998) (Basel Accord).

[47] For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or repurchase agreement subject to section 555 or 559 of the Bankruptcy Code, respectively (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR 231).

[48] If a banking organization holds the first and junior

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lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purposes of determining the loan-to-value ratio and assigning a risk weight.

[49] Loans that qualify as loans secured by 1- to 4-family residential properties or multifamily residential properties are listed in the instructions to the FR Y-9C Report. In addition, for risk-based capital purposes, loans secured by 1- to 4-family residential properties include loans to builders with substantial project equity for the construction of 1- to 4-family residences that have been presold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. Such loans to builders will be considered prudently underwritten only if the bank holding company has obtained sufficient documentation that the buyer of the home intends to purchase the home (*i.e.*, has a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (*i.e.*, has a firm written commitment for permanent financing of the home upon completion).

[50] Residential property loans that do not meet all the specified criteria or that are made for the purpose of speculative property development are placed in the 100 percent risk category.

[51] Prudent underwriting standards include a conservative ratio of the current loan balance to the value of the property. In the case of a loan secured by multifamily residential property, the loan-to-value ratio is not conservative if it exceeds 80 percent (75 percent if the loan is based on a floating interest rate). Prudent underwriting standards also dictate that a loan-to-value ratio used in the case of originating a loan to acquire a property would not be deemed conservative unless the value is based on the lower of the acquisition cost of the property or appraised (or if appropriate, evaluated) value. Otherwise, the loan-to-value ratio generally would be based upon the value of the property as determined by the most current appraisal, or if appropriate, the most current evaluation. All appraisals must be made in a manner consistent with the federal banking agencies' real estate appraisal regulations and guidelines and with the banking organization's own appraisal guidelines.

made on time for at least the year preceding placement in this category, or in the case where the existing property owner is refinancing a loan on that property, all principal and interest payments on the loan being refinanced must have been made on time for at least the year preceding placement in this category; amortization of the principal and interest must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years; and the annual net operating income (before debt service) generated by the property during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (115 percent if the loan is based on a floating interest rate) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the institution. Also included in this category are privately-issued mortgage-backed securities provided that:

(1) The structure of the security meets the criteria described in section III(B)(3) above;

(2) If the security is backed by a pool of conventional mortgages, on 1- to 4-family residential or multifamily residential properties, each underlying mortgage meets the criteria described above in this section for eligibility for the 50 percent risk category at the time the pool is originated;

(3) If the security is backed by privately issued mortgage-backed securities, each underlying security qualifies for the 50 percent risk category; and

(4) If the security is backed by a pool of multifamily residential mortgages, principal and interest payments on the security are not 30 days or more past due. Privately-issued mortgage-backed securities that do not meet these criteria or that do not qualify for a lower risk weight are generally assigned to the 100 percent risk category.

Also assigned to this category are revenue (non-general obligation) bonds or similar obligations, including loans and leases, that are obligations of states or other political subdivisions of the U.S. (for example, municipal revenue bonds) or other countries of the OECD-based group, but for which the government entity is committed to repay the debt with revenues from the specific projects financed, rather than from general tax funds.

Credit equivalent amounts of derivative contracts involving standard risk obligors (that is, obligors whose loans or debt securities would be assigned to the 100 percent risk category) are included in the 50 percent category, unless they are backed by collateral or guarantees that allow them to be placed in a lower risk category.

4. *Category 4: 100 percent.*

a. All assets not included in the categories above are assigned to this category, which comprises standard risk assets. The bulk of the assets typically found in a loan portfolio would be assigned to the 100 percent category.

b. This category includes long-term claims on, and the portions of long-term claims that are guaranteed by, non-OECD banks, and all claims on non-OECD central governments that entail some degree of transfer risk.[52] This category also includes all claims on foreign and domestic private-sector obligors not included in the categories above (including loans to nondepository financial institutions and bank holding companies); claims on commercial firms owned by the public sector; customer liabilities to the organization on acceptances outstanding involving standard risk claims;[53] investments in fixed assets, premises, and other real estate owned; common and preferred stock of corporations, including stock acquired for debts previously contracted; all stripped mortgage-backed securities and similar instruments; and commercial and consumer loans (except those assigned to lower risk categories due to recognized

[52] Such assets include all nonlocal-currency claims on, and the portions of claims that are guaranteed by, non-OECD central governments and those portions of local-currency claims on, or guaranteed by, non-OECD central governments that exceed the local-currency liabilities held by subsidiary depository institutions.

