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The Future of Affiliate Transaction Restrictions for Banks and the Federal Reserve's Emergency Intervention Authority

Case Study

This case study was prepared by Leila Perkins, Harvard Law School Class of 2013; Kirill Lebedev, Columbia Law School Class of 2014; and Jason Schachter, Harvard Law School Class of 2016; under the supervision of Professor Howell E. Jackson and Margaret Tahyar, a lecturer in law at Harvard and a partner at Davis Polk & Wardwell, LLP. It draws upon Kelley O'Mara's, Harvard Law School Class of 2014, unpublished memo, "Affiliate Transaction Restrictions: Historical Developments and Recent Events," written for Professor Jackson's class on August 28, 2013. It is intended for educational purposes only and is not intended to offer legal advice.
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I. Introduction

"One expert referred to Section 23(a) as the 'Magna Carta' of banking law"[1]
— Congressional Oversight Panel, 2010

Memorandum

TO: Deputy General Counsel

FROM: General Counsel

RE: FutureGroup

DATE: November 2017

You are a Deputy General Counsel for the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Based on reports coming out of the division of banking supervision, FutureGroup, a universal banking group that combines both a bank and a broker-dealer in its business model, is at significant risk of failing within the next few weeks. FutureGroup, with assets as of the most recent year-end of $1.32 trillion and with a largely domestic footprint, is the smallest among the large U.S. universal banking groups.[2]

A number of different work streams at FutureGroup, the banking regulators and the Department of the Treasury have been urgently tasked with examining different avenues by which FutureGroup could avoid failure.[3] The General Counsel of the Federal Reserve has assigned you to lead one of these work streams. Your work stream is to examine how much-needed liquidity could be immediately provided to FutureGroup's broker-dealer,

1 CONGRESSIONAL OVERSIGHT PANEL, THE UNIQUE TREATMENT OF GMAC UNDER THE TARP 20 (2010), https://www.gpo.gov/fdsys/pkg/CHRG-111shrg54875/pdf/CHRG-111shrg54875.pdf.

2 Based upon 2016 year-end numbers, FutureGroup is placed somewhat uncomfortably in the U.S. banking sector. It is larger than the largest U.S. super regionals—The PNC Financial Services Group, Inc. (approximately $366 billion) and U.S. Bancorp (approximately $446 billion)—but smaller than the four U.S. universal bank holding companies whose business model it most closely resembles—Citigroup Inc. (approximately $1.79 trillion), Bank of America Corporation (approximately $2.19 trillion), JPMorgan Chase & Co. (approximately $2.49 trillion) and Wells Fargo & Company (approximately $1.93 trillion).

3 Failure is understood to mean entering into a formal resolution proceeding under a Chapter 11 bankruptcy or an orderly liquidation under Title II.

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FutureBroker, to stave off failure or to provide more time for possible recovery actions.[4] Your instructions from the General Counsel are to focus solely on the means by which pre-failure liquidity might be provided immediately to FutureGroup's broker-dealer. She also has given you some background information on FutureGroup and copies of some of the statutes and regulations upon which you may be asked to provide opinions.

Over the past several years, FutureBroker has invested heavily in student loan asset-backed securities ("SLABS"). SLABS had been created as part of reform efforts in the last President's administration to partly re-privatize the student loan market and move the federal government away from being a direct lender in the market. The banking sector had been strongly encouraged to reenter the student loan market and to invest in SLABS, which in the beginning had benefited from a government subsidy and backstop. As time went on, the government backstop has declined, leading the market to reprice SLABS downward as defaults have sharply increased. As a consequence, FutureBroker's financial condition has been rapidly deteriorating. The financial decline of FutureBroker has caused knock-on effects throughout FutureGroup, which has also seen deposit outflows from FutureBank, FutureGroup's affiliate bank, as a consequence.

It is unclear whether permitting FutureGroup to fail would be orderly or disorderly and the extent to which any such failure would impact other portions of the financial sector. The worst-case scenarios, all of which are preliminary, posit that FutureGroup's failure could cause six other large banking organizations that have heavily invested in SLABS to enter into financial distress and that the contagion may transfer to a number of smaller banking groups that are less heavily invested. This may have a dire impact on the student loan market, including the possibility that student loans for the semester beginning in two weeks will not be disbursed. Various university presidents have been on cable news expressing their concerns, as have students and parents. The best-case scenarios show that the impact would be contained to FutureGroup and a few other banks with only slight disruption in the student loan and SLABS market.

[4] Another work stream is analyzing whether portfolios and businesses of FutureGroup could quickly be sold as a recovery action, but it is expected that regulatory approvals may take some time. Yet another work stream is analyzing whether it would make sense for FutureGroup to commence a Chapter 11 proceeding and bail-in its long-term debt as contemplated in its living will, which has been deemed credible by the regulators.

In conversations with Federal Reserve staff, FutureGroup senior management have discussed different methods that might improve FutureBroker's financial condition, including how to inject liquidity immediately into FutureBroker, in order to buy time for recovery actions such as sales of some of the stronger business units.[5] The main method under discussion in your work stream would involve FutureBank directly providing FutureBroker with liquidity. Section 23A and Section 23B of the Federal Reserve Act[6] ("Section 23A" and "Section 23B," respectively) place restrictions on affiliate transactions, and it is possible that some of these contemplated transactions would not be permitted under the statutes. One other possibility that FutureGroup senior management and the Federal Reserve have discussed, should the affiliate transactions proposed by FutureGroup senior management be insufficient, would be for the Federal Reserve itself to intervene to provide liquidity via collateralized loans to FutureBroker using the powers granted under Section 13(3) of the Federal Reserve Act[7] ("Section 13(3)").

FutureGroup is a recent amalgamation of several regional bank holding companies that merged to challenge the Wall Street giants. It has a technology-driven business model designed to appeal to the younger generation; starting a relationship with checking accounts and credit cards in their student years and moving forward with them throughout their life with brokerage and other services. FutureGroup consists of thousands of corporate entities, but only a few of these entities are material to the analysis requested by the General Counsel.

Figure 1 sets out a simplified organizational chart of FutureGroup focusing on these material entities. The parent top-level bank holding company is FutureGroup Holdings. Two of its wholly owned direct subsidiaries are FutureBank and FutureBroker. FutureBank is a national bank and a member of the Federal Reserve. FutureBank is also an insured depository institution ("IDI"), meaning that its deposits are insured by the FDIC pursuant to the Federal Deposit Insurance Act. FutureBroker is a broker-dealer registered with and regulated by the SEC.

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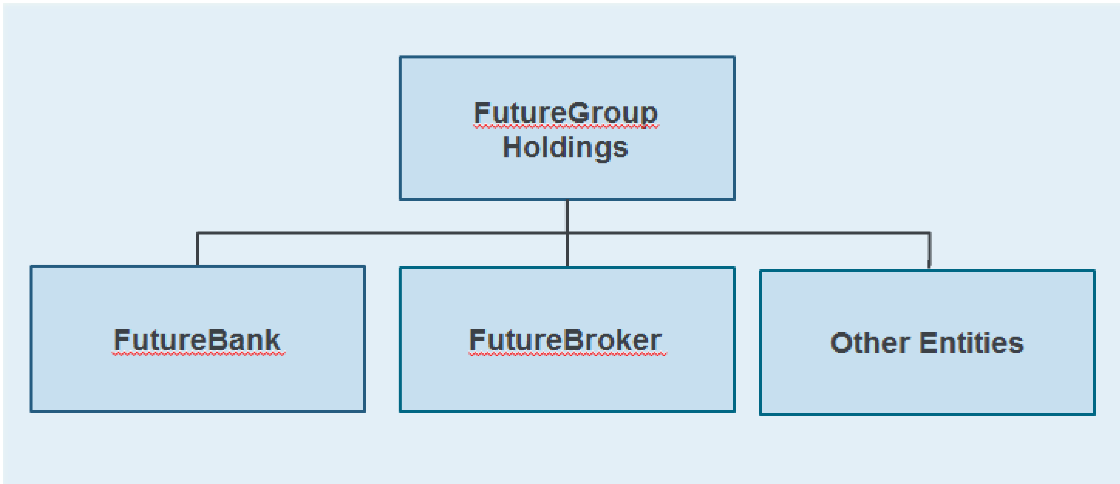
5 It has already been determined that it would not be possible to raise more debt in the private markets.

6 12 U.S.C. §§ 371c; 371c-1.

7 12 U.S.C. § 343(3).

Figure 1. FutureGroup – Simplified Organizational Structure



Source: Case Authors

The vast majority of FutureGroup's assets are concentrated in FutureBank, which holds approximately $1.02 trillion in assets, and FutureBroker, which holds approximately $302 billion in assets. The Appendix provides the simplified unconsolidated balance sheets of FutureBank and FutureBroker.

II. Sections 23A and 23B

II.A Overview of Section 23A and 23B Requirements

Sections 23A and 23B are "designed to protect against [an IDI] suffering losses in transactions with affiliates" and to "limit the ability of [an IDI] to transfer to its affiliates the subsidy arising from the institution's access to the Federal safety net."[8] One key point regarding Sections 23A and 23B is that, because of their mission to protect IDIs, these statutes are only concerned with the "transfer of cash or value **from** the bank **to** the nonbank affiliate."[9] Transactions that result in cash or value transferring from a nonbank affiliate to a bank, or transactions between two nonbank affiliates, are not covered by Sections 23A and 23B.

Most recently, during the Financial Crisis, the Federal Reserve "aggressively used its exemptive authority under Section 23A to provide liquidity to frozen markets," in

[8] Transactions Between Member Banks & Their Affiliates, 67 Fed. Reg. 76,560, 76,560 (Dec. 12, 2002) (codified at 12 C.F.R. pt. 223), http://www.gpo.gov/fdsys/pkg/FR-2002-12-12/pdf/02-30634.pdf.

[9] Michael S. Barr, Howell E. Jackson & Margaret E. Tahyar, Financial Regulation: Law and Policy 226 (2016).

conjunction with other government actions.[10] "While highly successful in helping to contain the systemic emergency," the Federal Reserve's actions raised concerns in some circles in the aftermath of the Financial Crisis.[11]

Subject to certain exemptions,[12] Section 23A places a number of limitations on affiliate transactions, including:

- **Quantitative Caps**. Covered transactions with a particular affiliate may not exceed 10% of a bank's capital stock and surplus. In aggregate, covered transactions with all affiliates may not exceed 20% of a bank's capital stock and surplus.[13]
- **Quality Requirements**. Banks may not purchase low-quality assets from an affiliate.[14]
- **Collateralization Requirements.** The statute requires that relevant transactions be fully collateralized at 100–130%, depending on the type of collateral and prohibits low-quality assets from being used as collateral.[15]
- **Safety and Soundness Evaluation**. The terms of the transaction must be consistent with safe and sound banking practices.[16]
- **Attribution Rule**. A transaction between a bank and third-party is a covered transaction "to the extent that the proceeds of the transaction are used for the benefit of, or transferred to" an affiliate.[17]

Section 23A gives the Federal Reserve the authority to issue regulations and orders "as may be necessary to administer and carry out the purposes of [Section 23A] and to prevent evasions thereof."[18] Additionally, the Federal Reserve has the authority to exempt certain

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10 *Id.* at 228.

11 *Id*.

12 Exemptions are listed in 12 U.S.C. § 371c(d). Exempt transactions remain subject to safety and soundness requirements. 12 U.S.C. § 371c(a)(4).

13 12 U.S.C. § 371c(a)(1).

14 12 U.S.C. § 371c(a)(3). An exception is if the bank committed itself to purchase the asset prior to the assets acquisition by an affiliate, pursuant to an independent credit evaluation.

15 12 U.S.C. § 371c(1), (2).

16 12 U.S.C. § 371c(a)(4).

17 12 U.S.C. § 371c(a)(2).

18 12 U.S.C. § 371c(f)(1). The statute also explicitly allows the Federal Reserve to issue regulations or interpretations regarding the treatment of netting agreements among affiliates. 12 U.S.C. § 371c(f)(4).

transactions from the requirements of Section 23A *by regulation* if (1) it "finds the exemption to be in the public interest and consistent with the purposes" of Section 23A, (2) it notifies the FDIC of such finding and (3) the FDIC does not object to the finding within 60 days on the grounds that it would pose an "unacceptable risk to the Deposit Insurance Fund."[19]

The statute also provides the OCC, the FDIC and the Federal Reserve with the authority to exempt transactions *by order* for banks under their supervision after making public interest findings in tandem with one other agency, provided that the FDIC does not object on grounds that such a finding would pose an "unacceptable risk to the Deposit Insurance Fund."[20]

Section 23B does not restrict the quantity of transactions with affiliates, but it does require that all affiliated transactions occur "on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies."[21] If there are no comparable transactions with nonaffiliates, the terms must be comparable to terms that, in good faith, would be offered to nonaffiliates.[22] Essentially, these provisions require that affiliate transactions be done on market terms. This section also restricts a bank's ability to purchase assets from an affiliate while acting in a fiduciary capacity,[23] or to purchase securities from an affiliate that is acting as the principal underwriter.[24]

Section 23B has less of a bite than Section 23A but casts a wider net, applying not only to "covered transactions," but also to sales of assets, payment of money for services,

[19] 12 U.S.C. § 371c(f)(2)(A).

[20] *See* 12 U.S.C. § 371c(f)(2)(B). The OCC is required to find in the public interest jointly with the Federal Reserve for national banks. 12 U.S.C. § 371c(f)(2)(B)(i). The FDIC and the Federal Reserve must find jointly with respect to state banks. 12 U.S.C. § 371c(f)(2)(B)(ii).

[21] 12 U.S.C. § 371c-1(a)(1)(A).

[22] 12 U.S.C. § 371c-1(a)(1)(B).

[23] 12 U.S.C. § 371c-1(b)(1)(A).

[24] 12 U.S.C. § 371c-1(b)(1)(B). This is subject to an exception if "the purchase or acquisition of such securities has been approved, before such securities are initially offered for sale to the public, by a majority of the directors of the bank based on a determination that the purchase is a sound investment for the bank irrespective of the fact that an affiliate of the bank is a principal underwriter of the securities." 12 U.S.C. § 371c-1(b)(2).

transactions in which an affiliate is an agent or broker and any third-party transactions where an affiliate has a demonstrated interest.[25]

The Federal Reserve has the authority to issue regulations providing exemptions or exclusions to Section 23B if (1) the Federal Reserve finds that "such an exemption or exclusion is in the public interest and is consistent with the purposes of" Section 23B, (2) it notifies the FDIC of such finding and (3) the FDIC does not object within 60 days that such exemption or exclusion would pose an "unacceptable risk to the Deposit Insurance Fund."[26] Unlike Section 23A, Section 23B exemptions can only be issued through regulations, not orders.

II.B History of Sections 23A and 23B

Section 23A was first enacted as part of the Banking Act of 1933 due to emerging policy concerns regarding transactions between IDIs and their non-bank affiliates.[27] As one scholar notes, "Section 23A was designed to assist the congressional effort to . . . [address] the past abusive practices of banks to extend credit and to make their financial resources available to affiliates without the benefit of careful scrutiny and unbiased consideration."[28] In 1982, considerable amendments were made to "tighten the statute and close several unintended loopholes, liberalize certain unduly restrictive provisions and simplify the statute in order to enhance compliance and enforcement."[29] Section 23B was enacted by Congress in 1987 in order to ensure that all transactions between IDIs and their affiliates are at "arm's length."[30]

It is important to note that neither Section 23A nor Section 23B is meant to prohibit transactions between banks and their affiliates, even transactions in which value leaves the bank for the affiliate. Instead, the provisions are designed to prohibit misuse and to control and regulate such transactions. When portions of the Glass-Steagall Act[31] were repealed by

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25 12 U.S.C. § 371c-1(a)(2).

26 12 U.S.C. § 371c-1(e).

27 Barr, Jackson & Tahyar, *supra* note 9, at 223.

28 Veryl Victoria Miles, Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act, 105 BANKING L.J. 476, 480 (1988).

29 S. Rep. No. 97-536 at 62 (1982).

30 Barr, Jackson & Tahyar, *supra* note 9, at 224.

31 Banking (Glass-Steagall) Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.), repealed in part by Financial Services Modernization (Gramm-Leach-Bliley) Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338.

the Gramm-Leach-Bliley Act[32] in 1999, permitting the combination of banks and broker-dealers under one affiliated group, such as FutureGroup and other banking groups in the U.S. banking sector today, Sections 23A and 23B were cited by advocates for reform as an adequate method for protecting the misuse of value leaving the bank to nonbank affiliates.[33]

Though the Federal Reserve had long possessed rulemaking authority with respect to Sections 23A and 23B, it declined to engage in rulemaking procedures until 2002, when it promulgated Regulation W, a comprehensive regime to implement Sections 23A and 23B.[34] With the issuance of Regulation W, the Federal Reserve rescinded most of its prior interpretations of Sections 23A and 23B.[35]

During the Financial Crisis, the Federal Reserve granted a number of exemptions to Section 23A. As it was written at the time, Section 23A permitted the Federal Reserve to, "at its discretion, by regulation or order exempt transactions or relationships from the requirements of this section if it finds such exemptions to be in the public interest and consistent with the purposes of this section."[36]

The Federal Reserve interpreted the "public interest" provision broadly, including finding that providing liquidity to the securities markets and not disrupting the credit market for automobile purchases are in the public interest. For example, on August 20, 2007, in conjunction with a special discount window lending facility, the Federal Reserve issued letters exempting Citigroup, Bank of America and JPMorgan Chase from the quantitative and qualitative limitations of Section 23A in order to allow their bank subsidiaries to engage in

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32 Financial Services Modernization (Gramm-Leach-Bliley) Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (codified as amended in scattered sections of 12 and 15 U.S.C.).

33 *See*, *e.g.*, S. Rep. No 106-44 at 66 (1999) (quoting the testimony of FDIC Chairman Donna Tanoue) ("From a safety-and-soundness perspective, both the bank operating subsidiary and the holding company affiliate structures can provide adequate protection to the insured depository institution from the direct and indirect effects of losses in nonbank subsidiaries or affiliates. . . .[I]n practice, regulatory safeguards for operating subsidiaries . . . and existing safeguards for affiliates, such as Sections 23A and 23B of the Federal Reserve Act, would inhibit a bank from passing any net marginal subsidy either to a direct subsidiary or to an affiliate of the holding company")

34 Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. 76,560 (Dec. 12, 2002) (codified at 12 C.F.R. pt. 223), http://www.gpo.gov/fdsys/pkg/FR-2002-12-12/pdf/02-30634.pdf.

35 Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. 76,620 (Dec. 12, 2002), http://www.gpo.gov/fdsys/pkg/FR-2002-12-12/pdf/02-30636.pdf.

36 12 U.S.C. § 371c (f)(2), prior to being amended by Dodd-Frank Act § 608(a)(4)(A).

certain securities financing transactions with their affiliated securities broker-dealers.[37] The Federal Reserve also granted exemptions to allow General Motor's banking affiliate to extend credit to consumers and dealers, covered transactions under Section 23A's attribution rule, beyond the quantitative limits to facilitate the purchase of GM automobiles.[38] Other exemptions issued by the Federal Reserve included: broad-based exemptions by regulation for money markets[39] and tri-party repo markets.[40] It is also the case that, before these exemptions were granted, the petitioning party often had to agree to certain conditions to attempt to limit potential negative repercussions of these transactions, including limits on the purposes for which the transferred funds could be used.[41]

While many have argued that these exemptions, along with other government measures, were "highly successful in helping to contain the systemic emergency," concerns about the Federal Reserve's discretion were raised.[42] For instance, Professor Saule Omarova has argued that the Federal Reserve's use of its authority to exempt transactions during the Financial Crisis, while necessary, set a bad precedent:

> During the recent crisis, the Board's strategy of dismantling the section 23A wall was a pragmatic and largely unavoidable response to severe market dislocation. As with most crisis containment measures, the Board's actions

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[37] *See* Letter from Robert deV. Frierson, Deputy Secretary of the Federal Reserve, to Patrick S. Antrim, Assistant General Counsel, Bank of America Corporation (Aug. 20, 2007), www.federalreserve.gov/boarddocs/legalint/FederalReserveAct/2007/20070820a/20070820a.pdf; Letter from Robert deV. Frierson, Deputy Secretary of the Federal Reserve, to Carl Howard, General Counsel, Citigroup Inc. (Aug. 20, 2007), www.federalreserve.gov/boarddocs/legalint/FederalReserveAct/2007/20070820b/20070820b.pdf; Letter from Robert deV. Frierson, Deputy of the Federal Reserve, to Kathleen A. Juhase, JPMorgan Chase & Co. (Aug. 20, 2007), www.federalreserve.gov/boarddocs/legalint/FederalReserveAct/2007/20070820c/20070820c.pdf.

[38] Letter from Robert deV. Frierson, Deputy Secretary of the Federal Reserve, to Richard K. Kim, Wachtell, Lipton, Rosen & Katz (Dec. 24, 2008), https://www.federalreserve.gov/supervisionreg/legalinterpretations/federalreserveact20081224.pdf; Letter from Robert deV. Frierson, Deputy Secretary of the Federal Reserve, to Richard K. Kim, Wachtell, Lipton, Rosen & Katz (May 21, 2009), https://www.federalreserve.gov/supervisionreg/legalinterpretations/federalreserveact20081224.pdf.

[39] 12 C.F.R. § 223.42(o); Transactions Between Member Banks and Their Affiliates: Exemption for Certain Purchases of Asset-Backed Commercial Paper by a Member Bank From an Affiliate, Interim Final Rule, 73 Fed. Reg. 55,708 (Sept. 26, 2008), http://www.gpo.gov/fdsys/pkg/FR-2008-09-26/pdf/E8-22701.pdf. Final Rule issued at 74 Fed. Reg. 6,226 (Feb. 6, 2009), http://www.gpo.gov/fdsys/pkg/FR-2009-02-06/pdf/E9-2338.pdf.

[40] 12 C.F.R. § 223.42(n). Transactions Between Member Banks and Their Affiliates: Exemption for Certain Securities Financing Transactions Between a Member Bank and an Affiliate, 73 Fed. Reg. 54,307 (Sept. 19, 2008), http://www.gpo.gov/fdsys/pkg/FR-2008-09-19/pdf/E8-21792.pdf. Final Rule issued at 74 Fed. Reg. 6,225 (Feb. 6, 2009), http://www.gpo.gov/fdsys/pkg/FR-2009-02-06/pdf/E9-2337.pdf.

[41] *See supra* notes 37 and 38.

[42] Barr, Jackson & Tahyar, *supra* note 9, at 228 (2016).

> operated to suspend peacetime regulation of bank affiliate transactions. However, such suspension inevitably creates a serious moral hazard issue and threatens to undermine the legitimacy and efficacy of the regulatory regime after the crisis, unless followed by regulatory reforms aimed at preventing future crises and redesigning peacetime regulation to address the causes of the prior failure. This is a particularly salient issue with respect to section 23A, given the massive nature of its "suspension" during the latest crisis. If a fundamental expectation built into the operation of section 23A is that regulators always remove the statutory limitations on bank affiliate transactions in crises, that expectation will shape the long-term incentives for financial institutions' risk-taking in ways contrary to the legislative intent. It is also highly likely to become a self-fulfilling prophecy.[43]

Partly as a consequence of these types of concerns,[44] the Dodd-Frank Wall Street Reform and Consumer Protection Act[45] ("Dodd-Frank") amended Sections 23A and 23B, which also necessitated changes to the Federal Reserve's past exemptive practices.[46] Most notably, Dodd-Frank:

- Expanded the definition of a "covered transaction" in Section 23A to include credit exposure from securities lending and borrowing transactions and derivative transactions.[47]
- Explicitly required the posting of collateral for securities borrowing and lending transactions, as well as derivative transactions, under Section 23A.[48]
- Reclassified repurchase agreements as loans or extensions of credit rather than asset purchases, thus requiring such transactions to be collateralized.[49]

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43 Saule T. Omarova, From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act, 89 N.C. L. Rev. 1683, 1769-70 (2011).

44 Barr, Jackson & Tahyar, *supra* note 9, at 228 (2016).

45 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S. Code).

46 The Federal Reserve should also make changes to Regulation W in light of the Dodd-Frank changes, but none have yet been published.

47 *See* 12 U.S.C. § 371c(b)(7)(F), (G), as amended by Dodd-Frank Act § 608(a)(1)(B)(iv).

48 *See* 12 U.S.C. § 371c(c)(1), as amended by Dodd-Frank Act § 608(a)(2)(A)(i).

49 *See* 12 U.S.C. § 371c(b)(7)(A), as amended by Dodd-Frank Act § 608(a)(1)(B)(i).

- Eliminated the exception from the quantitative limits for covered transactions between a bank and its financial subsidiaries.[50]

- Significantly curtailed the Federal Reserve's freedom in administering the statute by:

- Requiring that general exemptions occur by regulation, rather than order. Prior to Dodd-Frank, the Federal Reserve could make general exemptions through either procedure.

- Removing the Federal Reserve's unilateral exemptive authority pursuant to Section 23A. Under the new framework:

  - The FDIC may veto the Federal Reserve's proposed general exemptions if it finds that there may be an unacceptable risk to the Deposit Insurance Fund.[51]

  - The Federal Reserve must jointly find with the FDIC that a specific exemption for state member banks (directly supervised by the Federal Reserve) is in the public interest, or order to exempt by order.[52] The FDIC may still veto such an exemption.[53]

  - The OCC or the FDIC may by order approve exemptions for banks under their supervision if the agencies make a joint finding of public interest with the Federal Reserve, provided that the FDIC does not find that such exemption would pose an unacceptable risk to the Deposit Insurance Fund.[54]

- Removing the Federal Reserve's unilateral exemptive authority under Section 23B, allowing the FDIC to veto any proposed exemption.[55]

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50 *See* 12 U.S.C. § 371c(e), as amended by Dodd-Frank Act § 609(a).
51 *See* 12 U.S.C. § 371c(f)(2)(A)(ii), as amended by Dodd-Frank Act § 608(a)(4)(A)(ii).
52 *See* 12 U.S.C. § 371c(f)(2)(B)(ii)(I), as amended by Dodd-Frank Act § 608(a)(4)(A)(iv).
53 *See* 12 U.S.C. § 371c(f)(2)(B)(ii)(II), as amended by Dodd-Frank Act § 608(a)(4)(A)(iv).
54 *See* 12 U.S.C. § 371c(f)(2)(B)(i)(I), (f)(2)(B)(ii)(I); as amended by Dodd-Frank Act § 608(a)(4)(A)(iv).
55 *See* 12 U.S.C. § 371c-1(e)(2), amended by Dodd-Frank Act § 608(b)(6).

III. Sections 13(3)

III.A Overview of Section 13(3) Requirements

The Federal Reserve's traditional program for providing liquidity is its discount window whereby overnight extensions of secured credit to IDIs can help relieve strains on the banking system. The Federal Reserve's use of the discount window is generally viewed as a basic part of the central bank's functions and is mostly noncontroversial.[56]

Section 13(3) is more controversial, particularly after the Financial Crisis. Section 13(3), taken together with applicable provisions of Regulation A, permits the Federal Reserve, upon the vote of five of its members, to authorize any Federal Reserve Bank to extend secured loans[57] through a program or facility to eligible persons or entities under certain circumstances.[58] Section 13(3) is not limited to providing loans to IDIs, but rather has a broader scope of types of possible recipients. The following list summarizes the requirements for a Section 13(3) program or facility:

- **Unusual and exigent circumstances.** The Federal Reserve can only extend credit under Section 13(3) under "unusual and exigent circumstances." [59] Neither the statute nor the regulation defines "unusual" or "exigent."

- **Treasury Secretary approval.** Any program or facility established under Section 13(3) must obtain prior approval from the Treasury Secretary.[60]

- **Broad-based eligibility.** Any program or facility authorized under Section 13(3) must have broad-based eligibility,[61] which means that it is "designed to provide liquidity to

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[56] *See* Davis Polk & Wardwell LLP, *Financial Crisis Manual: A Guide to the Laws, Regulations, and Contracts of the Financial Crisis* 20 (2009), https://www.davispolk.com/files/files/Publication/d1ab7627-e45d-4d35-b6f1-ef356ba686f2/Preview/PublicationAttachment/2a31cab4-3682-420e-926f-054c72e3149d/fcm.pdf;

[57] This is an important point of distinction with other methods employed by the government during the Financial Crisis. While programs such as the Troubled Asset Relief Program ("TARP") involved an equity investment, Section 13(3) only permits fully collateralized loans. Furthermore, the taxpayer risk from a Federal Reserve loan is of a different type than that associated with a government equity investment. If the Federal Reserve is not repaid, it might have a lower surplus to remit to the Treasury at the end of the year. The risk taken is different from a direct equity investment by the taxpayer, which is, by its nature, not collateralized.

[58] 12 U.S.C. § 343(3); 12 C.F.R. § 201.4(d).

[59] 12 U.S.C. § 343(3)(A); 12 C.F.R. § 201.4(d)(1).

[60] 12 U.S.C. § 343(3)(B)(iv); 12 C.F.R. § 201.4(d)(2).

[61] 12 U.S.C. § 343(3)(A).

an identifiable market or sector of the financial system."[62] A program or facility does not have broad-based eligibility if: (1) It is "designed for the purpose of assisting one or more specific companies" avoid insolvency; (2) It is "designed for the purpose of aiding one or more failing financial companies"; or (3)"Fewer than five persons or entities would be eligible to participate in the program or facility." [63]

- **Adequate collateral.** Loans under Section 13(3) must be secured with collateral that satisfies the lending Federal Reserve Bank, which must, prior to the lending, "assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for" all such loans.[64]

- **Interest rate.** The Federal Reserve will set the interest rate established for any loan under Section 13(3) at a penalty level that is (1) at "a premium to the market rate in normal circumstances"; (2) "affords liquidity in unusual and exigent circumstances"; and (3) "encourages repayment of the [loan] and discourages use of the program or facility" once economic conditions normalize.[65]

- **Insolvency.** A Federal Reserve Bank cannot extend a loan under Section 13(3) to a person or entity that is insolvent.[66]

- **Unavailability of adequate credit accommodations.** In order to receive funds, evidence must be provided that participants in any program or facility are "unable to secure adequate credit accommodations from other banking institutions."[67]

- **Public disclosure.** As soon as reasonably practicable, but no later than seven days after authorizing a program or facility under Section 13(3), the Federal Reserve and the relevant Federal Reserve Banks must make publicly available: a description of (1) the program or facility, (2) the market or sector of the financial system it is intended

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62 12 C.F.R. § 201.4(d)(4)(ii).
63 12 C.F.R. § 201.4(d)(4)(iii); *see* 12 U.S.C. § 343(3)(B).
64 12 U.S.C. § 343(3)(B)(i); *see* 12 C.F.R. § 201.4(d)(6).
65 12 C.F.R. § 201.4(d)(7).
66 12 U.S.C. § 343(3)(B)(ii); 12 C.F.R. § 201.4(d)(5).
67 12 U.S.C. § 343(3)(A); 12 C.F.R. § 201.4(d)(8).

to provide liquidity to, (3) the unusual or exigent circumstances, (4) the intended effect, and (5) the terms or conditions for participation.[68]

- **Congressional disclosure.** The Federal Reserve must provide to Congress information concerning the identity of each participant, the amounts borrowed, and the value of the collateral. Such information shall be kept confidential from the public upon the written request of the Chairperson of the Federal Reserve.[69]

- **Termination.** The Federal Reserve may "at any time terminate a program or facility" established under Section 13(3).[70] Any program or facility must cease extending new credit one year after making its first loan, unless five members of the Federal Reserve vote to renew, and the Treasury Secretary approves, should "unusual and exigent circumstances continue to exist and the program or facility continues to appropriately provide liquidity to the financial system."[71]

III.B History of Section 13(3)

Section 13(3) was first enacted in 1932.[72] It was used in a limited fashion after its enactment but soon fell into disuse even during the Great Depression after other New Deal measures came to be used instead. Following the Great Depression, Section 13(3), while invoked on two other occasions, was not actually used again to make loans until 2008.[73] At that time, Section 13(3) permitted Federal Reserve Banks to extend secured loans, in "unusual and exigent circumstances," to "any individual, partnership, or corporation" that was "unable to secure adequate credit accommodations from other banking institutions."[74]

During the Financial Crisis, the Federal Reserve used its Section 13(3) powers to provide secured loans both (1) through facilities designed to extend credit to a wide range of market participants and (2) direct or indirect extensions of credit to particular institutions.[75]

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68 12 C.F.R. § 201.4(d)(3); *see* 12 U.S.C. § 343(3)(C).

69 12 U.S.C. § 343(3)(D); *see* 12 C.F.R. § 201.4(d)(3).

70 12 C.F.R. § 201.4(d)(9)(iv).

71 12 C.F.R. § 201.4(d)(9)(i), (ii).

72 *See* Davis Polk, *supra* note 56, at 21 n.17, https://www.davispolk.com/files/files/Publication/d1ab7627-e45d-4d35-b6f1-ef356ba686f2/Preview/PublicationAttachment/2a31cab4-3682-420e-926f-054c72e3149d/fcm.pdf.

73 *Id*.

74 12 U.S.C. § 343(3), prior to amendment by Dodd-Frank.

75 *See id.* at 22-35.

The Section 13(3) facilities set up by the Federal Reserve to extend credit to a wide range of market participants, included:

- The **Term Securities Lending Facility** (TSLF) and **Primary Dealer Credit Facility** (PDCF), which provided secured loans to primary dealers, which are firms authorized to purchase government securities directly from the government and resell on the market.[76]

- The **Asset-Backed Commercial Paper Money** (AMLF) and the **Commercial Paper Funding Facility** (CPFF), each designed to provide liquidity to the commercial paper market.[77]

- The **Term Asset-backed Securities Loan Facility** (TALF), which provided non-recourse loans to private investors to encourage the purchase of non-mortgage asset-backed securities.[78]

The Federal Reserve employed Section 13(3) to extend secured loans to provide direct or indirect assistance to particular institutions, including:

- **Bear Stearns**. In March 2008, Bear Stearns saw its cash reserves depleted and faced bankruptcy. The Federal Reserve provided a secured loan under a funding structure designed to assist JPMorgan's purchase of Bear Stearns. Some have argued that the "economic reality" of this transaction was that the Federal Reserve, using a special purchase vehicle, purchased certain illiquid assets from Bear Stearns, even though the transaction was structured as a secured loan with adequate collateral to the special purchase vehicle in accordance with the requirements of 13(3) at that time.[79]

- **AIG**. In September 2008, the Federal Reserve exercised its 13(3) authority to lend AIG funds under a secured revolving credit facility. These loans were subsequently restructured, and additional credit extended, under a funding structure designed to

[76] *See id.* at 22-24, 27-28.
[77] *See id.* at 32-34.
[78] *See id.* at 144-179.
[79] *See id.* at 24-27.

> permit special purchase vehicles, upon receiving a secured loan from the Federal Reserve, to purchase certain illiquid assets from AIG.[80]

Most notably, the Federal Reserve did not use its Section 13(3) authority to lend to Lehman Brothers, which subsequently failed. The Federal Reserve has argued that, unlike Bear Stearns and AIG, Lehman Brothers did not have sufficient collateral to permit a loan under Section 13(3) of sufficient size to make a difference. Many have been critical of the Federal Reserve's decision that Lehman Brothers lacked adequate collateral to permit lending under Section 13(3).[81]

> *If big financial institutions know they can get cheap cash from the Fed in a crisis, they have less incentive to manage their risks carefully – which further increases the chance of another Financial Crisis.*[82]
>
> *— Senator Elizabeth Warren (D-MA), 2015*

Others have criticized the Federal Reserve's use of Section 13(3), including Jeb Hensarling, Chairperson of the House Financial Services Committee, because, among other reasons, its "use risks exacerbating moral hazard costs," particularly following its unprecedented use during the Financial Crisis.[83] The crux of the moral hazard argument is that banking organization managers, shareholders, and bondholders may be willing engage in risky decisions if they think that the government will provide assistance should these risks not pay off. Ben Bernanke, Chairperson of the Federal Reserve during the Financial Crisis, has argued that the Federal Reserve helped limit the potential for moral hazard during the Financial Crisis by giving "tough deals" to the firms who were being bailed out.[84] Many have also

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80 *See id.* at 28-32.

81 *See, e.g.*, Alan Blinder, *Princeton's Alan Blinder Gives Old Friend Ben Bernanke an A-*, PBS NEWSHOUR (Feb. 3, 2014), http://www.pbs.org/newshour/making-sense/princetons-alan-blinder-gives-old-friend-ben-bernanke/.

82 Elizabeth Warren, *Warren, Vitter Introduce Bailout Prevention Act* (May 13, 2015), https://www.warren.senate.gov/?p=press_release&id=818.

83 Letter from Jeb Hensarling, Chairman of the U.S. House of Representatives Committee on Financial Services, to Ben Bernanke, Chairman of the Federal Reserve, Docket Number R-1476 (Jan. 13, 2014), https://www.federalreserve.gov/SECRS/2014/April/20140430/R-1476/R-1476_011614_111881_456865888833_1.pdf.

84 *See* Ylan Q. Mui, *Ben Bernanke on Why He Was Right about the Economy*, THE WASHINGTON POST (October 14, 2015), https://www.washingtonpost.com/news/wonk/wp/2015/10/14/ben-bernanke-on-why-he-was-right-about-the-economy/?utm_term=.64999d6c9c18 (quoting Bernanke: "The moral hazard is that if you bail out firms that they will imagine that they will always be bailed out and they won't have any incentive to be cautious or take risks . . . In real time, we weren't generous to the firms that were bailed out. They got very tough deals: Shareholders lost most of their equity. Creditors took a hit in some cases. Some workers lost their jobs. It wasn't a pleasant experience. I don't think many firms would voluntarily choose the fate of Bear Stearns").

contended that, regardless of moral hazard and other concerns, the Federal Reserve loans under Section 13(3) during the Financial Crisis prevented it from worsening.[85]

Dodd-Frank made significant changes to Section 13(3) in order to limit the circumstances by which the Federal Reserve could use its Section 13(3) powers under the statute. The following list[86] indicates the changes made by Dodd-Frank to Section 13(3):

- **Limits Power to Market-Wide Programs.** The Act limits Section 13(3) assistance to a "program or facility with broad-based eligibility," rather than to any single and specific individual, partnership or corporation that is not part of such a broad-based program.[87]

- **Policies and Procedures.** The Federal Reserve must establish by regulation, in consultation with the Treasury Secretary, policies and procedures governing emergency lending designed to ensure that any emergency lending program or facility is designed to provide liquidity to the financial system and not to aid a single and specific failing financial company, that collateral for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion.[88]

- The policies and procedures must require that a Federal Reserve Bank assign a lendable value to all collateral for any loan executed by such a Federal Reserve Bank

85 *See*, *e.g.*, Hal S. Scott, *Connectedness and Contagion: A Global Perspective*, Address to the International Monetary Fund (Nov. 7, 2016), https://www.imf.org/external/np/seminars/eng/2016/contagionrisk/110716.pdf. Former Congressperson Barney Frank has argued that the existence of Section 13(3) loans made the funds authorized by Congress go further than they otherwise would have. He argued: "It is very clear that the Obama administration . . . is using the money in the TARP program in conjunction with the lending authority of the Federal Reserve. That is, the TARP money is going further than it otherwise might because the Federal Reserve has its capacity to lend." *See* Davis Polk, *supra* note 56, (citing *An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis: Hearing Before the H. Comm. on Financial Servs.*, 111th Cong. 2 (2009) (opening statement of Rep. Barney Frank)).

86 Adapted with conforming changes from Davis Polk & Wardwell LLP, *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010*, 112-13 (July 21, 2010), https://www.davispolk.com/files/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf.

87 12 U.S.C. § 343(A), as amended by Dodd-Frank Act § 1101(a).

88 12 U.S.C. § 343(B)(i), as amended by Dodd-Frank Act § 1101(a)(6).

under amended Section 13(3) to determine whether the loan is secured satisfactorily.[89]

- The Federal Reserve must establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent.[90]

- Any program or facility must not be structured to assist a single and specific company.[91]

- If a recipient of a loan under Section 13(3) becomes subject to FDIC resolution authority, the Federal Reserve Bank has a claim against the covered entity equal to the amount of any net realized losses on such loans, with the same priority as an obligation to the Treasury Secretary.[92]

- **Approval from Treasury Secretary**. The Federal Reserve is required to obtain the Treasury Secretary's approval before establishing a program or facility under Section 13(3).[93]

- **Reporting Requirements**. The Federal Reserve must provide to Congress, within seven days, a report that justifies the exercise of authority and describes the material terms of the assistance. Upon the request of the Chairman of the Federal Reserve Board, certain information (including the identity of the participants in the program or facility) may be kept confidential.[94]

- **Additional Federal Reserve Transparency**. The U.S. Government Accountability Office ("GAO") is required to conduct a one-time audit of all loans or other financial assistance provided through the Federal Reserve's exercise of Section 13(3) authority between December 1, 2007, and the date of enactment. The GAO will also have the

89 12 U.S.C. § 343(B)(i), as amended by Dodd-Frank Act § 1101(a)(6).
90 12 U.S.C. § 343(B)(ii), as amended by Dodd-Frank Act § 1101(a)(6).
91 12 U.S.C. § 343(B)(iii), as amended by Dodd-Frank Act § 1101(a)(6).
92 12 U.S.C. § 343(E), as amended by Dodd-Frank Act § 1101(a)(6).
93 12 U.S.C. § 343(B)(iv), as amended by Dodd-Frank Act § 1101(a)(6).
94 12 U.S.C. § 343(C), as amended by Dodd-Frank Act § 1101(a)(6).

authority to audit the Federal Reserve's Section 13(3) assistance programs and other credit facilities for certain purposes.[95]

- **Disclosure.** The Federal Reserve is required to disclose on an ongoing basis, within specified time periods, additional information regarding the borrowers and counterparties participating in emergency credit facilities, discount window lending programs and open market transactions authorized or conducted by the Federal Reserve or a Federal Reserve Bank. These new transparency provisions will not affect any pending lawsuit filed under the Freedom of Information Act prior to enactment.[96]

In 2015, the Federal Reserve issued a rule to implement the changes to Section 13(3) required by Dodd-Frank. Of particular note, this rule gave "broad-based eligibility" the detailed definition described in Section III.A above.[97]

Many have criticized the Dodd-Frank changes to Section 13(3) and the accompanying regulation as unduly restricting the Federal Reserve's ability to contain another Financial Crisis. For instance, Professor Hal Scott has argued that the Federal Reserve now has "less effective weapons" at its disposal to respond to a Financial Crisis, which could "put more pressure on Congress to bail out large financial institutions in the future."[98] Others are less critical. For instance, Ben Bernanke has called this rule a "sensible compromise which clarifies the procedures for Fed lending in a panic while responding to critics' concerns," although he expressed concern that stigma from the new reporting requirements, in particular, may

[95] 31 U.S.C. § 714(e).

[96] 12 U.S.C. § 248(s)

[97] *See* 12 C.F.R. § 201.4(d)(4); *see* 12 U.S.C. § 343(3)(A).

[98] Hal S. Scott, Written Testimony of Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School, Director of the Committee on Capital Markets Regulation: Before the Comm. on Banking, Housing, and Urban Affairs, U.S. Senate (2016), https://www.banking.senate.gov/public/_cache/files/a7fc219d-7aab-47e0-a528-e041b48bf10a/C1C33EEEC64931BEE4E5C6E57060E61F.060716-scott-testimony.pdf; *see also* John L. Walker, *Emergency Tools to Contain a Financial Crisis*, 35 REV. OF BANKING & FIN. LAW 672, 730 (2016) ("The severe curtailment of the Federal Reserve's section 13(3) authority by the Dodd-Frank Act to prohibit lending to a single, but solvent, firm… represents a mistaken, populist driven, overreaction to Federal Reserve actions that prevented the financial system from going over the brink").

deter necessary borrowing in a time of panic, harming the government's ability to respond to a crisis.[99]

IV. Discussion Questions

V. Question 1

The General Counsel comes into your war room and asks you to analyze whether each of the following proposed transactions would be permitted under Section 23A.[100] If you determine that the transaction would be permitted under Section 23A, analyze whether it would also be permitted under Section 23B. Please indicate, where appropriate, if you need any additional information to complete your analysis. Each of these proposed transactions should be analyzed as independent alternatives of each other—they are not cumulative.

The General Counsel has provided you with additional information concerning existing FutureBank transactions: FutureBank has capital stock and surplus, as defined by Regulation W,[101] of $90 billion. It participates in outstanding covered transactions, as defined by Section 23A,[102] with FutureBroker worth $3 billion, which are in addition to any transactions discussed below. FutureBank does not participate in any covered transactions with other affiliates, as defined by Section 23A.[103]

Question 1(a): *An unsecured loan of $5 billion by FutureBank to FutureBroker.*

Question 1(b): *$5 billion loan by FutureBank to FutureBroker secured by state government bonds with a market value of $6 billion.*

Question 1(c): $10 billion loan by FutureBank to FutureBroker secured by state government bonds with a market value of $12 billion.

Question 1(d): Purchase by FutureBank from FutureBroker of highly liquid, recently issued U.S. Treasuries that have a combined market value of $5 billion, for $5 billion in cash. These

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99 Ben S. Bernanke, *Fed Emergency Lending*, BROOKINGS INSTITUTE (Dec. 3, 2015), https://www.brookings.edu/blog/ben-bernanke/2015/12/03/fed-emergency-lending/.

100 As part of your analysis, be sure to consider whether each of these transactions is a “covered transaction,” as defined by 12 U.S.C. § 371c(b)(7).

101 *See* 12 C.F.R. § 223.3(d).

102 *See* 12 U.S.C. § 371c(b)(7).

103 *See* 12 U.S.C. § 371c(b)(1).

U.S. Treasuries are quoted routinely in a widely disseminated publication that is readily available to the general public.

Question 1(e): FutureGroup Holdings and FutureBroker maintain separate deposit accounts at FutureBank. Transfer of $50 million in cash from FutureGroup Holdings' account at FutureBank to FutureBroker's account at FutureBank.

Question 1(f): A repurchase agreement under which FutureBank purchases, for $5 billion in cash, SLABS, that, collectively, had a face value of $6 billion at the time they were originally purchased. Based on its internal processes, FutureBroker recently classified the SLABS as substandard, meaning that they are now likely worth much less than the $6 billion that they were originally purchased for. In exchange, FutureBroker agrees to repurchase these securities at a price consistent with market terms for such agreements in six months.

Question 1(g): A repurchase agreement under which FutureBank purchases, for $5 billion in cash, high-quality corporate bonds issued by a non-affiliated company that are valued at $6 billion. In exchange, FutureBroker agrees to repurchase these securities at a price consistent with market terms for such agreements in six months.

Question 1(h): Instead of a repurchase agreement, outright purchase by FutureBank of the SLABS referred to in Question 1(f) above for $5 billion in cash.