[53] Customer liabilities on acceptances outstanding involving nonstandard risk claims, such as claims on U.S. depository institutions, are assigned to the risk category appropriate to the identity of the obligor or, if relevant, the nature of the collateral or guarantees backing the claims. Portions of acceptances conveyed as risk participations to U.S. depository institutions or foreign banks are assigned to the 20 percent risk category appropriate to short-term claims guaranteed by U.S. depository institutions and foreign banks.

guarantees or collateral and loans secured by residential property that qualify for a lower risk weight). This category also includes claims representing capital of a qualifying securities firm.

c. Also included in this category are industrial-development bonds and similar obligations issued under the auspices of states or political subdivisions of the OECD-based group of countries for the benefit of a private party or enterprise where that party or enterprise, not the government entity, is obligated to pay the principal and interest, and all obligations of states or political subdivisions of countries that do not belong to the OECD-based group.

d. The following assets also are assigned a risk weight of 100 percent if they have not been deducted from capital: investments in unconsolidated companies, joint ventures, or associated companies; instruments that qualify as capital issued by other banking organizations; and any intangibles, including those that may have been grandfathered into capital.

4–058.915

D. Off-Balance-Sheet Items

The face amount of an off-balance-sheet item is generally incorporated into risk-weighted assets in two steps. The face amount is first multiplied by a credit-conversion factor, except for direct-credit substitutes and recourse obligations as discussed in section III.D.1. of this appendix. The resultant credit-equivalent amount is assigned to the appropriate risk category according to the obligor, or, if relevant, the guarantor, the nature of the collateral, or external credit ratings.[54]

1. *Items with a 100 percent conversion factor.*

a. Except as otherwise provided in section III.B.3. of this appendix, the full amount of an asset or transaction supported, in whole or in part, by a direct-credit substitute or a recourse obligation. Direct-credit substitutes and recourse obligations are defined in section III.B.3. of this appendix.

b. Sale and repurchase agreements and forward agreements. Forward agreements are legally binding contractual obligations to purchase assets with certain drawdown at a specified future date. Such obligations include forward purchases, forward forward deposits placed,[55] and partly paid shares and securities; they do not include commitments to make residential mortgage loans or forward foreign-exchange contracts.

c. Securities lent by a banking organization are treated in one of two ways, depending upon whether the lender is at risk of loss. If a banking organization, as agent for a customer, lends the customer's securities and does not indemnify the customer against loss, then the transaction is excluded from the risk-based capital calculation. If, alternatively, a banking organization lends its own securities or, acting as agent for a customer, lends the customer's securities and indemnifies the customer against loss, the transaction is converted at 100 percent and assigned to the risk-weight category appropriate to the obligor, or, if applicable, to any collateral delivered to the lending organization, or the independent custodian acting on the lending organization's behalf. Where a banking organization is acting as agent for a customer in a transaction involving the lending or sale of securities that is collateralized by cash delivered to the banking organization, the transaction is deemed to be collateralized by cash on deposit in a subsidiary depository institution for purposes of determining the appropriate risk-weight category, provided that any indemnification is limited to no more than the difference between the market value of the securities and the cash collateral received and any reinvestment risk associated with that cash collateral is borne by the customer.

d. In the case of direct-credit substitutes in

[54] The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit-equivalent amount. Collateral and guarantees are subject to the same provisions noted under section II.B. of this appendix A.

[55] Forward forward deposits accepted are treated as interest-rate contracts.

which a risk participation[56] has been conveyed, the full amount of the assets that are supported, in whole or in part, by the credit enhancement are converted to a credit-equivalent amount at 100 percent. However, the pro rata share of the credit-equivalent amount that has been conveyed through a risk participation is assigned to whichever risk category is lower: the risk category appropriate to the obligor, after considering any relevant guarantees or collateral, or the risk category appropriate to the institution acquiring the participation.[57] Any remainder is assigned to the risk category appropriate to the obligor, guarantor, or collateral. For example, the pro rata share of the full amount of the assets supported, in whole or in part, by a direct-credit substitute conveyed as a risk participation to a U.S. domestic depository institution or foreign bank is assigned to the 20 percent risk category.[58]

e. In the case of direct-credit substitutes in which a risk participation has been acquired, the acquiring banking organization's percentage share of the direct-credit substitute is multiplied by the full amount of the assets that are supported, in whole or in part, by the credit enhancement and converted to a credit-equivalent amount at 100 percent. The credit-equivalent amount of an acquisition of a risk participation in a direct-credit substitute is assigned to the risk category appropriate to the account party obligor or, if relevant, the nature of the collateral or guarantees.