VI. Question 2

A Federal Reserve Governor, an economist by training who was around during the last Financial Crisis, wanders into your war room. He tells you he has just been on the phone with the Comptroller of the Currency, whose staff has concluded that FutureBank has the capacity to declare a dividend to FutureGroup, which could then downstream the cash received as a contribution to FutureBroker. The Office of the Comptroller of the Currency ("OCC") staff is still working out the exact amount that would be permitted, but it is hoped that it would provide enough of an equity infusion to make FutureBroker not insolvent—for the moment. The Governor asks you whether Section 23A would prohibit the dividend.

VII. Question 3

FutureGroup's senior management and Federal Reserve staff have both determined that a covered transaction that does not comply with the quantitative limits of Section 23A(a)(1) would be the preferred method to inject liquidity into FutureBroker. Can the Federal Reserve or another prudential regulator exempt the proposed transaction from the Section 23A requirements?

VIII. Question 4

The General Counsel pops her head into your war room to announce that the Chair of the Democrat-controlled Senate Banking Committee, who has been publicly expressing his deep concern about the SLABS market as its relates to student loans, has called for a hearing at which the Chair of the Federal Reserve will be asked to testify. Among many topics at the hearing, it is quite clear that she will be asked whether the Federal Reserve supports waiving Section 23A if necessary. The Chair of the FDIC has also been called to testify but has refused to share her views in advance with the Chair of the Federal Reserve. From public statements, there are Senators both for and hostile to any Section 23A exemptions.

Do you recommend that the Chair of the Federal Reserve support granting an exemption from Section 23A to FutureGroup? Do you think that the FDIC staff would think about this question any differently than you are?

IX. Question 5

Cable news is playing in the war room and it shows the Chairman of the Republican-controlled House Financial Services Committee announcing that there should be no bailouts like TARP that put taxpayer funds at risk for equity investments into banking organizations that have made poor choices.[104] The President has also announced that she expects the Federal Reserve to do "what is necessary" to fix the problems as she does not intend to invoke OLA or use the OLF at this time.

[104] Since the Financial Crisis, numerous politicians have come out against the use of future equity bailouts. *See, e.g.*, Jeb Hensarling, *Ending Bailouts*, https://hensarling.house.gov/issues/ending-bailouts ("I have been opposing bailouts since the beginning of the Financial Crisis. The answer to criminal greed on Wall Street is not more taxpayer bailouts, it is bankruptcy and more vigorous enforcement of our existing fraud and consumer protection laws. The fundamental truth is that the best way to prevent future taxpayer bailouts is to end taxpayer bailouts."); President Barack Obama, Remarks by the President on Financial Reform (Jan. 21, 2010), https://obamawhitehouse.archives.gov/the-press-office/remarks-president-financial-reform ("Never again will the American taxpayer be held hostage by a bank that is 'too big to fail'"); Sheila Bair, Chairperson of the FDIC, *Beyond Bankruptcy and Bailouts: The FDIC Resolution Process Is the Right Model for Failing Firms* (Apr. 7, 2010), https://www.fdic.gov/news/letters/beyond_bankruptcy.html ("Never again should taxpayers be asked to bail out large, failing financial firms").

At the same time, the Chair of the Senate Banking Committee, who is the likely Democratic nominee in the next Presidential election, has announced that he is deeply concerned about unaccountable discretion at the Federal Reserve and has warned that he will hold the Federal Reserve strictly accountable if it takes any actions that shield the bondholders and shareholders of banking organizations from taking losses. He has remarked that bondholders of the top-level holding company, in particular, should be bailed-in and not saved like in the last Financial Crisis. In his view, any use of the Federal Reserve's discount window or Section 13(3), even if it is a secured loan, is also tantamount to a "quasi-bailout" that the country should not support. He has stated: "We should let these financial institutions fail and use their credible living wills. Bondholders and shareholders need to take the hit. We will jail the management later."

News has also reached your war room that even though the OCC and the Federal Reserve would like to grant a Section 23A exemption, the FDIC staff is not yet convinced and wants more time to reflect. The FDIC staff is pointedly making it clear they have 60 days to make a decision.

The General Counsel informs you that all possible Section 23A transactions that could be entered into without an exemption have been entered into. She also informs you that FutureGroup management has asked the OCC for permission for FutureBank to pay a dividend to FutureGroup Holdings with the understanding that the cash would then be used for an equity infusion into FutureBroker. FutureBank's regional Federal Reserve Bank has also agreed that it will provide FutureBank access to the discount window (collateralized loans from the regional Federal Reserve Bank to FutureBank) and FutureBank has used up the limit of its possible collateralized lending from the Federal Home Loan Bank Board.[105]

Despite all of these efforts, however, it is becoming clear that none of these tools will be sufficient. The Treasury Secretary has informed the Chair of the Federal Reserve that he is prepared to approve any use of Section 13(3) that is cleared by the Federal Reserve. The General Counsel and several of the Federal Reserve Governors come to your war room with

[105] *See* Kathryn Judge, *Three Discount Windows*, 99 CORNELL L. REV 795 (2014), http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=4630&context=clr.

the message that, at the moment, Section 13(3) looks like the only feasible option to prevent FutureGroup from entering into a Chapter 11 bankruptcy.

There are competing views on whether an orderly resolution of FutureGroup by bailing in its bondholders or under OLA would cause a wider impact, either in the financial sector, the SLABS market, student loans or the wider economy. Treasury Department staff and Federal Reserve economists are in a war room across the hall debating the point. Talking heads on cable news are taking multiple points of view.

Your repeated entreaties to the General Counsel, the economists and even to the Federal Reserve Governors, who are crowding into your room, for them to give you a clear and crisp version of the facts that you might rely upon for your legal analysis, have been met with the response that you will have to reach your conclusion based on uncertain facts. One of the Federal Reserve governors, who was around during the Financial Crisis, takes you aside and points to the following passage from an interview with Alan Blinder:.

> "Bernanke, I know, disputes this judgment on the grounds that the Fed lacked the legal authority to do what he thought best: to "save" Lehman with a big loan, much as it had done with Bear Stearns six months earlier. . . Maybe so — if you construed the law narrowly and evaluated the quality of Lehman's collateral with green eyeshades. But were those Bear Stearns assets, which JP Morgan Chase had refused to accept, really of such fabulous quality? And can't you always find lawyers who will say yes, rather than no?"[106]

You ask the General Counsel and the Federal Reserve Governors for some time to confer alone with your team to come up with the best possible legal and policy analysis to invoke Section 13(3). They tell you that you have 45 minutes to do so.

Question 5(a): *Is the Federal Reserve legally permitted to use its Section 13(3) authority to authorize a secured loan solely to a single company, FutureBroker, for the purpose of keeping it from failing?*

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[106] Alan Blinder, *Princeton's Alan Blinder Gives Old Friend Ben Bernanke an A-*, PBS NEWSHOUR (Feb. 3, 2014), http://www.pbs.org/newshour/making-sense/princetons-alan-blinder-gives-old-friend-ben-bernanke/.

Question 5(b): *If any loan contemplated under Question 5(a) is impermissible or inadequate, can the Federal Reserve set up a program or facility to extend loans to FutureBroker and the six other at-risk bank groups that complies with Section 13(3)'s broad-based eligibility requirements?*

APPENDIX TO CASE STUDY

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Section 23A of the Federal Reserve Act

(codified in 12 U.S.C. § 371c. Banking affiliates)

Blackline Showing Dodd-Frank Amendments[1]

(a) Restrictions on transactions with affiliates

(1) A member bank and its subsidiaries may engage in a covered transaction with an affiliate only if—

(A) in the case of any affiliate, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 10 per centum of the capital stock and surplus of the member bank; and

(B) in the case of all affiliates, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 20 per centum of the capital stock and surplus of the member bank.

(2) For the purpose of this section, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.

(3) A member bank and its subsidiaries may not purchase a low-quality asset from an affiliate unless the bank or such subsidiary, pursuant to an independent credit evaluation, committed itself to purchase such asset prior to the time such asset was acquired by the affiliate.

(4) Any covered transactions and any transactions exempt under subsection (d) of this section between a member bank and an affiliate shall be on terms and conditions that are consistent with safe and sound banking practices.

(b) Definitions

For the purpose of this section—

(1) the term "affiliate" with respect to a member bank means—

(A) any company that controls the member bank and any other company that is controlled by the company that controls the member bank;

(B) a bank subsidiary of the member bank;

[1] Key for reading this blackline: Text that is ~~red and crossed out~~ was deleted from the statute by Dodd-Frank. Text that is blue and double underlined was added to the statute by Dodd-Frank. Text in green was deleted from one location in the statute, (where it is ~~green and crossed out~~), and added to another location in the statute, (where it is green and double underlined), by Dodd-Frank.

(C) any company—

(i) that is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the member bank or any company that controls the member bank; or

(ii) in which a majority of its directors or trustees constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank;

~~(D)~~

~~(i) any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the member bank or any subsidiary or affiliate of the member bank; or~~

(~~ii~~D) any investment ~~company~~fund with respect to which a member bank or ~~any~~ affiliate thereof is an investment ~~advisor as defined in section 80a-2(a)(20) of title 15~~adviser; and

(E) any company that the Board determines by regulation or order to have a relationship with the member bank or any subsidiary or affiliate of the member bank, such that covered transactions by the member bank or its subsidiary with that company may be affected by the relationship to the detriment of the member bank or its subsidiary; and

(2) the following shall not be considered to be an affiliate:

(A) any company, other than a bank, that is a subsidiary of a member bank, unless a determination is made under paragraph (1)(E) not to exclude such subsidiary company from the definition of affiliate;

(B) any company engaged solely in holding the premises of the member bank;

(C) any company engaged solely in conducting a safe deposit business;

(D) any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and

(E) any company where control results from the exercise of rights arising out of a bona fide debt previously contracted, but only for the period of time specifically authorized under applicable State or Federal law or regulation or, in the absence of such law or regulation, for a period of two years from the date of the exercise of such rights or the effective date of this Act, whichever date is later, subject, upon application, to authorization by the Board for good cause shown of extensions of time for not more than one year at a time, but such extensions in the aggregate shall not exceed three years;

(3)

(A) a company or shareholder shall be deemed to have control over another company if—

(i) such company or shareholder, directly or indirectly, or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the other company;

(ii) such company or shareholder controls in any manner the election of a majority of the directors or trustees of the other company; or

(iii) the Board determines, after notice and opportunity for hearing, that such company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company; and

(B) notwithstanding any other provision of this section, no company shall be deemed to own or control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in paragraph (1)(C) of this subsection or if the company owning or controlling such shares is a business trust;

(4) the term "subsidiary" with respect to a specified company means a company that is controlled by such specified company;

(5) the term "bank" includes a State bank, national bank, banking association, and trust company;

(6) the term "company" means a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term "company" includes a "member bank" and a "bank";

(7) the term "covered transaction" means with respect to an affiliate of a member bank—

(A) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase;

(B) a purchase of or an investment in securities issued by the affiliate;

(C) a purchase of assets~~, including assets subject to an agreement to repurchase,~~ from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Board by order or regulation;

(D) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; ~~or~~

(E) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate;

(F) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate; or

(G) a derivative transaction, as defined in paragraph (3) of section 84(b) of this title, with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate;

(8) the term “aggregate amount of covered transactions” means the amount of the covered transactions about to be engaged in added to the current amount of all outstanding covered transactions;

(9) the term “securities” means stocks, bonds, debentures, notes, or other similar obligations; and

(10) the term “low-quality asset” means an asset that falls in any one or more of the following categories:

(A) an asset classified as “substandard”, “doubtful”, or “loss” or treated as “other loans especially mentioned” in the most recent report of examination or inspection of an affiliate prepared by either a Federal or State supervisory agency;

(B) an asset in a nonaccrual status;

(C) an asset on which principal or interest payments are more than thirty days past due; or

(D) an asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

(11) REBUTTABLE PRESUMPTION OF CONTROL OF PORTFOLIO COMPANIES.—In addition to paragraph (3), a company or shareholder shall be presumed to control any other company if the company or shareholder, directly or indirectly, or acting through 1 or more other persons, owns or controls 15 percent or more of the equity capital of the other company pursuant to subparagraph (H) or (I) of section 1843(k)(4) of this title or rules adopted under section 122 of the Gramm-Leach-Bliley Act, if any, unless the company or shareholder provides information acceptable to the Board to rebut this presumption of control.

(c) Collateral for certain transactions with affiliates

(1) Each loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate by a member bank or its subsidiary, and any credit exposure of a member bank or a subsidiary to an affiliate resulting from a securities borrowing or lending transaction, or a derivative transaction, shall be secured at ~~the time of the transaction~~all times by collateral having a market value equal to—

(A) 100 per centum of the amount of such loan or extension of credit, guarantee, acceptance, ~~or~~ letter of credit, or credit exposure, if the collateral is composed of—

(i) obligations of the United States or its agencies;

(ii) obligations fully guaranteed by the United States or its agencies as to principal and interest;

(iii) notes, drafts, bills of exchange or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(iv) a segregated, earmarked deposit account with the member bank;

(B) 110 per centum of the amount of such loan or extension of credit, guarantee, acceptance, ~~or~~ letter of credit, or credit exposure if the collateral is composed of obligations of any State or political subdivision of any State;

(C) 120 per centum of the amount of such loan or extension of credit, guarantee, acceptance, ~~or~~ letter of credit, or credit exposure if the collateral is composed of other debt instruments, including receivables; or

(D) 130 per centum of the amount of such loan or extension of credit, guarantee, acceptance, ~~or~~ letter of credit, or credit exposure if the collateral is composed of stock, leases, or other real or personal property.

~~(2) Any such collateral that is subsequently retired or amortized shall be replaced by additional eligible collateral where needed to keep the percentage of the collateral value relative to the amount of the outstanding loan or extension of credit, guarantee, acceptance, or letter of credit equal to the minimum percentage required at the inception of the transaction.~~

(~~3~~2) A low-quality asset shall not be acceptable as collateral for a loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate, or credit exposure to an affiliate resulting from a securities borrowing or lending transaction, or derivative transaction.

(~~4~~3) The securities or other debt obligations issued by an affiliate of the member bank shall not be acceptable as collateral for a loan or extension of credit to, ~~or~~ guarantee, acceptance, or letter of credit issued on behalf of, or credit exposure from a securities borrowing or lending transaction, or derivative transaction to, that affiliate or any other affiliate of the member bank.

(~~5~~4) The collateral requirements of this paragraph shall not be applicable to an acceptance that is already fully secured either by attached documents or by other property having an ascertainable market value that is involved in the transaction.

(d) Exemptions

The provisions of this section, except subsection (a)(4) of this section, shall not be applicable to—

(1) any transaction, subject to the prohibition contained in subsection (a)(3) of this section, with a bank—

(A) which controls 80 per centum or more of the voting shares of the member bank;

(B) in which the member bank controls 80 per centum or more of the voting shares; or

(C) in which 80 per centum or more of the voting shares are controlled by the company that controls 80 per centum or more of the voting shares of the member bank;

(2) making deposits in an affiliated bank or affiliated foreign bank in the ordinary course of correspondent business, subject to any restrictions that the Board may prescribe by regulation or order;

(3) giving immediate credit to an affiliate for uncollected items received in the ordinary course of business;

(4) making a loan or extension of credit to, ~~or~~ issuing a guarantee, acceptance, or letter of credit on behalf of, or having credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction to, an affiliate that is fully secured by—

(A) obligations of the United States or its agencies;

(B) obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(C) a segregated, earmarked deposit account with the member bank;

(5) purchasing securities issued by any company of the kinds described in section 1843(c)(1) of this title;

(6) purchasing assets having a readily identifiable and publicly available market quotation and purchased at that market quotation or, subject to the prohibition contained in subsection (a)(3) of this section, purchasing loans on a nonrecourse basis from affiliated banks; and

(7) purchasing from an affiliate a loan or extension of credit that was originated by the member bank and sold to the affiliate subject to a repurchase agreement or with recourse.

(e) Rules relating to banks with financial subsidiaries

(1) Financial subsidiary defined

For purposes of this section and section 371c–1 of this title, the term "financial subsidiary" means any company that is a subsidiary of a bank that would be a financial subsidiary of a national bank under section 24a of this title.

(2) Financial subsidiary treated as an affiliate

For purposes of applying this section and section 371c–1 of this title, and notwithstanding subsection (b)(2) of this section or section 371c–1(d)(1) of this title, a financial subsidiary of a bank—

(A) shall be deemed to be an affiliate of the bank; and

(B) shall not be deemed to be a subsidiary of the bank.

~~(3) Exceptions for transactions with financial subsidiaries~~

~~(A) Exception from limit on covered transactions with any individual financial subsidiary~~

~~Notwithstanding paragraph (2), the restriction contained in subsection (a)(1)(A) of this section shall not apply with respect to covered transactions between a bank and any individual financial subsidiary of the bank.~~

~~(B) Exception for earnings retained by financial subsidiaries~~

~~Notwithstanding paragraph (2) or subsection (b)(7) of this section, a bank's investment in a financial subsidiary of the bank shall not include retained earnings of the financial subsidiary.~~

(~~4~~3) Anti-evasion provision

For purposes of this section and section 371c–1 of this title—

(A) any purchase of, or investment in, the securities of a financial subsidiary of a bank by an affiliate of the bank shall be considered to be a purchase of or investment in such securities by the bank; and

(B) any extension of credit by an affiliate of a bank to a financial subsidiary of the bank shall be considered to be an extension of credit by the bank to the financial subsidiary if the Board determines that such treatment is necessary or appropriate to prevent evasions of this chapter and the Gramm-Leach-Bliley Act.

(f) Rulemaking and additional exemptions

(1) The Board may issue such further regulations and orders, including definitions consistent with this section, as may be necessary to administer and carry out the purposes of this section and to prevent evasions thereof.

(2)

(A) IN GENERAL.—The Board may, at its discretion, by regulation ~~or order~~ exempt transactions or relationships from the requirements of this section if ~~it~~—

(i) the Board finds ~~such exemptions~~the exemption to be in the public interest and consistent with the purposes of this section~~.~~, and notifies the Federal Deposit Insurance Corporation of such finding; and

(ii) before the end of the 60-day period beginning on the date on which the Federal Deposit Insurance Corporation receives notice of the finding under clause (i), the Federal Deposit Insurance Corporation does not object, in writing, to the finding, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.

(B) ADDITIONAL EXEMPTIONS.—

(i) NATIONAL BANKS.—The Comptroller of the Currency may, by order, exempt a transaction of a national bank from the requirements of this section if—

(I) the Board and the Office of the Comptroller of the Currency jointly find the exemption to be in the public interest and consistent with the purposes of this section and notify the Federal Deposit Insurance Corporation of such finding; and

(II) before the end of the 60-day period beginning on the date on which the Federal Deposit Insurance Corporation receives notice of the finding under subclause (I), the Federal Deposit Insurance Corporation does not object, in writing, to the finding, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.

(ii) STATE BANKS.—The Federal Deposit Insurance Corporation may, by order, exempt a transaction of a State nonmember bank, and the Board may, by order, exempt a transaction of a State member bank, from the requirements of this section if—

(I) the Board and the Federal Deposit Insurance Corporation jointly find that the exemption is in the public interest and consistent with the purposes of this section; and

(II) the Federal Deposit Insurance Corporation finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund.

(3) RULEMAKING REQUIRED CONCERNING DERIVATIVE TRANSACTIONS AND INTRADAY CREDIT.—

(A) IN GENERAL.—Not later than 18 months after November 12, 1999, the Board shall adopt final rules under this section to address as covered transactions credit exposure arising out of derivative transactions between member banks and their affiliates and intraday extensions of credit by member banks to their affiliates.

(B) EFFECTIVE DATE.—The effective date of any final rule adopted by the Board pursuant to subparagraph (A) shall be delayed for such period as the Board deems necessary or appropriate to permit banks to conform their activities to the requirements of the final rule without undue hardship.

(4) AMOUNTS OF COVERED TRANSACTIONS.—The Board may issue such regulations or interpretations as the Board determines are necessary or appropriate with respect to the manner in which a netting agreement may be taken into account in determining the amount of a covered transaction between a member bank or a subsidiary and an affiliate, including the extent to which netting agreements between a member bank or a subsidiary and an affiliate may be taken into account in determining whether a covered transaction is fully secured for purposes of subsection (d)(4). An interpretation under this paragraph with respect to a specific member bank, subsidiary, or affiliate shall be issued jointly with the appropriate Federal banking agency for such member bank, subsidiary, or affiliate.

Section 23B of the Federal Reserve Act

(codified in 12 U.S.C. § 371c-1. Restrictions on transactions with affiliates)

Blackline Showing Dodd-Frank Amendments[1]

(a) In general

(1) Terms

A member bank and its subsidiaries may engage in any of the transactions described in paragraph (2) only—

(A) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or

(B) in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.

(2) Transactions covered

Paragraph (1) applies to the following:

(A) Any covered transaction with an affiliate.

(B) The sale of securities or other assets to an affiliate, including assets subject to an agreement to repurchase.

(C) The payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise.

(D) Any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or to any other person.

(E) Any transaction or series of transactions with a third party—

(i) if an affiliate has a financial interest in the third party, or

(ii) if an affiliate is a participant in such transaction or series of transactions.

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[1] Key for reading this blackline: Text that is ~~red and crossed out~~ was deleted from the statute by Dodd-Frank. Text that is blue and double underlined was added to the statute by Dodd-Frank. Text in green was deleted from one location in the statute, (where it is ~~green and crossed out~~), and added to another location in the statute, (where it is green and double underlined), by Dodd-Frank.

(3) Transactions that benefit affiliate

For the purpose of this subsection, any transaction by a member bank or its subsidiary with any person shall be deemed to be a transaction with an affiliate of such bank if any of the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

(b) Prohibited transactions

(1) In general

A member bank or its subsidiary—

(A) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchase is permitted—

(i) under the instrument creating the fiduciary relationship,

(ii) by court order, or

(iii) by law of the jurisdiction governing the fiduciary relationship; and

(B) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security if a principal underwriter of that security is an affiliate of such bank.

(2) Exception

Subparagraph (B) of paragraph (1) shall not apply if the purchase or acquisition of such securities has been approved, before such securities are initially offered for sale to the public, by a majority of the directors of the bank based on a determination that the purchase is a sound investment for the bank irrespective of the fact that an affiliate of the bank is a principal underwriter of the securities.

(3) Definitions

For the purpose of this subsection—

(A) the term “security” has the meaning given to such term in section 78c(a)(10) of title 15; and

(B) the term “principal underwriter” means any underwriter who, in connection with a primary distribution of securities—

(i) is in privity of contract with the issuer or an affiliated person of the issuer;

(ii) acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or

(iii) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

(c) Advertising restriction

A member bank or any subsidiary or affiliate of a member bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates.

(d) Definitions

For the purpose of this section—

(1) the term "affiliate" has the meaning given to such term in section 371c of this title (but does not include any company described in section[2] (b)(2) of such section or any bank);

(2) the terms "bank", "subsidiary", "person", and "security" (other than security as used in subsection (b) of this section) have the meanings given to such terms in section 371c of this title; and

(3) the term "covered transaction" has the meaning given to such term in section 371c of this title (but does not include any transaction which is exempt from such definition under subsection (d) of such section).

(e) Regulations

(1) In general

The Board may prescribe regulations to administer and carry out the purposes of this section, including—

(~~1~~A) regulations to further define terms used in this section; and

~~(2) regulations to—~~

(B) subject to paragraph (2), if the Board finds that an exemption or exclusion is in the public interest and is consistent with the purposes of this section, and notifies the Federal Deposit Insurance Corporation of such finding, regulations to—

[2] So in original. Probably should be "subsection".

(~~A~~i) exempt transactions or relationships from the requirements of this section; and

(~~B~~ii) exclude any subsidiary of a bank holding company from the definition of affiliate for purposes of this section~~,~~.

~~if the Board finds such exemptions or exclusions are in the public interest and are consistent with the purposes of this section.~~

(2) Exception

The Board may grant an exemption or exclusion under this subsection only if, during the 60-day period beginning on the date of receipt of notice of the finding from the Board under paragraph (1)(B), the Federal Deposit Insurance Corporation does not object, in writing, to such exemption or exclusion, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.

Appendix Item 3

13. Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is fictitious, a mail drop, or a prison; or

b. The phone number is invalid, or is associated with a pager or answering service.

14. The SSN provided is the same as that submitted by other persons opening an account or other customers.

15. The address or telephone number provided is the same as or similar to the address or telephone number submitted by an unusually large number of other persons opening accounts or by other customers.

16. The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

17. Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.

18. For financial institutions and creditors that use challenge questions, the person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.

Unusual Use of, or Suspicious Activity Related to, the Covered Account

19. Shortly following the notice of a change of address for a covered account, the institution or creditor receives a request for a new, additional, or replacement card or a cell phone, or for the addition of authorized users on the account.

20. A new revolving credit account is used in a manner commonly associated with known patterns of fraud. For example:

a. The majority of available credit is used for cash advances or merchandise that is easily convertible to cash (e.g., electronics equipment or jewelry); or

b. The customer fails to make the first payment or makes an initial payment but no subsequent payments.

21. A covered account is used in a manner that is not consistent with established patterns of activity on the account. There is, for example:

a. Nonpayment when there is no history of late or missed payments;

b. A material increase in the use of available credit;

c. A material change in purchasing or spending patterns;

d. A material change in electronic fund transfer patterns in connection with a deposit account; or

e. A material change in telephone call patterns in connection with a cellular phone account.

22. A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).

23. Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.

24. The financial institution or creditor is notified that the customer is not receiving paper account statements.

25. The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

Notice from Customers, Victims of Identity Theft, Law Enforcement Authorities, or Other Persons Regarding Possible Identity Theft in Connection with Covered Accounts Held by the Financial Institution or Creditor

26. The financial institution or creditor is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

[Reg. V, 72 FR 63758, Nov. 9, 2007, as amended at 74 FR 22642, May 14, 2009; 79 FR 30711, May 29, 2014]

PART 223—TRANSACTIONS BETWEEN MEMBER BANKS AND THEIR AFFILIATES (REGULATION W)

Subpart A—Introduction and Definitions

Sec.

Subpart B—General Provisions of Section 23A

Subpart C—Valuation and Timing Principles Under Section 23A

Subpart D—Other Requirements Under Section 23A

Subpart E—Exemptions from the Provisions of Section 23A

Subpart F—General Provisions of Section 23B

Subpart G—Application of Sections 23A and 23B to U.S. Branches and Agencies of Foreign Banks

Subpart H—Miscellaneous Interpretations

Subpart I—Savings Associations—Transactions with Affiliates

AUTHORITY: 12 U.S.C. 371c(b)(1)(E), (b)(2)(A), and (f), 371c–1(e), 1828(j), 1468(a), and section 312(b)(2)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5412).

SOURCE: 67 FR 76604, Dec. 12, 2002, unless otherwise noted.

Subpart A—Introduction and Definitions

§223.1 Authority, purpose, and scope.

(a) *Authority*. The Board of Governors of the Federal Reserve System (Board) has issued this part (Regulation W) under the authority of sections 23A(f) and 23B(e) of the Federal Reserve Act (FRA) (12 U.S.C. 371c(f), 371c–1(e)) section 11 of the Home Owners' Loan Act (12 U.S.C. 1468), and section 312(b)(2)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5412).

(b) *Purpose*. Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c–1) establish certain quantitative limits and other prudential requirements for loans, purchases of assets, and certain other transactions between a member bank and its affiliates. This regulation implements sections 23A and 23B by defining terms used in the statute, explaining the statute's requirements, and exempting certain transactions.

(c) *Scope*. Sections 23A and 23B and this regulation apply by their terms to ''member banks''—that is, any national bank, State bank, trust company, or other institution that is a member of the Federal Reserve System. In addition, the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) applies sections 23A and 23B to insured State nonmember banks in the same manner and to the same extent as if they were member banks. The Home Owners' Loan Act (12 U.S.C. 1468(a)) also applies sections 23A and 23B to insured savings associations in the same manner and to the same extent as if they were member banks (and imposes two additional restrictions).

[67 FR 76604, Dec. 12, 2002, as amended at 76 FR 56531, Sept. 13, 2011]

§ 223.2 What is an "affiliate" for purposes of sections 23A and 23B and this part?

(a) For purposes of this part and except as provided in paragraphs (b) and (c) of this section, ''affiliate'' with respect to a member bank means:

(1) *Parent companies.* Any company that controls the member bank;

(2) *Companies under common control by a parent company.* Any company, including any subsidiary of the member bank, that is controlled by a company that controls the member bank;

(3) *Companies under other common control.* Any company, including any subsidiary of the member bank, that is controlled, directly or indirectly, by trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the member bank or any company that controls the member bank;

(4) *Companies with interlocking directorates.* Any company in which a majority of its directors, trustees, or general partners (or individuals exercising similar functions) constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank;

(5) *Sponsored and advised companies.* Any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the member bank or an affiliate of the member bank;

(6) *Investment companies.* (i) Any investment company for which the member bank or any affiliate of the member bank serves as an investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(20)); and

(ii) Any other investment fund for which the member bank or any affiliate of the member bank serves as an investment advisor, if the member bank and its affiliates own or control in the aggregate more than 5 percent of any class of voting securities or of the equity capital of the fund;

(7) *Depository institution subsidiaries.* A depository institution that is a subsidiary of the member bank;

(8) *Financial subsidiaries.* A financial subsidiary of the member bank;

(9) *Companies held under merchant banking or insurance company investment authority*—(i) *In general.* Any company in which a holding company of the member bank owns or controls, directly or indirectly, or acting through one or more other persons, 15 percent or more of the equity capital pursuant to section 4(k)(4)(H) or (I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H) or (I)).

(ii) *General exemption.* A company will not be an affiliate under paragraph (a)(9)(i) of this section if the holding company presents information to the Board that demonstrates, to the Board's satisfaction, that the holding company does not control the company.

(iii) *Specific exemptions.* A company also will not be an affiliate under paragraph (a)(9)(i) of this section if:

(A) No director, officer, or employee of the holding company serves as a director, trustee, or general partner (or individual exercising similar functions) of the company;

(B) A person that is not affiliated or associated with the holding company owns or controls a greater percentage of the equity capital of the company than is owned or controlled by the 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

(C) A person that is not affiliated or associated with the holding company owns or controls more than 50 percent of the voting shares of the 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.

(iv) *Application of rule to private equity funds.* A holding company will not be deemed to own or control the equity capital of a company for purposes of paragraph (a)(9)(i) of this section solely by virtue of an investment made by the holding company in a private equity fund (as defined in the merchant banking subpart of the Board's Regulation Y (12 CFR 225.173(a))) that owns or controls the equity capital of the company unless the holding company controls the private equity fund under 12 CFR 225.173(d)(4).

(v) *Definition*. For purposes of this paragraph (a)(9), ''*holding company*'' with respect to a member bank means a company that controls the member bank, or a company that is controlled by shareholders that control the member bank, and all subsidiaries of the company (including any depository institution that is a subsidiary of the company).

(10) *Partnerships associated with the member bank or an affiliate*. Any partnership for which the member bank or any affiliate of the member bank serves as a general partner or for which the member bank or any affiliate of the member bank causes any director, officer, or employee of the member bank or affiliate to serve as a general partner;

(11) *Subsidiaries of affiliates*. Any subsidiary of a company described in paragraphs (a)(1) through (10) of this section; and

(12) *Other companies*. Any company that the Board determines by regulation or order, or that the appropriate Federal banking agency for the member bank determines by order, to have a relationship with the member bank, or any affiliate of the member bank, such that covered transactions by the member bank with that company may be affected by the relationship to the detriment of the member bank.

(b) ''*Affiliate*'' with respect to a member bank does *not* include:

(1) *Subsidiaries*. Any company that is a subsidiary of the member bank, unless the company is:

(i) A depository institution;

(ii) A financial subsidiary;

(iii) Directly controlled by:

(A) One or more affiliates (other than depository institution affiliates) of the member bank; or

(B) A shareholder that controls the member bank or a group of shareholders that together control the member bank;

(iv) An employee stock option plan, trust, or similar organization that exists for the benefit of the shareholders, partners, members, or employees of the member bank or any of its affiliates; or

(v) Any other company determined to be an affiliate under paragraph (a)(12) of this section;

(2) *Bank premises*. Any company engaged solely in holding the premises of the member bank;

(3) *Safe deposit*. Any company engaged solely in conducting a safe deposit business;

(4) *Government securities*. Any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and

(5) *Companies held DPC*. Any company where control results from the exercise of rights arising out of a bona fide debt previously contracted. This exclusion from the definition of ''affiliate'' applies only for the period of time specifically authorized under applicable State or Federal law or regulation or, in the absence of such law or regulation, for a period of two years from the date of the exercise of such rights. The Board may authorize, upon application and for good cause shown, extensions of time for not more than one year at a time, but such extensions in the aggregate will not exceed three years.

(c) For purposes of subpart F (implementing section 23B), ''affiliate'' with respect to a member bank also does *not* include any depository institution.

§223.3 What are the meanings of the other terms used in sections 23A and 23B and this part?

For purposes of this part:

(a) *Aggregate amount of covered transactions* means the amount of the covered transaction about to be engaged in added to the current amount of all outstanding covered transactions.

(b) *Appropriate Federal banking agency* with respect to a member bank or other depository institution has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(c) ''*Bank holding company*'' has the same meaning as in 12 CFR 225.2.

(d) ''*Capital stock and surplus*'' means the sum of:

(1) A member bank's tier 1 and tier 2 capital under the risk-based capital guidelines of the appropriate Federal banking agency, based on the member bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3);

(2) The balance of a member bank's allowance for loan and lease losses not included in its tier 2 capital under the risk-based capital guidelines of the appropriate Federal banking agency, based on the member bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3); and

(3) The amount of any investment by a member bank in a financial subsidiary that counts as a covered transaction and is required to be deducted from the member bank's capital for regulatory capital purposes.

(e) *Carrying value* with respect to a security means (unless otherwise provided) the value of the security on the financial statements of the member bank, determined in accordance with GAAP.

(f) *Company* means a corporation, partnership, limited liability company, business trust, association, or similar organization and, unless specifically excluded, includes a member bank and a depository institution.

(g) *Control*—(1) *In general.* ''*Control*'' by a company or shareholder over another company means that:

(i) The company or shareholder, directly or indirectly, or acting through one or more other persons, owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other company;

(ii) The company or shareholder controls in any manner the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the other company; or

(iii) The Board determines, after notice and opportunity for hearing, that the company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company.

(2) *Ownership or control of shares as fiduciary.* Notwithstanding any other provision of this regulation, no company will be deemed to control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in paragraph (a)(3) of § 223.2 or if the company owning or controlling the shares is a business trust.

(3) *Ownership or control of securities by subsidiary.* A company controls securities, assets, or other ownership interests owned or controlled, directly or indirectly, by any subsidiary (including a subsidiary depository institution) of the company.

(4) *Ownership or control of convertible instruments.* A company or shareholder that owns or controls instruments (including options or warrants) that are convertible or exercisable, at the option of the holder or owner, into securities, controls the securities, unless the company or shareholder presents information to the Board that demonstrates, to the Board's satisfaction, that the company or shareholder should not be deemed to control the securities.

(5) *Ownership or control of nonvoting securities.* A company or shareholder that owns or controls 25 percent or more of the equity capital of another company controls the other company, unless the company or shareholder presents information to the Board that demonstrates, to the Board's satisfaction, that the company or shareholder does not control the other company.

(h) *Covered transaction* with respect to an affiliate means:

(1) An extension of credit to the affiliate;

(2) A purchase of, or an investment in, a security issued by the affiliate;

(3) A purchase of an asset from the affiliate, including an asset subject to recourse or an agreement to repurchase, except such purchases of real and personal property as may be specifically exempted by the Board by order or regulation;

(4) The acceptance of a security issued by the affiliate as collateral for an extension of credit to any person or company; and

(5) The issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of

credit, on behalf of the affiliate, a confirmation of a letter of credit issued by the affiliate, and a cross-affiliate netting arrangement.

(i) *Credit transaction* with an affiliate means:

(1) An extension of credit to the affiliate;

(2) An issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of the affiliate and a confirmation of a letter of credit issued by the affiliate; and

(3) A cross-affiliate netting arrangement.

(j) *Cross-affiliate netting arrangement* means an arrangement among a member bank, one or more affiliates of the member bank, and one or more nonaffiliates of the member bank in which:

(1) A nonaffiliate is permitted to deduct any obligations of an affiliate of the member bank to the nonaffiliate when settling the nonaffiliate's obligations to the member bank; or

(2) The member bank is permitted or required to add any obligations of its affiliate to a nonaffiliate when determining the member bank's obligations to the nonaffiliate.

(k) ''*Depository institution*'' means, unless otherwise noted, an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), but does not include any branch of a foreign bank. For purposes of this definition, an operating subsidiary of a depository institution is treated as part of the depository institution.

(l) ''*Derivative transaction*'' means any derivative contract listed in sections III.E.1.a. through d. of appendix A to 12 CFR part 225 and any similar derivative contract, including a credit derivative contract.

(m) ''*Eligible affiliated mutual fund securities*'' has the meaning specified in paragraph (c)(2) of § 223.24.

(n) ''*Equity capital*'' means:

(1) With respect to a corporation, preferred stock, common stock, capital surplus, retained earnings, and accumulated other comprehensive income, less treasury stock, plus any other account that constitutes equity of the corporation; and

(2) With respect to a partnership, limited liability company, or other company, equity accounts similar to those described in paragraph (n)(1) of this section.

(o) ''*Extension of credit*'' to an affiliate means the making or renewal of a loan, the granting of a line of credit, or the extending of credit in any manner whatsoever, including on an intraday basis, to an affiliate. An extension of credit to an affiliate includes, without limitation:

(1) An advance to an affiliate by means of an overdraft, cash item, or otherwise;

(2) A sale of Federal funds to an affiliate;

(3) A lease that is the functional equivalent of an extension of credit to an affiliate;

(4) An acquisition by purchase, discount, exchange, or otherwise of a note or other obligation, including commercial paper or other debt securities, of an affiliate;

(5) Any increase in the amount of, extension of the maturity of, or adjustment to the interest rate term or other material term of, an extension of credit to an affiliate; and

(6) Any other similar transaction as a result of which an affiliate becomes obligated to pay money (or its equivalent).

(p) ''*Financial subsidiary*''

(1) *In general.* Except as provided in paragraph (p)(2) of this section, the term ''*financial subsidiary*'' means any subsidiary of a member bank that:

(i) Engages, directly or indirectly, in any activity that national banks are not permitted to engage in directly or that is conducted under terms and conditions that differ from those that govern the conduct of such activity by national banks; and

(ii) Is not a subsidiary that a national bank is specifically authorized to own or control by the express terms of a Federal statute (other than 12 U.S.C. 24a), and not by implication or interpretation.

(2) *Exceptions.* ''*Financial subsidiary*'' does not include:

(i) A subsidiary of a member bank that is considered a financial subsidiary under paragraph (p)(1) of this section solely because the subsidiary engages in the sale of insurance as agent or broker in a manner that is not permitted for national banks; and

(ii) A subsidiary of a State bank (other than a subsidiary described in section 46(a) of the Federal Deposit Insurance Act (12 U.S.C. 1831w(a))) that is considered a financial subsidiary under paragraph (p)(1) of this section solely because the subsidiary engages in one or more of the following activities:

(A) An activity that the State bank may engage in directly under applicable Federal and State law and that is conducted under the same terms and conditions that govern the conduct of the activity by the State bank; and

(B) An activity that the subsidiary was authorized by applicable Federal and State law to engage in prior to December 12, 2002, and that was lawfully engaged in by the subsidiary on that date.

(3) *Subsidiaries of financial subsidiaries.* If a company is a financial subsidiary under paragraphs (p)(1) and (p)(2) of this section, any subsidiary of such a company is also a financial subsidiary.

(q) ''*Foreign bank*'' and an ''*agency,*'' ''*branch,*'' or ''*commercial lending company*'' of a foreign bank have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(r) ''*GAAP*'' means U.S. generally accepted accounting principles.

(s) ''*General purpose credit card*'' has the meaning specified in paragraph (c)(4)(ii) of § 223.16.

(t) *In contemplation.* A transaction between a member bank and a nonaffiliate is presumed to be ''*in contemplation*'' of the nonaffiliate becoming an affiliate of the member bank if the member bank enters into the transaction with the nonaffiliate after the execution of, or commencement of negotiations designed to result in, an agreement under the terms of which the nonaffiliate would become an affiliate.

(u) ''*Intraday extension of credit*'' has the meaning specified in paragraph (l)(2) of § 223.42.

(v) ''*Low-quality asset*'' means:

(1) An asset (including a security) classified as ''substandard,'' ''doubtful,'' or ''loss,'' or treated as ''special mention'' or ''other transfer risk problems,'' either in the most recent report of examination or inspection of an affiliate prepared by either a Federal or State supervisory agency or in any internal classification system used by the member bank or the affiliate (including an asset that receives a rating that is substantially equivalent to ''classified'' or ''special mention'' in the internal system of the member bank or affiliate);

(2) An asset in a nonaccrual status;

(3) An asset on which principal or interest payments are more than thirty days past due;

(4) An asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor; and

(5) An asset acquired through foreclosure, repossession, or otherwise in satisfaction of a debt previously contracted, if the asset has not yet been reviewed in an examination or inspection.

(w) ''*Member bank*'' means any national bank, State bank, banking association, or trust company that is a member of the Federal Reserve System. For purposes of this definition, an operating subsidiary of a member bank is treated as part of the member bank.

(x) ''*Municipal securities*'' has the same meaning as in section 3(a)(29) of the Securities Exchange Act of 1934 (17 U.S.C. 78c(a)(29)).

(y) ''*Nonaffiliate*'' with respect to a member bank means any person that is not an affiliate of the member bank.

(z) ''*Obligations of, or fully guaranteed as to principal and interest by, the United States or its agencies*'' includes those obligations listed in 12 CFR 201.108(b) and any additional obligations as determined by the Board. The term does not include Federal Housing Administration or Veterans Administration loans.

(aa) ''*Operating subsidiary*'' with respect to a member bank or other depository institution means any subsidiary of the member bank or depository institution other than a subsidiary described in paragraphs (b)(1)(i) through (v) of § 223.2.

(bb) ''*Person*'' means an individual, company, trust, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

(cc) ''*Principal underwriter*'' has the meaning specified in paragraph (c)(1) of §223.53.

(dd) ''*Purchase of an asset*'' by a member bank from an affiliate means the acquisition by a member bank of an asset from an affiliate in exchange for cash or any other consideration, including an assumption of liabilities. The merger of an affiliate into a member bank is a purchase of assets by the member bank from an affiliate if the member bank assumes any liabilities of the affiliate or pays any other form of consideration in the transaction.

(ee) *Riskless principal*. A company is ''*acting exclusively as a riskless principal*'' if, after receiving an order to buy (or sell) a security from a customer, the company purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(ff) ''*Securities*'' means stocks, bonds, debentures, notes, or similar obligations (including commercial paper).

(gg) ''*Securities affiliate*'' with respect to a member bank means:

(1) An affiliate of the member bank that is registered with the Securities and Exchange Commission as a broker or dealer; or

(2) Any other securities broker or dealer affiliate of a member bank that is approved by the Board.

(hh) ''*State bank*'' has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(ii) ''*Subsidiary*'' with respect to a specified company means a company that is controlled by the specified company.

(jj) ''*Voting securities*'' has the same meaning as in 12 CFR 225.2.

(kk) ''*Well capitalized*'' has the same meaning as in 12 CFR 225.2 and, in the case of any holding company that is not a bank holding company, ''*well capitalized*'' means that the holding company has and maintains at least the capital levels required for a bank holding company to be well capitalized under 12 CFR 225.2.

(ll) ''*Well managed*'' has the same meaning as in 12 CFR 225.2.

Subpart B—General Provisions of Section 23A

§223.11 What is the maximum amount of covered transactions that a member bank may enter into with any single affiliate?

A member bank may not engage in a covered transaction with an affiliate (other than a financial subsidiary of the member bank) if the aggregate amount of the member bank's covered transactions with such affiliate would exceed 10 percent of the capital stock and surplus of the member bank.

§223.12 What is the maximum amount of covered transactions that a member bank may enter into with all affiliates?

A member bank may not engage in a covered transaction with any affiliate if the aggregate amount of the member bank's covered transactions with all affiliates would exceed 20 percent of the capital stock and surplus of the member bank.

§223.13 What safety and soundness requirement applies to covered transactions?

A member bank may not engage in any covered transaction, including any transaction exempt under this regulation, unless the transaction is on terms and conditions that are consistent with safe and sound banking practices.

§223.14 What are the collateral requirements for a credit transaction with an affiliate?

(a) *Collateral required for extensions of credit and certain other covered transactions*. A member bank must ensure that each of its credit transactions with an affiliate is secured by the amount of collateral required by paragraph (b) of this section at the time of the transaction.

(b) *Amount of collateral required*—(1) *The rule*. A credit transaction described in paragraph (a) of this section must be secured by collateral having a market value equal to at least:

(i) 100 percent of the amount of the transaction, if the collateral is:

(A) Obligations of the United States or its agencies;

(B) Obligations fully guaranteed by the United States or its agencies as to principal and interest;

(C) Notes, drafts, bills of exchange, or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(D) A segregated, earmarked deposit account with the member bank that is for the sole purpose of securing credit transactions between the member bank and its affiliates and is identified as such;

(ii) 110 percent of the amount of the transaction, if the collateral is obligations of any State or political subdivision of any State;

(iii) 120 percent of the amount of the transaction, if the collateral is other debt instruments, including loans and other receivables; or

(iv) 130 percent of the amount of the transaction, if the collateral is stock, leases, or other real or personal property.

(2) *Example*. A member bank makes a $1,000 loan to an affiliate. The affiliate posts as collateral for the loan $500 in U.S. Treasury securities, $480 in corporate debt securities, and $130 in real estate. The loan satisfies the collateral requirements of this section because $500 of the loan is 100 percent secured by obligations of the United States, $400 of the loan is 120 percent secured by debt instruments, and $100 of the loan is 130 percent secured by real estate.

(c) *Ineligible collateral*. The following items are not eligible collateral for purposes of this section:

(1) Low-quality assets;

(2) Securities issued by any affiliate;

(3) Equity securities issued by the member bank, and debt securities issued by the member bank that represent regulatory capital of the member bank;

(4) Intangible assets (including servicing assets), unless specifically approved by the Board; and

(5) Guarantees, letters of credit, and other similar instruments.

(d) *Perfection and priority requirements for collateral*—(1) *Perfection*. A member bank must maintain a security interest in collateral required by this section that is perfected and enforceable under applicable law, including in the event of default resulting from bankruptcy, insolvency, liquidation, or similar circumstances.