f. In the case of direct-credit substitutes that take the form of a syndication where each banking organization is obligated only for its pro rata share of the risk and there is no recourse to the originating banking organization, each banking organization will only include its pro rata share of the assets supported, in whole or in part, by the direct-credit substitute in its risk-based capital calculation.[59]

2. *Items with a 50 percent conversion factor.*

a. Transaction-related contingencies are converted at 50 percent. Such contingencies include bid bonds, performance bonds, warranties, standby letters of credit related to particular transactions, and performance standby letters of credit, as well as acquisitions of risk participations in performance standby letters of credit. Performance standby letters of credit represent obligations backing the performance of nonfinancial or commercial contracts or undertakings. To the extent permitted by law or regulation, performance standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

b. The unused portion of commitments with an *original* maturity exceeding one year, including underwriting commitments, and commercial and consumer credit commitments also are converted at 50 percent. Original maturity is defined as the length of time between the date the commitment is issued and the earliest date on which (1) the banking organization can, at its option, unconditionally (without cause) cancel the commitment[60] and (2) the banking organization is scheduled to (and as a normal practice actually does) review the facility to determine whether or not it should be extended. Such reviews must continue to be conducted at least annually for such a facility to qualify as a short-term commitment.

[56] That is, a participation in which the originating banking organization remains liable to the beneficiary for the full amount of the direct-credit substitute if the party that has acquired the participation fails to pay when the instrument is drawn.

[57] A risk participation in banker's acceptances conveyed to other institutions is also assigned to the risk category appropriate to the institution acquiring the participation or, if relevant, the guarantor or nature of the collateral.

[58] Risk participations with a remaining maturity of over one year that are conveyed to non-OECD banks are to be assigned to the 100 percent risk category, unless a lower risk category is appropriate to the obligor, guarantor, or collateral.

[59] For example, if a banking organization has a 10 percent share of a $10 syndicated direct-credit substitute that provides credit support to a $100 loan, then the banking organization's $1 pro rata share in the enhancement means that a $10 pro rata share of the loan is included in risk-weighted assets.

[60] In the case of consumer home-equity or mortgage lines of credit secured by liens on one- to four-family residential properties, the bank is deemed able to unconditionally cancel the commitment for the purpose of this criterion if, at its option, it can prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by relevant federal law.

c. i. Commitments are defined as any legally binding arrangements that obligate a banking organization to extend credit in the form of loans or leases; to purchase loans, securities, or other assets; or to participate in loans and leases. They also include overdraft facilities, revolving credit, home-equity and mortgage lines of credit, eligible ABCP liquidity facilities, and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain ''material adverse change'' clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the banking organization is obligated solely for its pro rata share, only the organization's proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio.

ii. Banking organizations that are subject to the market-risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit-equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market-risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct-credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section III.B.3. of this appendix.

d. Once a commitment has been converted at 50 percent, any portion that has been conveyed to U.S. depository institutions or OECD banks as participations in which the originating banking organization retains the full obligation to the borrower if the participating bank fails to pay when the instrument is drawn, is assigned to the 20 percent risk category. This treatment is analogous to that accorded to conveyances of risk participations in standby letters of credit. The acquisition of a participation in a commitment by a banking organization is converted at 50 percent and assigned to the risk category appropriate to the account-party obligor or, if relevant, the nature of the collateral or guarantees.

e. Revolving-underwriting facilities (RUFs), note-issuance facilities (NIFs), and other similar arrangements also are converted at 50 percent regardless of maturity. These are facilities under which a borrower can issue on a revolving basis short-term paper in its own name, but for which the underwriting organizations have a legally binding commitment either to purchase any notes the borrower is unable to sell by the rollover date or to advance funds to the borrower.