(2) *Priority*. A member bank either must obtain a first priority security interest in collateral required by this section or must deduct from the value of collateral obtained by the member bank the lesser of:

(i) The amount of any security interest in the collateral that is senior to that of the member bank; or

(ii) The amount of any credit secured by the collateral that is senior to that of the member bank.

(3) *Example*. A member bank makes a $2,000 loan to an affiliate. The affiliate grants the member bank a second priority security interest in a piece of real estate valued at $3,000. Another institution that previously lent $1,000 to the affiliate has a first priority security interest in the entire parcel of real estate. This transaction is not in compliance with the collateral requirements of this section. Due to the existence of the prior third-party lien on the real estate, the effective value of the real estate collateral for the member bank for purposes of this section is only $2,000—$600 less than the amount of real estate collateral required by this section for the transaction ($\$2,000 \times 130$ percent $= \$2,600$).

(e) *Replacement requirement for retired or amortized collateral*. A member bank must ensure that any required collateral that subsequently is retired or amortized is replaced with additional eligible collateral as needed to keep the percentage of the collateral value relative to the amount of the outstanding credit transaction equal to the minimum percentage required at the inception of the transaction.

(f) *Inapplicability of the collateral requirements to certain transactions*. The collateral requirements of this section do not apply to the following transactions.

(1) *Acceptances*. An acceptance that already is fully secured either by attached documents or by other property that is involved in the transaction and has an ascertainable market value.

(2) *The unused portion of certain extensions of credit*. The unused portion of an extension of credit to an affiliate as long as the member bank does not have

any legal obligation to advance additional funds under the extension of credit until the affiliate provides the amount of collateral required by paragraph (b) of this section with respect to the entire used portion (including the amount of the requested advance) of the extension of credit.

(3) *Purchases of affiliate debt securities in the secondary market*. The purchase of a debt security issued by an affiliate as long as the member bank purchases the debt security from a nonaffiliate in a bona fide secondary market transaction.

§223.15 May a member bank purchase a low-quality asset from an affiliate?

(a) *In general*. A member bank may not purchase a low-quality asset from an affiliate unless, pursuant to an independent credit evaluation, the member bank had committed itself to purchase the asset before the time the asset was acquired by the affiliate.

(b) *Exemption for renewals of loan participations involving problem loans*. The prohibition contained in paragraph (a) of this section does not apply to the renewal of, or extension of additional credit with respect to, a member bank's participation in a loan to a nonaffiliate that was originated by an affiliate if:

(1) The loan was not a low-quality asset at the time the member bank purchased its participation;

(2) The renewal or extension of additional credit is approved, as necessary to protect the participating member bank's investment by enhancing the ultimate collection of the original indebtedness, by the board of directors of the participating member bank or, if the originating affiliate is a depository institution, by:

(i) An executive committee of the board of directors of the participating member bank; or

(ii) One or more senior management officials of the participating member bank, if:

(A) The board of directors of the member bank approves standards for the member bank's renewals or extensions of additional credit described in this paragraph (b), based on the determination set forth in paragraph (b)(2) of this section;

(B) Each renewal or extension of additional credit described in this paragraph (b) meets the standards; and

(C) The board of directors of the member bank periodically reviews renewals and extensions of additional credit described in this paragraph (b) to ensure that they meet the standards and periodically reviews the standards to ensure that they continue to meet the criterion set forth in paragraph (b)(2) of this section;

(3) The participating member bank's share of the renewal or extension of additional credit does not exceed its proportional share of the original transaction by more than 5 percent, unless the member bank obtains the prior written approval of its appropriate Federal banking agency; and

(4) The participating member bank provides its appropriate Federal banking agency with written notice of the renewal or extension of additional credit not later than 20 days after consummation.

§223.16 What transactions by a member bank with any person are treated as transactions with an affiliate?

(a) *In general*. A member bank must treat any of its transactions with any person as a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

(b) *Certain agency transactions*. (1) Except to the extent described in paragraph (b)(2) of this section, an extension of credit by a member bank to a nonaffiliate is not treated as an extension of credit to an affiliate under paragraph (a) of this section if:

(i) The proceeds of the extension of credit are used to purchase an asset through an affiliate of the member bank, and the affiliate is acting exclusively as an agent or broker in the transaction; and

(ii) The asset purchased by the nonaffiliate is not issued, underwritten, or sold as principal by any affiliate of the member bank.

(2) The interpretation set forth in paragraph (b)(1) of this section does not apply to the extent of any agency fee,

brokerage commission, or other compensation received by an affiliate from the proceeds of the extension of credit. The receipt of such compensation may qualify, however, for the exemption contained in paragraph (c)(2) of this section.

(c) *Exemptions.* Notwithstanding paragraph (a) of this section, the following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12 or the collateral requirements of § 223.14. The transactions are, however, subject to the safety and soundness requirement of § 223.13 and the market terms requirement and other provisions of subpart F (implementing section 23B).

(1) *Certain riskless principal transactions.* An extension of credit by a member bank to a nonaffiliate, if:

(i) The proceeds of the extension of credit are used to purchase a security through a securities affiliate of the member bank, and the securities affiliate is acting exclusively as a riskless principal in the transaction;

(ii) The security purchased by the nonaffiliate is not issued, underwritten, or sold as principal (other than as riskless principal) by any affiliate of the member bank; and

(iii) Any riskless principal mark-up or other compensation received by the securities affiliate from the proceeds of the extension of credit meets the market terms standard set forth in paragraph (c)(2) of this section.

(2) *Brokerage commissions, agency fees, and riskless principal mark-ups.* An affiliate's retention of a portion of the proceeds of an extension of credit described in paragraph (b) or (c)(1) of this section as a brokerage commission, agency fee, or riskless principal mark-up, if that commission, fee, or mark-up is substantially the same as, or lower than, those prevailing at the same time for comparable transactions with or involving other nonaffiliates, in accordance with the market terms requirement of § 223.51.

(3) *Preexisting lines of credit.* An extension of credit by a member bank to a nonaffiliate, if:

(i) The proceeds of the extension of credit are used to purchase a security from or through a securities affiliate of the member bank; and

(ii) 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 purchase of securities from or through an affiliate of the member bank.

(4) *General purpose credit card transactions*—(i) *In general.* An extension of credit by a member bank to a nonaffiliate, if:

(A) The proceeds of the extension of credit are used by the nonaffiliate to purchase a product or service from an affiliate of the member bank; and

(B) The extension of credit is made pursuant to, and consistent with any conditions imposed in, a general purpose credit card issued by the member bank to the nonaffiliate.

(ii) *Definition.* ''*General purpose credit card*'' means a credit card issued by a member bank that is widely accepted by merchants that are not affiliates of the member bank for the purchase of products or services, if:

(A) Less than 25 percent of the total value of products and services purchased with the card by all cardholders are purchases of products and services from one or more affiliates of the member bank;

(B) All affiliates of the member bank would be permissible for a financial holding company (as defined in 12 U.S.C. 1841) under section 4 of the Bank Holding Company Act (12 U.S.C. 1843), and the member bank has no reason to believe that 25 percent or more of the total value of products and services purchased with the card by all cardholders are or would be purchases of products and services from one or more affiliates of the member bank; or

(C) The member bank presents information to the Board that demonstrates, to the Board's satisfaction, that less than 25 percent of the total value of products and services purchased with the card by all cardholders are and would be purchases of products and services from one or more affiliates of the member bank.

(iii) *Calculating compliance.* To determine whether a credit card qualifies as a general purpose credit card under the standard set forth in paragraph (c)(4)(ii)(A) of this section, a member bank must compute compliance on a monthly basis, based on cardholder purchases that were financed by the credit card during the preceding 12 calendar months. If a credit card has qualified as a general purpose credit card for 3 consecutive months but then ceases to qualify in the following month, the member bank may continue to treat the credit card as a general purpose credit card for such month and three additional months (or such longer period as may be permitted by the Board).

(iv) *Example of calculating compliance with the 25 percent test.* A member bank seeks to qualify a credit card as a general purpose credit card under paragraph (c)(4)(ii)(A) of this section. The member bank assesses its compliance under paragraph (c)(4)(iii) of this section on the 15th day of every month (for the preceding 12 calendar months). The credit card qualifies as a general purpose credit card for at least three consecutive months. On June 15, 2005, however, the member bank determines that, for the 12-calendar-month period from June 1, 2004, through May 31, 2005, 27 percent of the total value of products and services purchased with the card by all cardholders were purchases of products and services from an affiliate of the member bank. Unless the credit card returns to compliance with the 25 percent limit by the 12-calendar-month period ending August 31, 2005, the card will cease to qualify as a general purpose credit card as of September 1, 2005. Any outstanding extensions of credit under the credit card that were used to purchase products or services from an affiliate of the member bank would become covered transactions at such time.

Subpart C—Valuation and Timing Principles Under Section 23A

§223.21 What valuation and timing principles apply to credit transactions?

(a) *Valuation*—(1) *Initial valuation.* Except as provided in paragraph (a)(2) or (3) of this section, a credit transaction with an affiliate initially must be valued at the greater of:

(i) The principal amount of the transaction;

(ii) The amount owed by the affiliate to the member bank under the transaction; or

(iii) The sum of:

(A) The amount provided to, or on behalf of, the affiliate in the transaction; and

(B) Any additional amount that the member bank could be required to provide to, or on behalf of, the affiliate under the terms of the transaction.

(2) *Initial valuation of certain acquisitions of a credit transaction.* If a member bank acquires from a nonaffiliate a credit transaction with an affiliate, the covered transaction initially must be valued at the sum of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the credit transaction; and

(ii) Any additional amount that the member bank could be required to provide to, or on behalf of, the affiliate under the terms of the transaction.

(3) *Debt securities.* The valuation principles of paragraphs (a)(1) and (2) of this section do not apply to a member bank's purchase of or investment in a debt security issued by an affiliate, which is governed by §223.23.

(4) *Examples.* The following are examples of how to value a member bank's credit transactions with an affiliate.

(i) *Term loan.* A member bank makes a loan to an affiliate that has a principal amount of $100. The affiliate pays $2 in up-front fees to the member bank, and the affiliate receives net loan proceeds of $98. The member bank must initially value the covered transaction at $100.

(ii) *Revolving credit.* A member bank establishes a $300 revolving credit facility for an affiliate. The affiliate has drawn down $100 under the facility. The member bank must value the covered transaction at $300 throughout the life of the facility.

(iii) *Guarantee.* A member bank has issued a guarantee to a nonaffiliate on behalf of an affiliate under which the member bank would be obligated to pay the nonaffiliate $500 if the affiliate defaults on an issuance of debt securities. The member bank must value the guarantee at $500 throughout the life of the guarantee.

(iv) *Acquisition of a loan to an affiliate*. A member bank purchases from a nonaffiliate a fixed-rate loan to an affiliate. The loan has an outstanding principal amount of $100 but, due to movements in the general level of interest rates since the time of the loan's origination, the member bank is able to purchase the loan for $90. The member bank initially must value the credit transaction at $90 (and must ensure that the credit transaction complies with the collateral requirements of § 223.14 at the time of its acquisition of the loan).

(b) *Timing*—(1) *In general*. A member bank engages in a credit transaction with an affiliate at the time during the day that:

(i) The member bank becomes legally obligated to make an extension of credit to, issue a guarantee, acceptance, or letter of credit on behalf of, or confirm a letter of credit issued by, an affiliate;

(ii) The member bank enters into a cross-affiliate netting arrangement; or

(iii) The member bank acquires an extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate.

(2) *Credit transactions by a member bank with a nonaffiliate that becomes an affiliate of the member bank*—(i) *In general*. A credit transaction with a nonaffiliate becomes a covered transaction at the time that the nonaffiliate becomes an affiliate of the member bank. The member bank must treat the amount of any such credit transaction as part of the aggregate amount of the member bank's covered transactions for purposes of determining compliance with the quantitative limits of §§ 223.11 and 223.12 in connection with any future covered transactions. Except as described in paragraph (b)(2)(ii) of this section, the member bank is not required to reduce the amount of its covered transactions with any affiliate because the nonaffiliate has become an affiliate. If the nonaffiliate becomes an affiliate less than one year after the member bank enters into the credit transaction with the nonaffiliate, the member bank also must ensure that the credit transaction complies with the collateral requirements of § 223.14 promptly after the nonaffiliate becomes an affiliate.

(ii) *Credit transactions by a member bank with a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank*. Notwithstanding the provisions of paragraph (b)(2)(i) of this section, if a member bank engages in a credit transaction with a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank, the member bank must ensure that:

(A) The aggregate amount of the member bank's covered transactions (including any such credit transaction with the nonaffiliate) would not exceed the quantitative limits of § 223.11 or 223.12 at the time the nonaffiliate becomes an affiliate; and

(B) The credit transaction complies with the collateral requirements of § 223.14 at the time the nonaffiliate becomes an affiliate.

(iii) *Example*. A member bank with capital stock and surplus of $1,000 and no outstanding covered transactions makes a $120 unsecured loan to a nonaffiliate. The member bank does not make the loan in contemplation of the nonaffiliate becoming an affiliate. Nine months later, the member bank's holding company purchases all the stock of the nonaffiliate, thereby making the nonaffiliate an affiliate of the member bank. The member bank is not in violation of the quantitative limits of § 223.11 or 223.12 at the time of the stock acquisition. The member bank is, however, prohibited from engaging in any additional covered transactions with the new affiliate at least until such time as the value of the loan transaction falls below 10 percent of the member bank's capital stock and surplus. In addition, the member bank must bring the loan into compliance with the collateral requirements of § 223.14 promptly after the stock acquisition.

§ 223.22 What valuation and timing principles apply to asset purchases?

(a) *Valuation*—(1) *In general*. Except as provided in paragraph (a)(2) of this section, a purchase of an asset by a member bank from an affiliate must be valued initially at the total amount of consideration given (including liabilities assumed) by the member bank in exchange for the asset. The value of the covered transaction after the purchase may be reduced to reflect amortization or depreciation of the asset, to the extent that such reductions are consistent with GAAP.

(2) *Exceptions*—(i) *Purchase of an extension of credit to an affiliate.* A purchase from an affiliate of an extension of credit to an affiliate must be valued in accordance with §223.21, unless the note or obligation evidencing the extension of credit is a security issued by an affiliate (in which case the transaction must be valued in accordance with §223.23).

(ii) *Purchase of a security issued by an affiliate.* A purchase from an affiliate of a security issued by an affiliate must be valued in accordance with §223.23.

(iii) *Transfer of a subsidiary.* A transfer to a member bank of securities issued by an affiliate that is treated as a purchase of assets from an affiliate under §223.31 must be valued in accordance with paragraph (b) of §223.31.

(iv) *Purchase of a line of credit.* A purchase from an affiliate of a line of credit, revolving credit facility, or other similar credit arrangement for a nonaffiliate must be valued initially at the total amount of consideration given by the member bank in exchange for the asset plus any additional amount that the member bank could be required to provide to the borrower under the terms of the credit arrangement.

(b) *Timing*—(1) *In general.* A purchase of an asset from an affiliate remains a covered transaction for a member bank for as long as the member bank holds the asset.

(2) *Asset purchases by a member bank from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank.* If a member bank purchases an asset from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank, the asset purchase becomes a covered transaction at the time that the nonaffiliate becomes an affiliate of the member bank. In addition, the member bank must ensure that the aggregate amount of the member bank's covered transactions (including any such transaction with the nonaffiliate) would not exceed the quantitative limits of §223.11 or 223.12 at the time the nonaffiliate becomes an affiliate.

(c) *Examples.* The following are examples of how to value a member bank's purchase of an asset from an affiliate.

(1) *Cash purchase of assets.* A member bank purchases a pool of loans from an affiliate for $10 million. The member bank initially must value the covered transaction at $10 million. Going forward, if the borrowers repay $6 million of the principal amount of the loans, the member bank may value the covered transaction at $4 million.

(2) *Purchase of assets through an assumption of liabilities.* An affiliate of a member bank contributes real property with a fair market value of $200,000 to the member bank. The member bank pays the affiliate no cash for the property, but assumes a $50,000 mortgage on the property. The member bank has engaged in a covered transaction with the affiliate and initially must value the transaction at $50,000. Going forward, if the member bank retains the real property but pays off the mortgage, the member bank must continue to value the covered transaction at $50,000. If the member bank, however, sells the real property, the transaction ceases to be a covered transaction at the time of the sale (regardless of the status of the mortgage).

§223.23 What valuation and timing principles apply to purchases of and investments in securities issued by an affiliate?

(a) *Valuation*—(1) *In general.* Except as provided in paragraph (b) of §223.32 with respect to financial subsidiaries, a member bank's purchase of or investment in a security issued by an affiliate must be valued at the greater of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; or

(ii) The carrying value of the security.

(2) *Examples.* The following are examples of how to value a member bank's purchase of or investment in securities issued by an affiliate (other than a financial subsidiary of the member bank).

(i) *Purchase of the debt securities of an affiliate.* The parent holding company of a member bank owns 100 percent of the shares of a mortgage company. The member bank purchases debt securities issued by the mortgage company for $600. The initial carrying value of the securities is $600. The member bank initially must value the investment at $600.

(ii) *Purchase of the shares of an affiliate.* The parent holding company of a member bank owns 51 percent of the shares of a mortgage company. The member bank purchases an additional 30 percent of the shares of the mortgage company from a third party for $100. The initial carrying value of the shares is $100. The member bank initially must value the investment at $100. Going forward, if the member bank's carrying value of the shares declines to $40, the member bank must continue to value the investment at $100.

(iii) *Contribution of the shares of an affiliate.* The parent holding company of a member bank owns 100 percent of the shares of a mortgage company and contributes 30 percent of the shares to the member bank. The member bank gives no consideration in exchange for the shares. If the initial carrying value of the shares is $300, then the member bank initially must value the investment at $300. Going forward, if the member bank's carrying value of the shares increases to $500, the member bank must value the investment at $500.

(b) *Timing*—(1) *In general.* A purchase of or investment in a security issued by an affiliate remains a covered transaction for a member bank for as long as the member bank holds the security.

(2) *A member bank's purchase of or investment in a security issued by a nonaffiliate that becomes an affiliate of the member bank.* A member bank's purchase of or investment in a security issued by a nonaffiliate that becomes an affiliate of the member bank must be treated according to the same transition rules that apply to credit transactions described in paragraph (b)(2) of § 223.21.

§ 223.24 What valuation principles apply to extensions of credit secured by affiliate securities?

(a) *Valuation of extensions of credit secured exclusively by affiliate securities.* An extension of credit by a member bank to a nonaffiliate secured exclusively by securities issued by an affiliate of the member bank must be valued at the lesser of:

(1) The total value of the extension of credit; or

(2) The fair market value of the securities issued by an affiliate that are pledged as collateral, if the member bank verifies that such securities meet the market quotation standard contained in paragraph (e) of § 223.42 or the standards set forth in paragraphs (f)(1) and (5) of § 223.42.

(b) *Valuation of extensions of credit secured by affiliate securities and other collateral.* An extension of credit by a member bank to a nonaffiliate secured in part by securities issued by an affiliate of the member bank and in part by nonaffiliate collateral must be valued at the lesser of:

(1) The total value of the extension of credit less the fair market value of the nonaffiliate collateral; or

(2) The fair market value of the securities issued by an affiliate that are pledged as collateral, if the member bank verifies that such securities meet the market quotation standard contained in paragraph (e) of § 223.42 or the standards set forth in paragraphs (f)(1) and (5) of § 223.42.

(c) *Exclusion of eligible affiliated mutual fund securities*—(1) *The exclusion.* Eligible affiliated mutual fund securities are not considered to be securities issued by an affiliate, and are instead considered to be nonaffiliate collateral, for purposes of paragraphs (a) and (b) of this section, unless the member bank knows or has reason to know that the proceeds of the extension of credit will be used to purchase the eligible affiliated mutual fund securities collateral or will otherwise be used for the benefit of or transferred to an affiliate of the member bank.

(2) *Definition.* ''*Eligible affiliated mutual fund securities*'' with respect to a member bank are securities issued by an affiliate of the member bank that is

an open-end investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), if:

(i) The securities issued by the investment company:

(A) Meet the market quotation standard contained in paragraph (e) of §223.42;

(B) Meet the standards set forth in paragraphs (f)(1) and (5) of §223.42; or

(C) Have closing prices that are made public through a mutual fund ''supermarket'' website maintained by an unaffiliated securities broker-dealer or mutual fund distributor; and

(ii) The member bank and its affiliates do not own or control in the aggregate more than 5 percent of any class of voting securities or of the equity capital of the investment company (excluding securities held by the member bank or an affiliate in good faith in a fiduciary capacity, unless the member bank or affiliate holds the securities for the benefit of the member bank or affiliate, or the shareholders, employees, or subsidiaries of the member bank or affiliate).

(3) *Example.* A member bank proposes to lend $100 to a nonaffiliate secured exclusively by eligible affiliated mutual fund securities. The member bank knows that the nonaffiliate intends to use all the loan proceeds to purchase the eligible affiliated mutual fund securities that would serve as collateral for the loan. Under the attribution rule in §223.16, the member bank must treat the loan to the nonaffiliate as a loan to an affiliate, and, because securities issued by an affiliate are ineligible collateral under §223.14, the loan would not be in compliance with §223.14.

Subpart D—Other Requirements Under Section 23A

§223.31 How does section 23A apply to a member bank's acquisition of an affiliate that becomes an operating subsidiary of the member bank after the acquisition?

(a) *Certain acquisitions by a member bank of securities issued by an affiliate are treated as a purchase of assets from an affiliate.* A member bank's acquisition of a security issued by a company that was an affiliate of the member bank before the acquisition is treated as a purchase of assets from an affiliate, if:

(1) As a result of the transaction, the company becomes an operating subsidiary of the member bank; and

(2) The company has liabilities, or the member bank gives cash or any other consideration in exchange for the security.

(b) *Valuation*—(1) *Initial valuation.* A transaction described in paragraph (a) of this section must be valued initially at the greater of:

(i) The sum of:

(A) The total amount of consideration given by the member bank in exchange for the security; and

(B) The total liabilities of the company whose security has been acquired by the member bank, as of the time of the acquisition; or

(ii) The total value of all covered transactions (as computed under this part) acquired by the member bank as a result of the security acquisition.

(2) *Ongoing valuation.* The value of a transaction described in paragraph (a) of this section may be reduced after the initial transfer to reflect:

(i) Amortization or depreciation of the assets of the transferred company, to the extent that such reductions are consistent with GAAP; and

(ii) Sales of the assets of the transferred company.

(c) *Valuation example.* The parent holding company of a member bank contributes between 25 and 100 percent of the voting shares of a mortgage company to the member bank. The parent holding company retains no shares of the mortgage company. The member bank gives no consideration in exchange for the transferred shares. The mortgage company has total assets of $300,000 and total liabilities of $100,000. The mortgage company's assets do not include any loans to an affiliate of the member bank or any other asset that would represent a separate covered transaction for the member bank upon consummation of the share transfer. As a result of the transaction, the mortgage company becomes an operating subsidiary of the member bank. The transaction is treated as a purchase of the assets of the mortgage company by the member bank from an affiliate under paragraph (a) of this section. The member bank initially must value the transaction at $100,000, the total amount of the liabilities of the mortgage company. Going forward, if the member bank pays off the liabilities, the member bank must continue to value the covered transaction at $100,000. If the member bank, however, sells $15,000 of the transferred assets of the mortgage company or if $15,000 of the transferred assets amortize, the member bank may value the covered transaction at $85,000.

(d) *Exemption for step transactions.* A transaction described in paragraph (a) of this section is exempt from the requirements of this regulation (other than the safety and soundness requirement of § 223.13 and the market terms requirement of § 223.51) if:

(1) The member bank acquires the securities issued by the transferred company within one business day (or such longer period, up to three months, as may be permitted by the member bank's appropriate Federal banking agency) after the company becomes an affiliate of the member bank;

(2) The member bank acquires all the securities of the transferred company that were transferred in connection with the transaction that made the company an affiliate of the member bank;

(3) The business and financial condition (including the asset quality and liabilities) of the transferred company does not materially change from the time the company becomes an affiliate of the member bank and the time the member bank acquires the securities issued by the company; and

(4) At or before the time that the transferred company becomes an affiliate of the member bank, the member bank notifies its appropriate Federal banking agency and the Board of the member bank's intent to acquire the company.

(e) *Example of step transaction.* A bank holding company acquires 100 percent of the shares of an unaffiliated leasing company. At that time, the subsidiary member bank of the holding company notifies its appropriate Federal banking agency and the Board of its intent to acquire the leasing company from its holding company. On the day after consummation of the acquisition, the holding company transfers all of the shares of the leasing company to the member bank. No material change in the business or financial condition of the leasing company occurs between the time of the holding company's acquisition and the member bank's acquisition. The leasing company has liabilities. The leasing company becomes an operating subsidiary of the member bank at the time of the transfer. This transfer by the holding company to the member bank, although deemed an asset purchase by the member bank from an affiliate under paragraph (a) of this section, would qualify for the exemption in paragraph (d) of this section.

§ 223.32 What rules apply to financial subsidiaries of a member bank?

(a) *Exemption from the 10 percent limit for covered transactions between a member bank and a single financial subsidiary.* The 10 percent quantitative limit contained in § 223.11 does not apply with respect to covered transactions between a member bank and a financial subsidiary of the member bank. The 20 percent quantitative limit contained in § 223.12 does apply to such transactions.

(b) *Valuation of purchases of or investments in the securities of a financial subsidiary*—(1) *General rule.* A member bank's purchase of or investment in a security issued by a financial subsidiary of the member bank must be valued at the greater of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; and

(ii) The carrying value of the security (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the security).

(2) *Carrying value of an investment in a consolidated financial subsidiary.* If a financial subsidiary is consolidated with its parent member bank under GAAP, the carrying value of the member bank's investment in securities issued

by the financial subsidiary shall be equal to the carrying value of the securities on parent-only financial statements of the member bank, determined in accordance with GAAP (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the securities).

(3) *Examples of the valuation of purchases of and investments in the securities of a financial subsidiary*. The following are examples of how a member bank must value its purchase of or investment in securities issued by a financial subsidiary of the member bank. Each example involves a securities underwriter that becomes a financial subsidiary of the member bank after the transactions described below.

(i) *Initial valuation.* (A) *Direct acquisition by a member bank*. A member bank pays $500 to acquire 100 percent of the shares of a securities underwriter. The initial carrying value of the shares on the member bank's parent-only GAAP financial statements is $500. The member bank initially must value the investment at $500.

(B) *Contribution of a financial subsidiary to a member bank*. The parent holding company of a member bank acquires 100 percent of the shares of a securities underwriter in a transaction valued at $500, and immediately contributes the shares to the member bank. The member bank gives no consideration in exchange for the shares. The member bank initially must value the investment at the carrying value of the shares on the member bank's parent-only GAAP financial statements. Under GAAP, the member bank's initial carrying value of the shares would be $500.

(ii) *Carrying value not adjusted for earnings and losses of the financial subsidiary*. A member bank and its parent holding company engage in the transaction described in paragraph (b)(3)(i)(B) of this section, and the member bank initially values the investment at $500. In the following year, the securities underwriter earns $25 in profit, which is added to its retained earnings. The member bank's carrying value of the shares of the underwriter is not adjusted for purposes of this part, and the member bank must continue to value the investment at $500. If, however, the member bank contributes $100 of additional capital to the securities underwriter, the member bank must value the aggregate investment at $600.

(c) *Treatment of an affiliate's investments in, and extensions of credit to, a financial subsidiary of a member bank*—(1) *Investments*. Any purchase of, or investment in, the securities of a financial subsidiary of a member bank by an affiliate of the member bank is treated as a purchase of or investment in such securities by the member bank.

(2) *Extensions of credit that are treated as regulatory capital of the financial subsidiary*. Any extension of credit to a financial subsidiary of a member bank by an affiliate of the member bank is treated as an extension of credit by the member bank to the financial subsidiary if the extension of credit is treated as capital of the financial subsidiary under any Federal or State law, regulation, or interpretation applicable to the subsidiary.

(3) *Other extensions of credit*. Any other extension of credit to a financial subsidiary of a member bank by an affiliate of the member bank will be treated as an extension of credit by the member bank to the financial subsidiary, if the Board determines, by regulation or order, that such treatment is necessary or appropriate to prevent evasions of the Federal Reserve Act or the Gramm-Leach-Bliley Act.

§ 223.33 What rules apply to derivative transactions?

(a) *Market terms requirement*. Derivative transactions between a member bank and its affiliates (other than depository institutions) are subject to the market terms requirement of § 223.51.

(b) *Policies and procedures*. A member bank must establish and maintain policies and procedures reasonably designed to manage the credit exposure arising from its derivative transactions with affiliates in a safe and sound manner. The policies and procedures must at a minimum provide for:

(1) Monitoring and controlling the credit exposure arising at any one time

from the member bank's derivative transactions with each affiliate and all affiliates in the aggregate (through, among other things, imposing appropriate credit limits, mark-to-market requirements, and collateral requirements); and

(2) Ensuring that the member bank's derivative transactions with affiliates comply with the market terms requirement of § 223.51.

(c) *Credit derivatives.* A credit derivative between a member bank and a nonaffiliate in which the member bank provides credit protection to the nonaffiliate with respect to an obligation of an affiliate of the member bank is a guarantee by a member bank on behalf of an affiliate for purposes of this regulation. Such derivatives would include:

(1) An agreement under which the member bank, in exchange for a fee, agrees to compensate the nonaffiliate for any default of the underlying obligation of the affiliate; and

(2) An agreement under which the member bank, in exchange for payments based on the total return of the underlying obligation of the affiliate, agrees to pay the nonaffiliate a spread over funding costs plus any depreciation in the value of the underlying obligation of the affiliate.

Subpart E—Exemptions from the Provisions of Section 23A

§ 223.41 What covered transactions are exempt from the quantitative limits and collateral requirements?

The following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12 or the collateral requirements of § 223.14. The transactions are, however, subject to the safety and soundness requirement of § 223.13 and the prohibition on the purchase of a low-quality asset of § 223.15.

(a) *Parent institution/subsidiary institution transactions.* Transactions with a depository institution if the member bank controls 80 percent or more of the voting securities of the depository institution or the depository institution controls 80 percent or more of the voting securities of the member bank.

(b) *Transactions between a member bank and a depository institution owned by the same holding company.* Transactions with a depository institution if the same company controls 80 percent or more of the voting securities of the member bank and the depository institution.

(c) *Certain loan purchases from an affiliated depository institution.* Purchasing a loan on a nonrecourse basis from an affiliated depository institution.

(d) *Internal corporate reorganization transactions.* Purchasing assets from an affiliate (including in connection with a transfer of securities issued by an affiliate to a member bank described in paragraph (a) of § 223.31), if:

(1) The asset purchase is part of an internal corporate reorganization of a holding company and involves the transfer of all or substantially all of the shares or assets of an affiliate or of a division or department of an affiliate;

(2) The member bank provides its appropriate Federal banking agency and the Board with written notice of the transaction before consummation, including a description of the primary business activities of the affiliate and an indication of the proposed date of the asset purchase;

(3) The member bank's top-tier holding company commits to its appropriate Federal banking agency and the Board before consummation either:

(i) To make quarterly cash contributions to the member bank, for a two-year period following the member bank's purchase, equal to the book value plus any write-downs taken by the member bank, of any transferred assets that have become low-quality assets during the quarter; or

(ii) To repurchase, on a quarterly basis for a two-year period following the member bank's purchase, at a price equal to the book value plus any write-downs taken by the member bank, any transferred assets that have become low-quality assets during the quarter;

(4) The member bank's top-tier holding company complies with the commitment made under paragraph (d)(3) of this section;

(5) A majority of the member bank's directors reviews and approves the transaction before consummation;

(6) The value of the covered transaction (as computed under this part), when aggregated with the value of any

other covered transactions (as computed under this part) engaged in by the member bank under this exemption during the preceding 12 calendar months, represents less than 10 percent of the member bank's capital stock and surplus (or such higher amount, up to 25 percent of the member bank's capital stock and surplus, as may be permitted by the member bank's appropriate Federal banking agency after conducting a review of the member bank's financial condition and the quality of the assets transferred to the member bank); and

(7) The holding company and all its subsidiary member banks and other subsidiary depository institutions are well capitalized and well managed and would remain well capitalized upon consummation of the transaction.

§ 223.42 What covered transactions are exempt from the quantitative limits, collateral requirements, and low-quality asset prohibition?

The following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12, the collateral requirements of § 223.14, or the prohibition on the purchase of a low-quality asset of § 223.15. The transactions are, however, subject to the safety and soundness requirement of § 223.13.

(a) *Making correspondent banking deposits.* Making a deposit in an affiliated depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) or affiliated foreign bank that represents an ongoing, working balance maintained in the ordinary course of correspondent business.

(b) *Giving credit for uncollected items.* Giving immediate credit to an affiliate for uncollected items received in the ordinary course of business.

(c) *Transactions secured by cash or U.S. government securities*—(1) *In general.* Engaging in a credit transaction with an affiliate to the extent that the transaction is and remains secured by:

(i) Obligations of the United States or its agencies;

(ii) Obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(iii) A segregated, earmarked deposit account with the member bank that is for the sole purpose of securing credit transactions between the member bank and its affiliates and is identified as such.

(2) *Example.* A member bank makes a $100 non-amortizing term loan to an affiliate secured by U.S. Treasury securities with a market value of $50 and real estate with a market value of $75. The value of the covered transaction is $50. If the market value of the U.S. Treasury securities falls to $45 during the life of the loan, the value of the covered transaction would increase to $55.

(d) *Purchasing securities of a servicing affiliate.* Purchasing a security issued by any company engaged solely in providing services described in section 4(c)(1) of the Bank Holding Company Act (12 U.S.C. 1843(c)(1)).

(e) *Purchasing certain liquid assets.* Purchasing an asset having a readily identifiable and publicly available market quotation and purchased at or below the asset's current market quotation. An asset has a readily identifiable and publicly available market quotation if the asset's price is quoted routinely in a widely disseminated publication that is readily available to the general public.

(f) *Purchasing certain marketable securities.* Purchasing a security from a securities affiliate, if:

(1) The security has a ''ready market,'' as defined in 17 CFR 240.15c3–1(c)(11)(i);

(2) The security is eligible for a State member bank to purchase directly, subject to the same terms and conditions that govern the investment activities of a State member bank, and the member bank records the transaction as a purchase of a security for purposes of its Call Report, consistent with the requirements for a State member bank;

(3) The security is not a low-quality asset;

(4) The member bank does not purchase the security during an underwriting, or within 30 days of an underwriting, if an affiliate is an underwriter of the security, unless the security is purchased as part of an issue of obligations of, or obligations fully guaranteed as to principal and interest by, the United States or its agencies;

(5) The security's price is quoted routinely on an unaffiliated electronic service that provides indicative data from real-time financial networks, provided that:

(i) The price paid by the member bank is at or below the current market quotation for the security; and

(ii) The size of the transaction executed by the member bank does not cast material doubt on the appropriateness of relying on the current market quotation for the security; and

(6) The member bank maintains, for a period of two years, records and supporting information that are sufficient to enable the appropriate Federal banking agency to ensure the member bank's compliance with the terms of this exemption.

(g) *Purchasing municipal securities.* Purchasing a municipal security from a securities affiliate if:

(1) The security is rated by a nationally recognized statistical rating organization or is part of an issue of securities that does not exceed $25 million;

(2) The security is eligible for purchase by a State member bank, subject to the same terms and conditions that govern the investment activities of a State member bank, and the member bank records the transaction as a purchase of a security for purposes of its Call Report, consistent with the requirements for a State member bank; and

(3)(i) The security's price is quoted routinely on an unaffiliated electronic service that provides indicative data from real-time financial networks, provided that:

(A) The price paid by the member bank is at or below the current market quotation for the security; and

(B) The size of the transaction executed by the member bank does not cast material doubt on the appropriateness of relying on the current market quotation for the security; or

(ii) The price paid for the security can be verified by reference to two or more actual, current price quotes from unaffiliated broker-dealers on the exact security to be purchased or a security comparable to the security to be purchased, where:

(A) The price quotes obtained from the unaffiliated broker-dealers are based on a transaction similar in size to the transaction that is actually executed; and

(B) The price paid is no higher than the average of the price quotes; or

(iii) The price paid for the security can be verified by reference to the written summary provided by the syndicate manager to syndicate members that discloses the aggregate par values and prices of all bonds sold from the syndicate account, if the member bank:

(A) Purchases the municipal security during the underwriting period at a price that is at or below that indicated in the summary; and

(B) Obtains a copy of the summary from its securities affiliate and retains the summary for three years.

(h) *Purchasing an extension of credit subject to a repurchase agreement.* Purchasing from an affiliate an extension of credit that was originated by the member bank and sold to the affiliate subject to a repurchase agreement or with recourse.

(i) *Asset purchases by a newly formed member bank.* The purchase of an asset from an affiliate by a newly formed member bank, if the appropriate Federal banking agency for the member bank has approved the asset purchase in writing in connection with its review of the formation of the member bank.

(j) *Transactions approved under the Bank Merger Act.* Any merger or consolidation between a member bank and an affiliated depository institution or U.S. branch or agency of a foreign bank, or any acquisition of assets or assumption of deposit liabilities by a member bank from an affiliated depository institution or U.S. branch or agency of a foreign bank, if the transaction has been approved by the responsible Federal banking agency pursuant to the Bank Merger Act (12 U.S.C. 1828(c)).

(k) *Purchasing an extension of credit from an affiliate.* Purchasing from an affiliate, on a nonrecourse basis, an extension of credit, if:

(1) The extension of credit was originated by the affiliate;

(2) The member bank makes an independent evaluation of the creditworthiness of the borrower before the affiliate makes or commits to make the extension of credit;

(3) The member bank commits to purchase the extension of credit before the affiliate makes or commits to make the extension of credit;

(4) The member bank does not make a blanket advance commitment to purchase extensions of credit from the affiliate; and

(5) The dollar amount of the extension of credit, when aggregated with the dollar amount of all other extensions of credit purchased from the affiliate during the preceding 12 calendar months by the member bank and its depository institution affiliates, does not represent more than 50 percent (or such lower percent as is imposed by the member bank's appropriate Federal banking agency) of the dollar amount of extensions of credit originated by the affiliate during the preceding 12 calendar months.

(l) *Intraday extensions of credit*—(1) *In general*. An intraday extension of credit to an affiliate, if the member bank:

(i) Has established and maintains policies and procedures reasonably designed to manage the credit exposure arising from the member bank's intraday extensions of credit to affiliates in a safe and sound manner, including policies and procedures for:

(A) Monitoring and controlling the credit exposure arising at any one time from the member bank's intraday extensions of credit to each affiliate and all affiliates in the aggregate; and

(B) Ensuring that any intraday extension of credit by the member bank to an affiliate complies with the market terms requirement of §223.51;

(ii) Has no reason to believe that the affiliate will have difficulty repaying the extension of credit in accordance with its terms; and

(iii) Ceases to treat any such extension of credit (regardless of jurisdiction) as an intraday extension of credit at the end of the member bank's business day in the United States.

(2) *Definition*. *Intraday extension of credit* by a member bank to an affiliate means an extension of credit by a member bank to an affiliate that the member bank expects to be repaid, sold, or terminated, or to qualify for a complete exemption under this regulation, by the end of its business day in the United States.

(m) *Riskless principal transactions*. Purchasing a security from a securities affiliate of the member bank if:

(1) The member bank or the securities affiliate is acting exclusively as a riskless principal in the transaction; and

(2) The security purchased is not issued, underwritten, or sold as principal (other than as riskless principal) by any affiliate of the member bank.

(n) *Securities financing transactions*. (1) From September 15, 2008, until October 30, 2009 (unless further extended by the Board), securities financing transactions with an affiliate, if:

(i) The security or other asset financed by the member bank in the transaction is of a type that the affiliate financed in the U.S. tri-party repurchase agreement market at any time during the week of September 8–12, 2008;

(ii) The transaction is marked to market daily and subject to daily margin-maintenance requirements, and the member bank is at least as overcollateralized in the transaction as the affiliate's clearing bank was overcollateralized in comparable transactions with the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iii) The aggregate risk profile of the securities financing transactions under this exemption is no greater than the aggregate risk profile of the securities financing transactions of the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iv) The member bank's top-tier holding company guarantees the obligations of the affiliate under the securities financing transactions (or provides other security to the bank that is acceptable to the Board); and

(v) The member bank has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

(2) For purposes of this exemption:

(i) *Securities financing transaction* means:

(A) A purchase by a member bank from an affiliate of a security or other asset, subject to an agreement by the affiliate to repurchase the asset from the member bank;

(B) A borrowing of a security by a member bank from an affiliate on a collateralized basis; or

(C) A secured extension of credit by a member bank to an affiliate.

(ii) *U.S. tri-party repurchase agreement market* means the U.S. market for securities financing transactions in which the counterparties use custodial arrangements provided by JPMorgan Chase Bank or Bank of New York or another financial institution approved by the Board.

(o) *Purchases of certain asset-backed commercial paper*. Purchases of asset-backed commercial paper from an affiliated 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), if the member bank:

(1) Purchases the asset-backed commercial paper on or after September 19, 2008;

(2) Pledges the asset-backed commercial paper to a Federal Reserve Bank to secure financing from the asset-backed commercial paper lending facility (AMLF) established by the Board on September 19, 2008; and

(3) Has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

[67 FR 76604, Dec. 12, 2002, as amended at 73 FR 54308, Sept. 19, 2008; 73 FR 55709, Sept. 26, 2008; 74 FR 6226, 6227, Feb. 6, 2009]

§ 223.43 What are the standards under which the Board may grant additional exemptions from the requirements of section 23A?

(a) *The standards*. The Board may, at its discretion, by regulation or order, exempt transactions or relationships from the requirements of section 23A and subparts B, C, and D of this part if it finds such exemptions to be in the public interest and consistent with the purposes of section 23A.

(b) *Procedure*. A member bank may request an exemption from the requirements of section 23A and subparts B, C, and D of this part by submitting a written request to the General Counsel of the Board. Such a request must:

(1) Describe in detail the transaction or relationship for which the member bank seeks exemption;

(2) Explain why the Board should exempt the transaction or relationship; and

(3) Explain how the exemption would be in the public interest and consistent with the purposes of section 23A.

Subpart F—General Provisions of Section 23B

§ 223.51 What is the market terms requirement of section 23B?

A member bank may not engage in a transaction described in § 223.52 unless the transaction is:

(a) On terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the member bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates; or

(b) In the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliates.

§ 223.52 What transactions with affiliates or others must comply with section 23B's market terms requirement?

(a) The market terms requirement of § 223.51 applies to the following transactions:

(1) Any covered transaction with an affiliate, unless the transaction is exempt under paragraphs (a) through (c) of § 223.41 or paragraphs (a) through (e) or (h) through (j) of § 223.42;

(2) The sale of a security or other asset to an affiliate, including an asset subject to an agreement to repurchase;

(3) The payment of money or the furnishing of a service to an affiliate under contract, lease, or otherwise;

(4) Any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the member bank or to any other person; and

(5) Any transaction or series of transactions with a nonaffiliate, if an affiliate:

(i) Has a financial interest in the nonaffiliate; or

(ii) Is a participant in the transaction or series of transactions.

(b) For the purpose of this section, any transaction by a member bank with any person will be deemed to be a transaction with an affiliate of the member bank if any of the proceeds of the transaction are used for the benefit of, or transferred to, the affiliate.

§ 223.53 What asset purchases are prohibited by section 23B?

(a) *Fiduciary purchases of assets from an affiliate.* A member bank may not purchase as fiduciary any security or other asset from any affiliate unless the purchase is permitted:

(1) Under the instrument creating the fiduciary relationship;

(2) By court order; or

(3) By law of the jurisdiction governing the fiduciary relationship.

(b) *Purchase of a security underwritten by an affiliate.* (1) A member bank, whether acting as principal or fiduciary, may not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security if a principal underwriter of that security is an affiliate of the member bank.

(2) Paragraph (b)(1) of this section does not apply if the purchase or acquisition of the security has been approved, before the security is initially offered for sale to the public, by a majority of the directors of the member bank based on a determination that the purchase is a sound investment for the member bank, or for the person on whose behalf the member bank is acting as fiduciary, as the case may be, irrespective of the fact that an affiliate of the member bank is a principal underwriter of the security.

(3) The approval requirement of paragraph (b)(2) of this section may be met if:

(i) A majority of the directors of the member bank approves standards for the member bank's acquisitions of securities described in paragraph (b)(1) of this section, based on the determination set forth in paragraph (b)(2) of this section;

(ii) Each acquisition described in paragraph (b)(1) of this section meets the standards; and

(iii) A majority of the directors of the member bank periodically reviews acquisitions described in paragraph (b)(1) of this section to ensure that they meet the standards and periodically reviews the standards to ensure that they continue to meet the criterion set forth in paragraph (b)(2) of this section.

(4) A U.S. branch, agency, or commercial lending company of a foreign bank may comply with paragraphs (b)(2) and (b)(3) of this section by obtaining the approvals and reviews required by paragraphs (b)(2) and (b)(3) from either:

(i) A majority of the directors of the foreign bank; or

(ii) A majority of the senior executive officers of the foreign bank.

(c) *Special definitions.* For purposes of this section:

(1) ''*Principal underwriter*'' means any underwriter who, in connection with a primary distribution of securities:

(i) Is in privity of contract with the issuer or an affiliated person of the issuer;

(ii) Acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or

(iii) Is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

(2) ''*Security*'' has the same meaning as in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)).

§ 223.54 What advertisements and statements are prohibited by section 23B?

(a) *In general.* A member bank and its affiliates may not publish any advertisement or enter into any agreement stating or suggesting that the member bank will in any way be responsible for the obligations of its affiliates.

(b) *Guarantees, acceptances, letters of credit, and cross-affiliate netting arrangements subject to section 23A.* Paragraph (a) of this section does not prohibit a member bank from:

(1) Issuing a guarantee, acceptance, or letter of credit on behalf of an affiliate, confirming a letter of credit

issued by an affiliate, or entering into a cross-affiliate netting arrangement, to the extent such transaction satisfies the quantitative limits of §§ 223.11 and 223.12 and the collateral requirements of § 223.14, and is otherwise permitted under this regulation; or

(2) Making reference to such a guarantee, acceptance, letter of credit, or cross-affiliate netting arrangement if otherwise required by law.

§ 223.55 What are the standards under which the Board may grant exemptions from the requirements of section 23B?

The Board may prescribe regulations to exempt transactions or relationships from the requirements of section 23B and subpart F of this part if it finds such exemptions to be in the public interest and consistent with the purposes of section 23B.

§ 223.56 What transactions are exempt from the market-terms requirement of section 23B?

The following transactions are exempt from the market-terms requirement of § 223.51.