3. *Items with a 20 percent conversion factor.* Short-term, self-liquidating, trade-related contingencies which arise from the movement of goods are converted at 20 percent. Such contingencies generally include commercial letters of credit and other documentary letters of credit collateralized by the underlying shipments.

4. *Items with a 10 percent conversion factor.*

a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less also are converted at 10 percent.

b. Banking organizations that are subject to the market-risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit-equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market-risk rules may not be applied as set forth in section 2(a) of ap-

pendix E of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct-credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section III.B.3. of this appendix.

5. *Items with a zero percent conversion factor.* These include unused portions of commitments (with the exception of eligible ABCP liquidity facilities) with an original maturity of one year or less, or which are unconditionally cancellable at any time, provided a separate credit decision is made before each drawing under the facility. Unused portions of lines of credit on retail credit cards and related plans are deemed to be short-term commitments if the banking organization has the unconditional right to cancel the line of credit at any time, in accordance with applicable law.

4–058.916

E. Derivative Contracts (Interest-Rate, Exchange-Rate, Commodity- (Including Precious Metals) and Equity-Linked Contracts)

1. *Scope.* Credit-equivalent amounts are computed for each of the following off-balance-sheet derivative contracts:

a. *Interest-rate contracts.* These include single-currency interest-rate swaps, basis swaps, forward rate agreements, interest-rate options purchased (including caps, collars, and floors purchased), and any other instrument linked to interest rates that gives rise to similar credit risks (including when-issued securities and forward forward deposits accepted).

b. *Exchange-rate contracts.* These include cross-currency interest-rate swaps, forward foreign-exchange contracts, currency options purchased, and any other instrument linked to exchange rates that gives rise to similar credit risks.

c. *Equity derivative contracts.* These include equity-linked swaps, equity-linked options purchased, forward equity-linked contracts, and any other instrument linked to equities that gives rise to similar credit risks.

d. *Commodity (including precious metal) derivative contracts.* These include commodity-linked swaps, commodity-linked options purchased, forward commodity-linked contracts, and any other instrument linked to commodities that gives rise to similar credit risks.

e. *Exceptions.* Exchange-rate contracts with an original maturity of 14 or fewer calendar days and derivative contracts traded on exchanges that require daily receipt and payment of cash-variation margin may be excluded from the risk-based ratio calculation. Gold contracts are accorded the same treatment as exchange-rate contracts except that gold contracts with an original maturity of 14 or fewer calendar days are included in the risk-based ratio calculation. Over-the-counter options purchased are included and treated in the same way as other derivative contracts.

2. *Calculation of credit-equivalent amounts.*

a. The credit-equivalent amount of a derivative contract that is not subject to a qualifying bilateral netting contract in accordance with section III.E.3. of this appendix A is equal to the sum of (i) the current exposure (sometimes referred to as the replacement cost) of the contract; and (ii) an estimate of the potential future credit exposure of the contract.

b. The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. Mark-to-market values are measured in dollars, regardless of the currency or currencies specified in the contract, and should reflect changes in underlying rates, prices, and indices, as well as counterparty credit quality.

c. The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount of the contract by a credit-conversion factor. Banking organizations should use, subject to examiner review, the effective rather than the apparent or stated notional amount in this calculation. The conversion factors are:

Conversion Factors (in percent) *Remaining maturity*	*Interest-rate*	*Exchange-rate and gold*	*Equity*	*Commodity, excluding precious metals*	*Precious metals, except gold*
One year or less	0.0	1.0	6.0	10.0	7.0
Over one to five years	0.5	5.0	8.0	12.0	7.0
Over five years	1.5	7.5	10.0	15.0	8.0

d. For a contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity is equal to the time until the next reset date. For an interest-rate contract with a remaining maturity of more than one year that meets these criteria, the minimum conversion factor is 0.5 percent.

e. For a contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the contract. A derivative contract not included in the definitions of interest-rate, exchange-rate, equity, or commodity contracts as set forth in section III.E.1. of this appendix A is subject to the same conversion factors as a commodity, excluding precious metals.

f. No potential future exposure is calculated for a single-currency interest-rate swap in which payments are made based upon two floating-rate indices (a so-called floating/floating or basis swap); the credit exposure on such a contract is evaluated solely on the basis of the mark-to-market value.

g. The Board notes that the conversion factors set forth above, which are based on observed volatilities of the particular types of instruments, are subject to review and modification in light of changing volatilities or market conditions.

3. *Netting.*

a. For purposes of this appendix A, netting refers to the offsetting of positive and negative mark-to-market values when determining a current exposure to be used in the calculation of a credit-equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of derivative contracts is recognized for purposes of calculating the credit-equivalent amount provided that—

i. the netting is accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the organization would have a claim to receive, or obligation to pay, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to any of the following events: default, bankruptcy, liquidation, or similar circumstances;

ii. the banking organization obtains a written and reasoned legal opinion(s) representing that in the event of a legal challenge—including one resulting from default, bankruptcy, liquidation, or similar circumstances—the relevant court and administrative authorities would find the banking organization's exposure to be the net amount under—

1. the law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

2. the law that governs the individual contracts covered by the netting contract; and

3. the law that governs the netting contract;

iii. the banking organization establishes and maintains procedures to ensure that the legal characteristics of netting contracts are kept under review in the light of possible changes in relevant law; and

iv. the banking organization maintains in its files documentation adequate to support the netting of derivative contracts, including a copy of the bilateral netting contract and necessary legal opinions.

b. A contract containing a walkaway clause is not eligible for netting for purposes of calculating the credit-equivalent amount.[61]

c. A banking organization netting individual contracts for the purpose of calculating credit-equivalent amounts of derivative contracts represents that it has met the requirements of this appendix A and all the appropriate documents are in the organization's files and available for inspection by the Federal Reserve. The Federal Reserve may determine that a banking organization's files are inadequate or that a netting contract, or any of its underlying individual contracts, may not be legally enforceable under any one of the bodies of law described in section III.E.3.a.ii. of this appendix A. If such a determination is made, the netting contract may be disqualified from recognition for risk-based capital purposes or underlying individual contracts may be treated as though they are not subject to the netting contract.

d. The credit-equivalent amount of contracts that are subject to a qualifying bilateral netting contract is calculated by adding (i) the current exposure of the netting contract (net current exposure) and (ii) the sum of the estimates of potential future credit exposures on all individual contracts subject to the netting contract (gross potential future exposure) adjusted to reflect the effects of the netting contract.[62]

e. The net current exposure is the sum of all positive and negative mark-to-market values of the individual contracts included in the netting contract. If the net sum of the mark-to-market values is positive, then the net current exposure is equal to that sum. If the net sum of the mark-to-market values is zero or negative, then the current exposure is zero. The Federal Reserve may determine that a netting contract qualifies for risk-based capital netting treatment even though certain individual contracts included under the netting contract may not qualify. In such instances, the nonqualifying contracts should be treated as individual contracts that are not subject to the netting contract.

f. Gross potential future exposure, or A_{gross} is calculated by summing the estimates of potential future exposure (determined in accordance with section III.E.2 of this appendix A) for each individual contract subject to the qualifying bilateral netting contract.

g. The effects of the bilateral netting contract on the gross potential future exposure are recognized through the application of a formula that results in an adjusted add-on amount (A_{net}). The formula, which employs the ratio of net current exposure to gross current exposure (NGR), is expressed as:

$A_{net} = (0.4 \times A_{gross}) + 0.6\ (NGR \times A_{gross})$

h. The NGR may be calculated in accordance with either the counterparty-by-counterparty approach or the aggegate approach.

i. Under the counterparty-by-counterparty approach, the NGR is the ratio of the net current exposure for a netting contract to the gross current exposure of the netting contract. The gross current exposure is the sum of the current exposures of all individual contracts subject to the netting contract calculated in accordance with section III.E.2. of this appendix A. Net negative mark-to-market values for individual netting contracts with the same counterparty may not be used to offset net positive mark-to-market values for

[61] A walkaway clause is a provision in a netting contract that permits a nondefaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the contract.

[62] For purposes of calculating potential future credit exposure to a netting counterparty for foreign-exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts falling due on each value date in each currency.