(a) *Purchases of certain asset-backed commercial paper*. Purchases of asset-backed commercial paper from an affiliated 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), if the member bank:

(1) Purchases the asset-backed commercial paper on or after September 19, 2008;

(2) Pledges the asset-backed commercial paper to a Federal Reserve Bank to secure financing from the asset-backed commercial paper lending facility (AMLF) established by the Board on September 19, 2008; and

(3) Has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

(b) [Reserved]

[Reg. W, 74 FR 6228, Feb. 6, 2009]

Subpart G—Application of Sections 23A and 23B to U.S. Branches and Agencies of Foreign Banks

§ 223.61 How do sections 23A and 23B apply to U.S. branches and agencies of foreign banks?

(a) *Applicability of sections 23A and 23B to foreign banks engaged in underwriting insurance, underwriting or dealing in securities, merchant banking, or insurance company investment in the United States*. Except as provided in this subpart, sections 23A and 23B of the Federal Reserve Act and the provisions of this regulation apply to each U.S. branch, agency, or commercial lending company of a foreign bank in the same manner and to the same extent as if the branch, agency, or commercial lending company were a member bank.

(b) *Affiliate defined*. For purposes of this subpart, any company that would be an affiliate of a U.S. branch, agency, or commercial lending company of a foreign bank if such branch, agency, or commercial lending company were a member bank is an affiliate of the branch, agency, or commercial lending company if the company also is:

(1) Directly engaged in the United States in any of the following activities:

(i) Insurance underwriting pursuant to section 4(k)(4)(B) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(B));

(ii) Securities underwriting, dealing, or market making pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(E));

(iii) Merchant banking activities pursuant to section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) (but only to the extent that the proceeds of the transaction are used for the purpose of funding the affiliate's merchant banking activities);

(iv) Insurance company investment activities pursuant to section 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(I)); or

(v) Any other activity designated by the Board;

(2) A portfolio company (as defined in the merchant banking subpart of Regulation Y (12 CFR 225.177(c))) controlled by the foreign bank or an affiliate of the foreign bank or a company that would be an affiliate of the branch, agency, or commercial lending company of the foreign bank under paragraph (a)(9) of § 223.2 if such branch, agency, or commercial lending company were a member bank; or

(3) A subsidiary of an affiliate described in paragraph (b)(1) or (2) of this section.

(c) *Capital stock and surplus.* For purposes of this subpart, the ''*capital stock and surplus*'' of a U.S. branch, agency, or commercial lending company of a foreign bank will be determined by reference to the capital of the foreign bank as calculated under its home country capital standards.

Subpart H—Miscellaneous Interpretations

§ 223.71 How do sections 23A and 23B apply to transactions in which a member bank purchases from one affiliate an asset relating to another affiliate?

(a) *In general.* In some situations in which a member bank purchases an asset from an affiliate, the asset purchase qualifies for an exemption under this regulation, but the member bank's resulting ownership of the purchased asset also represents a covered transaction (which may or may not qualify for an exemption under this part). In these situations, the transaction engaged in by the member bank would qualify as two different types of covered transaction. Although an asset purchase exemption may suffice to exempt the member bank's asset purchase from the first affiliate, the asset purchase exemption does not exempt the member bank's resulting covered transaction with the second affiliate. The exemptions subject to this interpretation include §§ 223.31(e), 223.41(a) through (d), and 223.42(e), (f), (i), (j), (k), and (m).

(b) *Examples*—(1) *The (d)(6) exemption.* A member bank purchases from Affiliate A securities issued by Affiliate B in a purchase that qualifies for the (d)(6) exemption in section 23A. The member bank's asset purchase from Affiliate A would be an exempt covered transaction under § 223.42(e); but the member bank also would have acquired an investment in securities issued by Affiliate B, which would be a covered transaction between the member bank and Affiliate B under § 223.3(h)(2) that does not qualify for the (d)(6) exemption. The (d)(6) exemption, by its terms, only exempts asset purchases by a member bank from an affiliate; hence, the (d)(6) exemption cannot exempt a member bank's investment in securities issued by an affiliate (even if the securities would qualify for the (d)(6) exemption).

(2) T*he sister-bank exemption.* A member bank purchases from Sister-Bank Affiliate A a loan to Affiliate B in a purchase that qualifies for the sister-bank exemption in section 23A. The member bank's asset purchase from Sister-Bank Affiliate A would be an exempt covered transaction under § 223.41(b); but the member bank also would have acquired an extension of credit to Affiliate B, which would be a covered transaction between the member bank and Affiliate B under § 223.3(h)(1) that does not qualify for the sister-bank exemption. The sister-bank exemption, by its terms, only exempts transactions by a member bank with a sister-bank affiliate; hence, the sister-bank exemption cannot exempt a member bank's extension of credit to an affiliate that is not a sister bank (even if the extension of credit was purchased from a sister bank).

Subpart I—Savings Associations—Transactions with Affiliates

§ 223.72 Transactions with affiliates.

(a) *Scope.* (1) This subpart implements section 11(a) of the Home Owners' Loan Act (12 U.S.C. 1468(a)). Section 11(a) applies sections 23A and 23B of the FRA (12 U.S.C. 371c and 371c1) to every savings association in the same manner and to the same extent as if the association were a member bank; prohibits certain types of transactions with affiliates; and authorizes the Board to impose additional restrictions on a savings association's transactions with affiliates.

(2) For the purposes of this subpart, ''savings association'' is defined at section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), and also includes any savings bank or any cooperative bank that is a savings association under 12 U.S.C. 1467a(l). A non-affiliate subsidiary of a savings association is treated as part of the savings association. For purposes of this subpart, a ''non-affiliate subsidiary'' is a subsidiary of a savings association other than a subsidiary described at 12 CFR 223.2(b)(1)(i), and (b)(1)(iii) through (v).

(b) *Sections 23A and 23B of the FRA.* A savings association must comply with sections 23A and 23B of the Federal Reserve Act and this part as if it were a member bank, except as described in the following chart.

Provision of Regulation W	Application
(1) 12 CFR 223.2(a)(8)—''Affiliate'' includes a financial subsidiary.	Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.
(2) 12 CFR 223.2(a)(12)—Determination that ''affiliate'' includes other types of companies.	Read to include the following statement: ''Affiliate also includes any company that the Board determines, by order or regulation, to present a risk to the safety and soundness of the savings association.''
(3) 12 CFR 223.2(b)(1)(ii)—''Affiliate'' includes a subsidiary that is a financial subsidiary.	Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.
(4) 12 CFR 223.3(d)—Definition of ''capital stock and surplus.''	''Capital stock and surplus'' for a savings association has the same meaning as under the regulatory capital requirements applicable to that savings association.
(5) 12 CFR 223.3(h)(1)—Section 23A covered transactions include an extension of credit to the affiliate.	Read to incorporate paragraph (c)(1) of this section, which prohibits loans or extensions of credit to an affiliate, unless the affiliate is engaged only in the activities described at 12 U.S.C. 1467a(c)(2)(F)(i), as defined in Regulation LL at 12 CFR 238.54.
(6) 12 CFR 223.3(h)(2)—Section 23A covered transactions include a purchase of or investment in securities issued by an affiliate.	Read to incorporate paragraph (c)(2) of this section, which prohibits purchases and investments in securities issued by an affiliate, other than with respect to shares of a subsidiary.
(7) 12 CFR 223.3(k)—Definition of ''depository institution.''	Read to include the following statement: ''For the purposes of this definition, a non-affiliate subsidiary of a savings association is treated as part of the depository institution.''
(8) 12 CFR 223.3(p)—Definition of ''financial subsidiary.''	Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.
(9) 12 CFR 223.3(w)—Definition of ''member bank.''	Read to include the following statement: ''Member bank also includes a savings association. For purposes of this definition, a non-affiliate subsidiary of a savings association is treated as part of the savings association.''
(10) 12 CFR 223.3(aa)—Definition of ''operating subsidiary.''	Does not apply.
(11) 12 CFR 223.31—Application of section 23A to an acquisition of an affiliate that becomes an operating subsidiary.	Read to refer to ''a non-affiliate subsidiary'' instead of ''operating subsidiary.''
(12) 12 CFR 223.32—Rules that apply to financial subsidiaries of a bank.	Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.
(13) 12 CFR 223.42(f)(2)—Exemption for purchasing certain marketable securities.	Read to refer to ''Thrift Financial Report'' instead of ''Call Report.'' References to ''state member bank'' are unchanged.
(14) 12 CFR 223.42(g)(2)—Exemption for purchasing municipal securities.	Read to refer to ''Thrift Financial Report'' instead of ''Call Report.'' References to ''state member bank'' are unchanged.
(15) 12 CFR 223.61—Application of sections 23A and 23B to U.S. branches and agencies of foreign banks.	Does not apply to savings associations or their subsidiaries.

(c) *Additional prohibitions and restrictions.* A savings association must comply with the additional prohibitions and restrictions in this paragraph (c). Except as described in paragraph (b) of this section, the definitions in this part apply to these additional prohibitions and restrictions.

(1) *Loans and extensions of credit.* (i) A savings association may not make a loan or other extension of credit to an affiliate, unless the affiliate is solely engaged in the activities described at 12 U.S.C. 1467a(c)(2)(F)(i), as defined in §238.54 of Regulation LL (12 CFR 238.54). A loan or extension of credit to a third party is not prohibited merely because proceeds of the transaction are used for the benefit of, or are transferred to, an affiliate.

(ii) If the Board determines that a particular transaction is, in substance, a loan or extension of credit to an affiliate that is engaged in activities other than those described at 12 U.S.C. 1467a(c)(2)(F)(i), as defined in §238.54 of Regulation LL (12 CFR 238.54), or the Board has other supervisory concerns concerning the transaction, the Board may inform the savings association that the transaction is prohibited under this paragraph (c)(1), and require the savings association to divest the loan, unwind the transaction, or take other appropriate action.

(2) *Purchases or investments in securities.* A savings association may not purchase or invest in securities issued by any affiliate other than with respect to shares of a subsidiary. For the purposes of this paragraph (c)(2), subsidiary includes a bank and a savings association.

[76 FR 56531, Sept. 13, 2011]

PART 224—BORROWERS OF SECURITIES CREDIT (REGULATION X)

AUTHORITY: 15 U.S.C. 78g.

SOURCE: Reg. X, 48 FR 56572, Dec. 22, 1983, unless otherwise noted.

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting part 224, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

§224.1 Authority, purpose, and scope.

(a) *Authority and purpose.* Regulation X (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) under the Securities Exchange Act of 1934, as amended (the Act) (15 U.S.C. 78a *et seq.*). This part implements section 7(f) of the Act (15 U.S.C. 78g(f)), the purpose of which is to require that credit obtained within or outside the United States complies with the limitations of the Board's Margin Regulations T and U (12 CFR parts 220 and 221, respectively).

(b) *Scope and exemptions.* The Act and this part apply the Board's margin regulations to United States persons and foreign persons controlled by or acting on behalf of or in conjunction with United States persons (hereinafter borrowers), who obtain credit outside the United States to purchase or carry United States securities, or within the United States to purchase or carry any securities (both types of credit are hereinafter referred to as purpose credit). The following borrowers are exempt from the Act and this part:

(1) Any borrower who obtains purpose credit within the United States, unless the borrower willfully causes the credit to be extended in contravention of Regulations T or U.

(2) Any borrower whose permanent residence is outside the United States and who does not obtain or have outstanding, during any calendar year, a total of more than $100,000 in purpose credit obtained outside the United States; and

(3) Any borrower who is exempt by Order upon terms and conditions set by the Board.

[Reg. X, 48 FR 56572, Dec. 22, 1983, as amended by Reg. X, 63 FR 2839, Jan. 16, 1998]

§224.2 Definitions.

The terms used in this part have the meanings given to them in sections 3(a) and 7(f) of the Act, and in Regulations T and U. Section 7(f) of the Act contains the following definitions:

(a) *United States person* includes a person which is organized or exists under the laws of any State or, in the case of a natural person, a citizen or resident of the United States; a domestic estate; or a trust in which one or more of the foregoing persons has a cumulative direct or indirect beneficial interest in excess of 50 per centum of the valve of the trust.

(b) *United States security* means a security (other than an exempted security) issued by a person incorporated under the laws of any State, or whose principal place of business is within a State.

(c) *Foreign person controlled by a United States person* includes any noncorporate entity in which United States persons directly or indirectly have more than a 50 per centum beneficial interest, and any corporation in which one or more United States persons, directly or indirectly, own stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or

Section 13(3) of the Federal Reserve Act

(codified in 12 U.S.C. § 343. Discount of obligations arising out of actual commercial transactions)

Blackline Showing Dodd-Frank Amendments[1]

(3)(A)[2] In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 357 of this title, to discount for any ~~individual, partnership, or corporation~~participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal reserve bank: Provided, That before discounting any such note, draft, or bill of exchange~~ for an individual or a partnership or corporation~~, the Federal reserve bank shall obtain evidence that such ~~individual, partnership, or corporation~~participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions. All such discounts for ~~individuals, partnerships, or corporations~~any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

(B)

(i) As soon as is practicable after July 21, 2010, the Board shall establish, by regulation, in consultation with the Secretary of the Treasury, the policies and procedures governing emergency lending under this paragraph. Such policies and procedures shall be designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion. The policies and procedures established by the Board shall require that a Federal reserve bank assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan executed by a Federal reserve bank under this paragraph in determining whether the loan is secured satisfactorily for purposes of this paragraph.

(ii) The Board shall establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent. Such procedures may include a

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[1] Key for reading this blackline: Text that is ~~red and crossed out~~ was deleted from the statute by Dodd-Frank. Text that is blue and double underlined was added to the statute by Dodd-Frank. Text in green was deleted from one location in the statute, (where it is ~~green and crossed out~~), and added to another location in the statute, (where it is green and double underlined), by Dodd-Frank.

[2] So in original

certification from the chief executive officer (or other authorized officer) of the borrower, at the time the borrower initially borrows under the program or facility (with a duty by the borrower to update the certification if the information in the certification materially changes), that the borrower is not insolvent. A borrower shall be considered insolvent for purposes of this subparagraph, if the borrower is in bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act [12 U.S.C. 5381 et seq.], or any other Federal or State insolvency proceeding.

(iii) A program or facility that is structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company avoid bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding, shall not be considered a program or facility with broadbased eligibility.

(iv) The Board may not establish any program or facility under this paragraph without the prior approval of the Secretary of the Treasury.

(C) The Board shall provide to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—

(i) not later than 7 days after the Board authorizes any loan or other financial assistance under this paragraph, a report that includes—

(I) the justification for the exercise of authority to provide such assistance;

(II) the identity of the recipients of such assistance;

(III) the date and amount of the assistance, and form in which the assistance was provided; and

(IV) the material terms of the assistance, including—

(aa) duration;

(bb) collateral pledged and the value thereof;

(cc) all interest, fees, and other revenue or items of value to be received in exchange for the assistance;

(dd) any requirements imposed on the recipient with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance; and

(ee) the expected costs to the taxpayers of such assistance; and

(ii) once every 30 days, with respect to any outstanding loan or other financial assistance under this paragraph, written updates on—

(I) the value of collateral;

(II) the amount of interest, fees, and other revenue or items of value received in exchange for the assistance; and

(III) the expected or final cost to the taxpayers of such assistance.

(D) The information required to be submitted to Congress under subparagraph (C) related to—

(i) the identity of the participants in an emergency lending program or facility commenced under this paragraph;

(ii) the amounts borrowed by each participant in any such program or facility;

(iii) identifying details concerning the assets or collateral held by, under, or in connection with such a program or facility,

shall be kept confidential, upon the written request of the Chairman of the Board, in which case such information shall be made available only to the Chairpersons or Ranking Members of the Committees described in subparagraph (C).

(E) If an entity to which a Federal reserve bank has provided a loan under this paragraph becomes a covered financial company, as defined in section 201 of the Dodd-Frank Wall Street Reform and Consumer Protection Act [12 U.S.C. 5381], at any time while such loan is outstanding, and the Federal reserve bank incurs a realized net loss on the loan, then the Federal reserve bank shall have a claim equal to the amount of the net realized loss against the covered entity, with the same priority as an obligation to the Secretary of the Treasury under section 210(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act [12 U.S.C. 5390(b)].

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Friday, December 18, 2015

FEDERAL RESERVE SYSTEM

12 CFR Part 201

[Regulation A; Docket No. R–1476]

RIN 7100–AE08

Extensions of Credit by Federal Reserve Banks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting amendments to Regulation A (Extensions of Credit by Federal Reserve Banks) to implement the emergency lending authorities provided under the 3rd undesignated paragraph of section 13 of the Federal Reserve Act (the FRA) as amended by sections 1101 and 1103 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). These provisions of the Dodd-Frank Act require the Board, in consultation with the Secretary of the Treasury, to establish by regulation policies and procedures with respect to emergency lending under section 13(3) of the FRA.

DATES: Effective January 1, 2016.

FOR FURTHER INFORMATION CONTACT: Laurie S. Schaffer, Associate General Counsel (202) 452–2272, Sophia H. Allison, Special Counsel (202) 452–3565, or Jay R. Schwarz, Senior Counsel (202) 452–2970, Legal Division. Board of Governors of the Federal Reserve System, 20th Street and Constitution Ave. NW., Washington, DC 20551. For the hearing impaired only, Telecommunications Device for the Deaf (TDD) users may contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Introduction

On December 23, 2013, the Board invited public comment on proposed amendments to Regulation A (Extensions of Credit by Federal Reserve Banks) to implement sections 1101 and 1103 of the Dodd-Frank Act (Pub. L. 111–203, 124 Stat. 1376).[1] The purpose of the proposed amendments was to implement the Dodd-Frank Act revisions to the Board's emergency lending authority in section 13(3) of the Federal Reserve Act that limit the use of this authority to the provision of liquidity through broadly-based facilities for solvent firms in a time of crisis. After careful review and consideration of the comments, the final rule adopted by the Board includes a number of changes and additional limitations to address concerns raised by commenters.

Prior to the enactment of the Dodd-Frank Act, section 13(3) provided that the Board may authorize a Federal Reserve Bank to extend credit to any individual, partnership, or corporation subject to four principal conditions. These conditions required that (1) credit be extended only in unusual and exigent circumstances; (2) credit be extended only if the Board authorizes the lending by the affirmative vote of at least five of its members;[2] (3) the lending Federal Reserve Bank obtain evidence before extending the credit that the borrower is unable to secure adequate credit from other banking institutions; and (4) the extension of credit be indorsed or otherwise secured to the satisfaction of the Federal Reserve Bank. This statutory authority to extend emergency credit to any person in unusual and exigent circumstances was enacted by Congress in 1932 to enable the Federal Reserve, as the nation's central bank, to provide liquidity in times of financial stress.[3]

Effective on July 21, 2010, the Dodd-Frank Act (Pub. L. 111–203, 124 Stat. 1376) amended section 13(3) to limit this emergency lending authority to broad-based programs and facilities that relieve liquidity pressures in financial markets. To accomplish this, the Dodd-Frank Act amended section 13(3) to remove the general authority to lend to an individual, partnership, or corporation and to replace that general authority with the limited authority to extend emergency credit only to participants in a program or facility with broad-based eligibility designed for the purpose of providing liquidity to the financial system.[4] In addition, the amendments to section 13(3) provide that a program or facility that is structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company avoid bankruptcy or resolution under a Federal or State insolvency proceeding would not be considered a program or facility with broad-based eligibility.[5] The Dodd-Frank Act also prohibits lending under section 13(3) to insolvent borrowers, and requires that the Board establish policies and procedures that assign a value to all collateral for an emergency loan and that are designed to ensure that the collateral is sufficient to protect taxpayers from losses. Moreover, section 13(3) was amended to provide that a program or facility may not be established without the prior approval of the Secretary of the Treasury. The Dodd-Frank Act also imposed certain publication and congressional reporting requirements regarding lending under section 13(3).

The draft rule proposed by the Board for public comment adopted all of the requirements and much of the specific statutory language contained in the Dodd-Frank Act amendments to section 13(3). The Board received fewer than a dozen comments on the proposed rule from financial institutions, policy institutions, individuals, and members of Congress.

While commenters generally expressed support for the proposed rule, most commenters recommended revisions to the proposed rule. Among the suggestions made by the commenters are that the rule:

- Provide a more specific definition of what it means for a program or facility to be ''broad-based'';
- adopt a broader definition of insolvency for purposes of the prohibition on lending to insolvent borrowers;

[1] 79 FR 615 (January 6, 2014).

[2] A lesser number of votes is required in certain emergency situations where at least five members of the Board are unavailable or not in service. 12 U.S.C. 248(r).

[3] *See* H.R. Rep. No. 1777, at 19, 20 (1932) (Conf. Rep.); S. Rep. No. 102–167, at 202 (1991) (Conf. Rep.).

[4] Public Law 13–203, Sec. 1101(a)(2): 124 STAT 2113(amending section 13 of the Federal Reserve Act, 12 U.S.C. 343).

[5] Public Law 13–203, Sec. 1101(a)(6): 124 STAT 2113(amending section 13 of the Federal Reserve Act, 12 U.S.C. 343).

- clarify that solvent firms may not borrow for the purpose of passing the proceeds of emergency loans on to insolvent firms;
- specify that emergency loans would only be made at a penalty rate that exceeds the market rate for such loans;
- include a specific timeline for evaluating whether an emergency lending program or facility should be terminated;
- limit the classes of collateral that can be accepted for emergency loans and require that the collateral be independently appraised; and
- require the Board to seek a joint resolution of Congress prior to granting an emergency loan.

The final rule adopts all of the limitations and revisions required by the Dodd-Frank Act. In addition, in response to the comments, the Board has revised the final rule in a number of significant ways. In particular, as discussed below, the Board modified the final rule to:

- Further limit the definition of a broad-based program by including, in addition to the proposed requirement that the program be designed to provide liquidity to an identifiable market or sector of the financial system and not be for the purpose of assisting a specific firm to avoid bankruptcy or other resolution, a requirement that at least five persons be eligible to participate in the facility and a requirement that the facility not be designed to assist any number of identified firms to avoid bankruptcy or resolution;
- Expand the definition of insolvency to include potential borrowers that are generally not paying their undisputed debts as they become due during the 90 days preceding borrowing from the program, and potential borrowers that are otherwise determined by the Board or the lending Federal Reserve Bank to be insolvent, in addition to the proposal to identify as insolvent any person in a resolution or bankruptcy proceeding;
- Provide that loans may not be made to companies that are borrowing for the purpose of lending to insolvent companies;
- Specify that emergency loans must be extended at a penalty rate;
- Provide that the Board will make public and report to Congress a description of the market or sector of the financial system to which a program or facility with broad-based eligibility is intended to provide liquidity;
- Provide that the Board will review each program or facility at least every six months and that each program or facility will terminate within one year from the date of its first extension of credit or its latest renewal date unless the Board determines, by a vote of at least five members of the Board[6] and with the approval of the Secretary of the Treasury, to renew the program or facility; and,
- Clarify that, if a company or its representative is found to have made a knowing material misrepresentation regarding its solvency in obtaining emergency credit, the credit plus all applicable interest, fees, and penalties will become immediately due and payable, and the Federal Reserve will refer the matter to the relevant law enforcement authorities for appropriate action.

II. Section by Section Summary of Final Rule

A. Section 201.4(d)—Emergency Credit for Others

1. Authorization To Extend Credit

Section 201.4(d)(1) of the final rule provides that, in unusual and exigent circumstances, the Board may, upon the affirmative vote of not less than five of its members,[7] authorize any Federal Reserve Bank to extend credit under section 13(3) of the FRA through a program or facility with broad-based eligibility. This requirement mirrors the statutory requirement and is unchanged from the proposed rule. Conditions governing when a program or facility has broad-based eligibility are discussed below.