Continued

other netting contracts with the same counterparty.

ii. Under the aggregate approach, the NGR is the ratio of the sum of all of the net current exposures for qualifying bilateral netting contracts to the sum of all of the gross current exposures for those netting contracts (each gross current exposure is calculated in the same manner as in section III.E.3.h.i. of this appendix A). Net negative mark-to-market values for individual counterparties may not be used to offset net positive current exposures for other counterparties.

iii. A banking organization must use consistently either the counterparty-by-counterparty approach or the aggregate approach to calculate the NGR. Regardless of the approach used, the NGR should be applied individually to each qualifying bilateral netting contract to determine the adjusted add-on for that netting contract.

i. In the event a netting contract covers contracts that are normally excluded from the risk-based ratio calculation—for example, exchange-rate contracts with an original maturity of 14 or fewer calendar days or instruments traded on exchanges that require daily payment and receipt of cash-variation margin—an institution may elect to either include or exclude all mark-to-market values of such contracts when determining net current exposure, provided the method chosen is applied consistently.

4. *Risk weights.* Once the credit-equivalent amount for a derivative contract, or a group of derivative contracts subject to a qualifying bilateral netting contract, has been determined, that amount is assigned to the risk category appropriate to the counterparty, or, if relevant, the guarantor or the nature of any collateral.[63] However, the maximum risk weight applicable to the credit-equivalent amount of such contracts is 50 percent.

Avoidance of double-counting.

a. In certain cases, credit exposures arising from the derivative contracts covered by section III.E. of this appendix A may already be reflected, in part, on the balance sheet. To avoid double-counting such exposures in the assessment of capital adequacy and, perhaps, assigning inappropriate risk weights, counterparty credit exposures arising from the derivative instruments covered by these guidelines may need to be excluded from balance-sheet assets in calculating a banking organization's risk-based capital ratios.

b. Examples of the calculation of credit-equivalent amounts for contracts covered under this section III.E. are contained in attachment V of this appendix A.

4–058.917

IV. Minimum Supervisory Ratios and Standards

The interim and final supervisory standards set forth below specify *minimum* supervisory ratios based primarily on broad credit-risk considerations. As noted above, the risk-based ratio does not take explicit account of the quality of individual asset portfolios or the range of other types of risks to which banking organizations may be exposed, such as interest-rate, liquidity, market, or operational risks. For this reason, banking organizations are generally expected to operate with capital positions well above the minimum ratios.

Institutions with high or inordinate levels of risk are expected to operate well above minimum capital standards. Banking organizations experiencing or anticipating significant growth are also expected to maintain capital, including tangible capital positions, well above the minimum levels. For example, most such organizations generally have operated at capital levels ranging from 100 to 200 basis points above the stated minimums. Higher capital ratios could be required if warranted by the particular circumstances or risk profiles of individual banking organizations. In all cases, organizations should hold capital commensurate with the level and nature of all of the

[63] For derivative contracts, sufficiency of collateral or guarantees is generally determined by the market value of the collateral or the amount of the guarantee in relation to the credit-equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B. of this appendix A.

risks, including the volume and severity of problem loans, to which they are exposed.

Upon adoption of the risk-based framework, any organization that does not meet the interim or final supervisory ratios, or whose capital is otherwise considered inadequate, is expected to develop and implement a plan acceptable to the Federal Reserve for achieving an adequate level of capital consistent with the provisions of these guidelines or with the special circumstances affecting the individual organization. In addition, such organizations should avoid any actions, including increased risk-taking or unwarranted expansion, that would lower or further erode their capital positions.

4–058.918

A. Minimum Risk-Based Ratio After Transition Period

As reflected in attachment VI, by year-end 1992, all bank holding companies[64] should meet a minimum ratio of qualifying total capital to weighted-risk assets of 8 percent, of which at least 4.0 percentage points should be in the form of tier 1 capital. For purposes of section IV.A., tier 1 capital is defined as the sum of core capital elements less goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix. The maximum amount of supplementary capital elements that qualifies as tier 2 capital is limited to 100 percent of tier 1 capital. In addition, the combined maximum amount of subordinated debt and intermediate-term preferred stock that qualifies as tier 2 capital is limited to 50 percent of tier 1 capital. The maximum amount of the allowance for loan and lease losses that qualifies as tier 2 capital is limited to 1.25 percent of gross weighted-risk assets. Allowances for loan and lease losses in excess of this limit may, of course, be maintained, but would not be included in an organization's total capital. The Federal Reserve will continue to require bank holding companies to maintain reserves at levels fully sufficient to cover losses inherent in their loan portfolios.

Qualifying total capital is calculated by adding tier 1 capital and tier 2 capital (limited to 100 percent of tier 1 capital) and then deducting from this sum certain investments in banking or finance subsidiaries that are not consolidated for accounting or supervisory purposes, reciprocal holdings of banking organizations' capital securities, or other items at the direction of the Federal Reserve. The conditions under which these deductions are to be made and the procedures for making the deductions are discussed above in section II(B).

4–058.919

B. Transition Arrangements

The transition period for implementing the risk-based capital standard ends on December 31, 1992. Initially, the risk-based capital guidelines do not establish a minimum level of capital. However, by year-end 1990, banking organizations are expected to meet a minimum interim target ratio for qualifying total capital to weighted-risk assets of 7.25 percent, at least one-half of which should be in the form of tier 1 capital. For purposes of meeting the 1990 interim target, the amount of loan-loss reserves that may be included in capital is limited to 1.5 percent of weighted-risk assets and up to 10 percent of an organization's tier 1 capital may consist of supplementary capital elements. Thus, the 7.25 percent interim target ratio implies a minimum ratio of tier 1 capital to weighted-risk assets of 3.6 percent (one-half of 7.25) and a minimum ratio of core capital elements to weighted-risk assets ratio of 3.25 percent (nine-tenths of the tier 1 capital ratio).

Through year-end 1990, banking organizations have the option of complying with the minimum 7.25 percent year-end 1990 risk-based capital standard, in lieu of the minimum 5.5 percent primary and 6 percent total capital to total assets ratios set forth in appendix B of this part. In addition, as more fully set forth in appendix D to this part, banking organizations are expected to maintain a minimum ratio or tier 1 capital to total assets during this transition period.

[64] As noted in section 1, bank holding companies with less than $500 million in consolidated assets would generally be exempt from the calculation and analysis of risk-based ratios on a consolidated holding company basis, subject to certain terms and conditions.

4–058.92

Attachment I—Sample Calculation of Risk-Based Capital Ratio for Bank Holding Companies

Example of a banking organization with $6,000 in total capital and the following assets and off-balance-sheet items.

Balance-sheet assets	
Cash	$ 5,000
U.S. Treasuries	20,000
Balances at domestic banks	5,000
Loans secured by first liens on 1- to 4-family residential properties	5,000
Loans to private corporations	65,000
Total Balance-Sheet Assets	$ 100,000
Off-balance-sheet items	
Standby letters of credit (SLCs) backing general-obligation debt issues of U.S. municipalities (GOs)	$ 10,000
Long-term legally binding commitments to private corporations	20,000
Total Off-Balance-Sheet Items	$ 30,000

This bank holding company's total capital to *total* assets (leverage ratio) would be:

($6,000/$100,000) = 6.00%.

To compute the bank holding company's weighted-risk assets:

1. Compute the credit-equivalent amount of each off-balance-sheet (OBS) item.

OBS item	*Face value*		*Conversion factor*		*Credit-equivalent amount*
SLCs backing municipal GOs	$10,000	×	1.00	=	$10,000
Long-term commitments to private corporations	$20,000	×	0.50	=	$10,000

Table continued

2. Multiply each balance-sheet asset and the credit-equivalent amount of each OBS item by the appropriate risk weight.

OBS item	*Face value*		*Conversion factor*		*Credit-equivalent amount*
0% category					
Cash	$ 5,000				
U.S. Treasuries	20,000				
	$25,000	×	0	=	0
20% category					
Balances at domestic banks	$ 5,000				
Credit-equivalent amounts of SLCs backing GOs of U.S. municipalities	10,000				
	$15,000	×	0.20	=	$ 3,000
50% category					
Loans secured by first liens on 1- to 4-family residential properties	$ 5,000	×	0.50	=	$ 2,500
100% category					
Loans to private corporations	$65,000				
Credit-equivalent amounts of long-term commitments to private corporations	10,000				
	$75,000	×	1.00	=	$75,000
Total Risk-Weighted Assets					$80,500

This bank holding company's ratio of total capital to weighted-risk assets (risk-based capital ratio) would be:

($6,000/$80,500) = 7.45%

4–058.921

C. Optional Transition Provisions Related to the Implementation of Consolidation Requirements under FAS 167

This section IV.C. provides optional transition provisions for a banking organization that is required for financial and regulatory reporting purposes, as a result of its implementation of Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (FAS 167), to consolidate certain variable interest entities (VIEs) as defined under United States generally accepted accounting principles (GAAP). These transition provisions apply through the end of the fourth quarter following the date of a banking organization's implementation of FAS 167 (implementation date).

1. Exclusion Period

a. *Exclusion of risk-weighted assets for the first and second quarters.* For the first two quarters after the implementation date (exclusion period), including for the two calendar quarter-end regulatory report dates within those quarters, a banking organization may exclude from risk-weighted assets:

i. Subject to the limitations in section IV.C.3, assets held by a VIE, provided that the following conditions are met:

(1) The VIE existed prior to the implementation date,

(2) The banking organization did not consolidate the VIE on its balance sheet for calendar quarter-end regulatory report dates prior to the implementation date,

(3) The banking organization must consolidate the VIE on its balance sheet beginning as of the implementation date as a result of its implementation of FAS 167, and

(4) The banking organization excludes all assets held by VIEs described in paragraphs C.1.a.i. (1) through (3) of this section IV.C.1.a.i; and

ii. Subject to the limitations in section IV.C.3, assets held by a VIE that is a consolidated ABCP program, provided that the following conditions are met:

(1) The banking organization is the sponsor of the ABCP program,

(2) Prior to the implementation date, the banking organization consolidated the VIE onto its balance sheet under GAAP and excluded the VIE's assets from the banking organization's risk-weighted assets, and

(3) The banking organization chooses to exclude all assets held by ABCP program VIEs described in paragraphs (1) and (2) of this section IV.C.1.a.ii.

b. *Risk-weighted assets during exclusion period.* During the exclusion period, including the two calendar quarter-end regulatory report dates during the exclusion period, a banking organization adopting the optional provisions in section IV.C.1.a must calculate risk-weighted assets for its contractual exposures to the VIEs referenced in section IV.C.1.a on the implementation date and include this calculated amount in its risk-weighted assets. Such contractual exposures may include direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans.

c. *Inclusion of allowance for loan and lease losses in tier 2 capital for the first and second quarters.* During the exclusion period, including for the two calendar quarter-end regulatory report dates within the exclusion period, a banking organization that excludes VIE assets from risk-weighted assets pursuant to section IV.C.1.a may include in tier 2 capital the full amount of the allowance for loan and lease losses (ALLL) calculated as of the implementation date that is attributable to the assets it excludes pursuant to section IV.C.1.a (inclusion amount). The amount of ALLL includable in tier 2 capital in accordance with this paragraph shall not be subject to the limitations set forth in section II.A.2.a of this appendix.

2. Phase-In Period

a. *Exclusion amount.* For purposes of this section IV.C., exclusion amount is defined as the amount of risk-weighted assets ex cluded in section IV.C.1.a as of the implementation date.

b. *Risk-weighted assets for the third and fourth quarters.* A banking organization that excludes assets of consolidated VIEs from

risk-weighted assets pursuant to section IV.C.1.a. may, for the third and fourth quarters after the implementation date (phase-in period), including for the two calendar quarter-end regulatory report dates within those quarters, exclude from risk-weighted assets 50 percent of the exclusion amount, provided that the banking organization may not include in risk-weighted assets pursuant to this paragraph an amount less than the aggregate risk-weighted assets calculated pursuant to section IV.C.1.b.

c. *Inclusion of ALLL in tier 2 capital for the third and fourth quarters.* A banking organization that excludes assets of consolidated VIEs from risk-weighted assets pursuant to section IV.C.2.b. may, for the phase-in period, include in tier 2 capital 50 percent of the inclusion amount it included in tier 2 capital during the exclusion period, notwithstanding the limit on including ALLL in tier 2 capital in section II.A.2.a. of this appendix.

3. *Implicit recourse limitation.* Notwithstanding any other provision in this section IV.C., assets held by a VIE to which the banking organization has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold may not be excluded from risk-weighted assets.

APPENDIX B—[Reserved]

4–058.98

APPENDIX C—Small Bank Holding Company and Savings and Loan Holding Company Policy Statement

See 4–868.

APPENDIX D—[Reserved]

APPENDIX E—[Reserved]

APPENDIX F—Interagency Guidelines Establishing Information Security Standards

See 4–863.