In addition, section 201.4(d)(1) provides that any credit extended under section 13(3) of the FRA is subject to such other conditions as the Board may determine. These could include conditions that govern the timing of, collateral supporting, duration of, consideration for, terms of, counterparties to, and other conditions governing the extension of credit.

2. Approval of the Secretary of the Treasury

Section 201.4(d)(2) of the final rule provides that a program or facility under section 13(3) of the FRA may not be established without the prior approval of the Secretary of the Treasury. This condition implements a requirement of the Dodd-Frank Act.[8]

One commenter suggested that, in addition to this approval, the Board should seek a joint resolution of Congress in connection with the establishment of a program or facility. While Congress in the Dodd-Frank Act imposed a similar requirement as a condition of certain emergency actions by the Federal Deposit Insurance Corporation (FDIC), Congress did not adopt this requirement in connection with emergency lending under section 13(3) of the FRA. Instead, Congress established a number of other specific procedural requirements for emergency lending in section 1101 of the Dodd-Frank Act, including the requirement that the Secretary of the Treasury approve the establishment of a program or facility.

The final rule does not adopt a requirement that Congress ratify a lending program or facility. It is the exclusive prerogative of Congress to determine when and on what matters it will act. However, to further Congressional oversight of emergency lending facilities, the Board's final rule establishes a process by which the Board will promptly provide written notice to Congress of any emergency program or facility established under section 13(3) of the FRA.

3. Disclosure of Justification and Terms

Section 201.4(d)(3) of the final rule requires that the Board make publicly available, as soon as is reasonably practicable, and no later than 7 days after the Board authorizes the program or facility, a description of the program or facility, the unusual and exigent circumstances that exist, the intended effect of the program or facility, and the terms and conditions for participation in the program or facility. The final rule also provides that, within the same 7-day period, this information will be provided by the Board to the Committee on Banking, Housing and Urban Affairs of the U.S. Senate and the Committee on Financial Services of the U.S. House of Representatives.

Some commenters suggested that the Board provide additional clarity regarding the scope of the market that must be eligible for a facility to have ''broad-based eligibility.'' While this is addressed below, as part of its response to this comment, the Board amended section 201.4(d)(3) of the final rule to require that the Board publicly disclose the market or sector of the financial system to which the program or facility is intended to provide liquidity. The Board added this disclosure requirement to help provide transparency regarding the broad-based nature of a program or facility at the time it is created.

[6] A lesser number of votes is required in certain emergency situations where at least five members of the Board are unavailable or not in service. 12 U.S.C. 248(r).

[7] The rule permits the Board to authorize lending under the rule by a vote of fewer than five members in certain emergency situations permitted by statute where at least five members of the Board are not available or not in service. 12 U.S.C. 248(r).

[8] 12 U.S.C. 343(3)(B)(iv).

4. Definition of Broad-Based Eligibility

The Dodd-Frank Act limits emergency lending under section 13(3) of the FRA to lending conducted through a program or facility ''with broad-based eligibility.'' [9] The draft implementing rule as originally proposed would have implemented this restriction in the Dodd-Frank Act by incorporating the language contained in the Dodd-Frank Act prohibiting lending for the purpose of removing assets from the balance sheet of ''a single and specific company,'' assisting ''a single and specific company'' to avoid bankruptcy, resolution under Title II of the Dodd-Frank Act, or any other Federal or State insolvency proceeding, or aiding a failing financial company.[10]

Several commenters expressed concern that the reference in the proposed rule to ''a single and specific company'' could allow the Board to circumvent the limits imposed by the Dodd-Frank Act by grouping two or more bankrupt or failing firms in a program or facility. Some of these commenters suggested that the Board specify the number of eligible participants that would be required for a program or facility to have broad-based eligibility. One legislative proposal would provide that a program or facility is not broad-based unless at least five persons are eligible to participate in the program or facility.

The Board believes that the requirement that a program or facility have ''broad-based eligibility'' cannot be avoided by grouping two or more failing or bankrupt firms into a single facility. Thus, section 201.4(d)(4) of the final rule has been modified to make clear that an emergency program or facility has broad-based eligibility under the final rule only if three conditions are met. First, the program or facility must be designed for the purpose of providing liquidity to an identifiable market or sector of the financial system.

Second, the program or facility must not be designed for the purpose of assisting one or more specific companies to avoid bankruptcy or other resolution, including by removing assets from the balance sheet of the company or companies. The original proposal would have adopted the language in the Dodd-Frank Act that a program not be designed for the purpose of assisting ''a single and specific company'' avoid bankruptcy or resolution. The final rule has been changed to provide that a program or facility may not be designed to assist ''one or more'' specific companies to avoid bankruptcy or resolution. This change is intended to accent that a program or facility would not qualify as a broad-based program or facility if it is designed for the purpose of assisting any number of specific persons or entities to avoid resolution. A program or facility that is designed to remove assets from a single and specific firm's balance sheet to help the firm avoid bankruptcy or resolution such as was done with regard to Bear Stearns would not be permissible.

Third, the final rule provides that a program or facility would not be considered broad-based if fewer than five persons are eligible to participate in the program or facility. In this context, eligibility would be determined by qualification under all the terms and conditions established for participation in the program or facility.

Together, these limitations are designed to ensure that emergency credit programs and facilities are established only to fulfill the central bank's role as lender of last resort to the financial system and not as a lender to troubled firms seeking to avoid resolution or failure. For example, this approach would permit the Federal Reserve to establish programs or facilities like the Term Asset-backed Securities Loan Facility (TALF), which provided several thousand loans that provided liquidity to fund several billion dollars of student loans, car loans, small business loans and other loans in the securitization market; the Commercial Paper Funding Facility (CPFF), which was a program with broad-based eligibility designed to provide liquidity to the commercial paper market; the Asset-backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) and the Money Market Investor Funding Facility (MMIFF), which were programs with broad-based eligibility designed to provide liquidity to the money market fund sector; and the Primary Dealer Credit Facility (PDCF), which provided liquidity to all primary dealers in support of trading in the U.S. Government securities market.

However, these restrictions would not permit emergency lending to remove assets from a failing firm as was done in the case of the emergency loan to Bear Stearns, or to provide credit to prevent a firm from entering bankruptcy as was done in the case of the emergency credit facility established for AIG. Importantly, the final rule would not authorize a program or facility that sought to evade these limitations by grouping multiple failing or insolvent firms in a single program or facility. Thus, the revisions in the final rule would not permit the Federal Reserve to extend emergency credit in a case like the Bear Stearns or AIG situation simply by establishing a single program or facility for the purpose of providing credit to both Bear Stearns and AIG, or any other number of specific failing or insolvent firms.[11]

The Board is adopting section 201.4(d)(4)(iv) as proposed. That section authorizes the Board to determine the type of mechanism or vehicle used to extend credit, so long as the facility is broad-based. For example, liquidity facilities may extend credit directly to participants in those facilities in some cases, or through a special purpose vehicle in other cases. In any case, the extensions of credit would be subject to all of the requirements related to the provision of liquidity under section 13(3) of the FRA.

5. Definition of Insolvency

As noted above, section 1101 of the Dodd-Frank Act requires the Board to ''establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent.'' Section 1101 also provides that a borrower ''shall be considered insolvent'' if the borrower ''is in bankruptcy, resolution under Title II of [the Dodd-Frank Act], or any other Federal or State insolvency proceeding.'' [12] Some commenters suggested that section 1101 does not preclude the Board from identifying other situations where a person or entity has not yet entered into formal proceedings but nevertheless should be deemed to be insolvent and encouraged the Board to extend the definition of insolvency to apply to these circumstances.

As an initial matter, the final rule adopts the insolvency constraint as provided in the Dodd-Frank Act. Section 201.4(d)(5) provides that a Federal Reserve Bank may not extend credit through a program or facility established under section 13(3) of the FRA to any person or entity that is in bankruptcy, resolution under Title II of the Dodd-Frank Act, or any other Federal or State insolvency proceeding.

In response to these comments, the Board has amended the final rule to acknowledge that there may be situations that are not identified

[9] 12 U.S.C. 343(3)(A).

[10] *See* 12 U.S.C. 343(3)(B)(iii).

[11] While the final rule requires that at least five persons be eligible to participate in a program or facility, that requirement is in addition to the restriction on establishing a program or facility for the purpose of providing credit to prevent the failure or resolution of any number of specific failing or insolvent persons, and would not allow a program or facility designed for the purpose of preventing the resolution or failure of more than five persons.

[12] 124 Stat. 1376 at 2113–15.

explicitly in the statute where the Board may determine that an entity is insolvent. In particular, the final rule provides that a person or entity is insolvent if the person or entity is generally not paying its undisputed debts as they become due during the 90 days preceding the date of borrowing under the program or facility. The final rule also provides that the Board or Federal Reserve Bank may determine, based on recent audited financial statements or other relevant documentation, that an entity is otherwise insolvent.

Section 201.4(d)(5) of the final rule requires the Board or the lending Federal Reserve Bank, prior to extending credit, to obtain evidence that the person or entity is not insolvent. As provided by the Dodd-Frank Act, the final rule provides that the Board and a Federal Reserve Bank may rely on a written certification from the person, the chief executive officer of the entity or another authorized officer of the entity, at the time the person or entity initially borrows under a program or facility, that the person or entity is not in bankruptcy or in a resolution or other insolvency proceeding. The Board has broadened this part of the final rule to require that the certification also state that the potential borrower has not failed to generally pay its undisputed debts as they become due during the 90 days preceding the date of borrowing.

The statute specifically permits the Board to rely on a certification to establish solvency. Use of a certification is particularly important in the context of programs and facilities with broad-based eligibility because these programs and facilities have the potential to involve numerous borrowers seeking credit in unusual periods of severe illiquidity. A binding certification aids in quickly and effectively making liquidity available on safe and reasonable terms in these difficult economic circumstances.

The final rule contains a number of provisions designed to ensure the continued accuracy of the certification. First, the final rule provides that a person or entity that submits a written certification must immediately notify the lending Federal Reserve Bank if the information in the certification changes. Section 201.4(d)(5)(vi) of the final rule also provides that a participant that is or has become insolvent would be prohibited from receiving any new extension of credit under the program or facility.

Moreover, to improve the reliability of a certification, the final rule provides that, if a participant or a person has provided a certification under section 201.4(d)(5) or (8) that includes a knowing material misrepresentation, all emergency credit extended to the borrower immediately becomes due and payable, and the Federal Reserve will promptly refer the matter to appropriate law enforcement authorities for action under applicable criminal and civil law.

Some commenters expressed concern that third-party conduits would be used to evade any insolvency restrictions in the rule by passing borrowed funds on to an entity that is insolvent. Section 201.4(d)(5)(i) of the final rule provides that a Federal Reserve Bank may not extend credit through a program or facility to any person that is borrowing for the purpose of lending the proceeds of the loan to an insolvent entity.

Another commenter suggested that the final rule clarify whether conservatorships are eligible to participate in broad-based facilities. Section 13(3) as amended by the Dodd-Frank Act prohibits lending to an insolvent borrower or to aid a failing firm. As a general matter, conservators are appointed to conserve a failing company's assets.[13] Accordingly, a conservatorship and a company in conservatorship would not be eligible to borrow from a program or facility established under section 13(3) of the FRA.

6. Indorsement or Other Security

Prior to the Dodd-Frank Act, section 13(3) provided that any extension of credit under that section must be ''indorsed or otherwise secured to the satisfaction of the Federal Reserve bank.''[14] The Dodd-Frank Act retained this provision of the original statute and added two further requirements. First, the Dodd-Frank Act directs the Board to adopt policies and procedures ''designed to ensure . . . that the security for emergency loans is sufficient to protect taxpayers from losses.''[15] Second, the Dodd-Frank Act requires that the Board's policies and procedures ''require that a Federal Reserve bank assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan executed'' under section 13(3) of the FRA.[16]

Protecting taxpayers from losses as a result of emergency lending has always been an important concern for the Board, and the Board notes that the extensions of credit under the emergency lending programs it authorized during the recent financial crisis were all repaid in full with interest. The proposed rule incorporated the new statutory requirements from the Dodd-Frank Act into Regulation A.

Some commenters argued that the Board should limit the types of collateral the Federal Reserve Banks may accept in support of an emergency credit. Several commenters argued that the Federal Reserve should establish haircuts for collateral accepted by programs and facilities that extend emergency credit.

The final rule continues to emphasize the importance of ensuring that the security for emergency loans is sufficient to protect taxpayers from losses. As proposed and as adopted in the final rule, section 201.4(d)(6) provides that all credit extended under emergency lending programs and facilities must be indorsed or otherwise secured to the satisfaction of the lending Federal Reserve Bank.

The final rule also requires the Federal Reserve Bank, no later than at the time the credit is initially extended, to assign a lendable value to all collateral for the program or facility, consistent with sound risk management practices and to ensure protection for the taxpayer. The Federal Reserve Banks have long assigned a lendable value to collateral at the time credit is extended. Much of the collateral accepted as security for emergency lending has a readily available market value. In connection with assigning a lendable value to other collateral, Reserve Banks readily take into account independent appraisals of the collateral that may be available. In all cases, the Reserve Bank applies appropriate discounts or ''haircuts'' to the value of the collateral. The haircuts applied to collateral are described in the Federal Reserve Discount Window & Payment System Risk Collateral Margins Table and the Federal Reserve Collateral Guidelines, available on the Federal Reserve Discount Window & Payment System Risk Web site.[17] The Federal Reserve Banks also consider the financial strength of the borrower, the presence of any indorsement, and other factors, in determining whether the credit is satisfactorily secured.

The Board believes that these provisions allow the Federal Reserve to impose collateral and other requirements to protect the taxpayer from loss and address the statutory requirement for policies and procedures that are designed to ensure protection for the taxpayer.

[13] *See* 12 U.S.C. 1821(c)(5).

[14] *See* 12 U.S.C. 343, 47 Stat. 715.

[15] 12 U.S.C. 343(3)(B)(1).

[16] *Id.*

[17] *http://www.frbdiscountwindow.org/index.cfm.*

7. Penalty Rate

Section 13(3) of the FRA has always provided that emergency credit extended under that section shall be at rates established in accordance with the provisions of section 14(d) of the FRA. Commenters suggested that the Board amend the proposed rule to require that extensions of emergency credit be subject to a penalty rate of interest.

The practice of the Federal Reserve in extending emergency credit has been to set the relevant interest rate at a penalty rate designed to encourage borrowers to repay emergency credit as quickly as possible once the unusual and exigent circumstances that justify the program or facility have receded and financial conditions have normalized. This approach has also ensured that the taxpayer is compensated by a higher interest rate than would be charged during normal times for the increased risk taken in extending emergency credit. Indeed, while the Federal Reserve adopted different rates for the various broad-based facilities that it established during the recent financial crisis, in each case, the rate set for the facility exceeded the rate for comparable instruments during normal times. As a result of this practice, emergency broad-based credit facilities established by the Federal Reserve under section 13(3) terminated and wound down as economic conditions normalized.

In keeping with this practice, section 201.4(d)(7) of the final rule provides that a penalty rate will be imposed on emergency extensions of credit. Because the appropriate interest rate depends on a number of factors, such as the duration of the credit, the collateral requirements, and the other terms and conditions for the credit, it is not feasible to establish a single penalty rate for all emergency facilities or to set penalty rates in advance of designing the facility. Consequently, the final rule provides that the interest rate for credit extended under section 13(3) must be at a level that is a premium to the market rate in normal circumstances, affords liquidity in unusual and exigent circumstances, and encourages repayment and discourages use of the program as unusual and exigent circumstances normalize.

Section 201.4(d)(7)(iii) of the final rule sets forth a non-exhaustive list of factors that the Board will take into account when establishing the penalty rate. These factors include the condition of the affected markets and the financial system generally, the historical rate of interest for loans of comparable terms and maturity during normal times, the purpose of the program or facility, the risk of repayment, the collateral supporting the credit, the duration, terms and amount of the credit, and other factors relevant to ensuring the taxpayer is appropriately compensated for the risks associated with the emergency credit. The final rule also explains that the rate on emergency credit under section 13(3) may be set by auction or other method consistent with section 14(d) of the FRA. Such an auction could be structured with a minimum stop out rate to ensure that the resulting rate would satisfy the requirements of a penalty rate.

8. Evidence Regarding Unavailability of Adequate Credit Accommodation

Section 13(3) has always required that a Federal Reserve Bank, prior to extending credit to any participant in a program or facility under that section, obtain evidence that such participant is unable to secure adequate credit accommodations from other banking institutions. The proposed rule incorporated this requirement and provided that this evidence may include evidence based on economic conditions in the market or markets addressed by the program or facility or evidence obtained from other sources, including facility or market participants and certifications from borrowers. In response to comments, the Board has amended the final rule to add as relevant evidence a certification from the participant that it is unable to secure adequate credit accommodations from other banking institutions.

9. Termination of Program or Facility

The Dodd-Frank Act requires that the Board's policies and procedures with respect to section 13(3) extensions of credit be designed to ensure that any such program is terminated in a timely and orderly fashion.[18] In order to address this requirement, the proposed rule would have required the Board periodically to review the existence of unusual and exigent circumstances; the extent of usage of the program or facility; the extent to which the continuing authorization of the program or facility facilitates restoring or sustaining confidence in financial markets; economic and market conditions; the functioning of financial markets; the ongoing need for the liquidity support provided by such program or facility; and such other factors as the Board may deem to be appropriate.

Some commenters suggested that a specific time period for review be adopted. The Board has amended the draft proposal to adopt this suggestion. Section 201.4(d)(9)(i) of the final rule provides that a program or facility will terminate no later than one year after the date of the first extension of credit under the program or facility. The rule allows the Board to renew the program or facility if it finds, by a vote of five members,[19] that unusual and exigent circumstances continue to exist, and the Secretary of the Treasury has approved the renewal. Each renewal may extend the program or facility for not more than one year. The final rule requires the Board promptly to report publicly and to the relevant congressional committees any renewal of a program or facility under section 13(3).

The final rule has been amended to provide that the Board will, not less frequently than every six months, review whether each emergency lending program or facility should be terminated. The final rule provides that the Board may terminate an emergency lending program or facility at any time, and will terminate an emergency program or facility upon finding that conditions no longer warrant continuation of the program or facility.

The final rule retains the provisions of the proposed rule providing factors for the Board to consider in conducting this review, with some additional modifications. Specifically, the final rule provides that the Board will consider such factors as the continued existence of unusual and exigent circumstances; the extent of usage of the program or facility; the extent to which the continuing authorization of the program or facility facilitates restoring or sustaining confidence in the identified financial markets; the ongoing need for the liquidity support provided by such program or facility; and other appropriate factors.

One commenter suggested that the final rule include procedures for the orderly unwinding of a program or facility, including how the Board will cover any associated losses. The Board expects, as it has with past facilities, to evaluate the appropriate methods for an orderly unwinding of any emergency credit facility at the time the facility is unwound.

10. Reporting Requirements

The Dodd-Frank Act contains detailed reporting requirements with respect to section 13(3) extensions of credit.[20] The proposed rule set forth the statutory requirements as enacted, and no comments were received on those

[18] Dodd-Frank Act Section 1101(a)(6).

[19] See 12 U.S.C. 248(r).

[20] Dodd-Frank Act Sections 1101(a)(6) and 1103(b).

provisions of the proposed rule. Therefore, the Board is adopting these provisions as proposed. The final rule provides that the Board will comply with 12 U.S.C. 248(s) and 12 U.S.C. 343(3)(C) pursuant to their terms.

11. No Obligation To Extend Credit

Section 201.4(d)(11) of the proposed rule provided that Federal Reserve Banks have no obligation to extend credit to any particular person or entity through an emergency lending program or facility. This provision mirrors the provision applicable to lending to depository institutions set forth in section 201.3(b) of Regulation A. No comments were received on this provision, and the Board is adopting it as proposed.

12. Participation in Programs and Facilities and Vendor Selection

The final rule reflects existing legal requirements that participation in any program or facility under section 13(3) of the Federal Reserve Act will not be limited or conditioned on the basis of any legally prohibited basis, such as the race, religion, color, gender, national origin, age or disability of the borrower. Moreover, in accordance with existing law, the selection of third-party vendors used in the design, marketing or implementation of any program or facility under this subsection will be without regard to the race, religion, color, gender, national origin, age or disability of the vendor or any principal shareholder of the vendor, and, to the extent possible and consistent with law, will involve a process designed to support equal opportunity and diversity.

13. Short-Term Emergency Credit Secured Solely by United States or Agency Obligations

Section 201.4(d)(13) of the proposed rule retained, but relocated, a provision in current Regulation A that authorizes a Federal Reserve Bank to extend credit under section 13(13) of the FRA if the collateral used to secure the credit consists solely of obligations of, or obligations fully guaranteed as to principal and interest by, the United States or an agency of the United States. Section 201.4(d)(13) of the final rule retains the provision that extensions of credit under this section be at a rate above the highest rate in effect for advances to depository institutions. As set forth in section 13(13) of the FRA, section 201.4(d)(13) of the final rule also provides that credit extended under this provision may not be extended for a term exceeding 90 days.

One commenter suggested that section 201.4(d)(13) should be revised to limit the number of times a loan issued pursuant to its provisions may be rolled over. However, the commenter did not provide a suggested limit on roll overs and acknowledged that there would need to be exceptions made to any limit imposed. Instead of imposing such a limit, the Board will rely on its ability to assess whether unusual and exigent circumstances continue to exist at the time that the loan is renewed in order to appropriately limit roll overs of such loans. Therefore, the Board is retaining section 201.4(d)(13) as written.

B. Section 201.3(b)—No Obligation To Make Advances or Discounts

Section 201.3(b) of the final rule reflects a technical change to conform the language of that section with the language of section 201.4(d)(11) of the final rule.

III. Administrative Law Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule for which a general notice of proposed rulemaking is required or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.

The Board solicited public comment on the rule in a notice of proposed rulemaking. The Board did not receive any comments regarding burden to small banking organizations.

In accordance with section 1101 and 1103 of the Dodd-Frank Act, the Board is amending Regulation A (12 CFR part 201 *et seq.*) to establish policies and procedures for emergency lending under section 13(3) of the FRA. The reasons and justification for the final rule are described in the **SUPPLEMENTARY INFORMATION**. The Board does not believe that the final rule duplicates, overlaps, or conflicts with any other Federal rules. Under regulations issued by the Small Business Administration (''SBA''), a ''small entity'' includes those firms within the ''Finance and Insurance'' sector with asset sizes that vary from $75.5 million or less in assets to $550 million or less in assets. The Board believes that the Finance and Insurance sector constitutes a reasonable universe of firms for these purposes because such firms generally engage in activities that are financial in nature and the vast majority of emergency loans under section 13(3) during the recent financial crisis were extended to such firms.

As discussed in the **SUPPLEMENTARY INFORMATION**, the final rule would apply to any participant in an emergency lending program or facility with broad-based eligibility. To the extent that small entities are participants in these programs or facilities, they would be receiving extensions of emergency credit from Federal Reserve Banks. It is not possible to ascertain at this time the number of small entities that might participate in these programs and facilities were they to be authorized, or what requirements would be imposed on them if they do so. At a minimum, it is likely that participants would be required to pay interest on credit extended to them and to keep records of the use of proceeds of such extensions of credit. However, the positive economic impact of receiving such a credit is likely to substantially outweigh any economic burden of participating in the program or facility.

In light of the foregoing, the Board does not believe that the final rule would have a significant negative economic impact on a substantial number of small entities.

B. Paperwork Reduction Act Analysis

Certain provisions of the final rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number for the Board is 7100–NEW. The Board reviewed the final rule under the authority delegated to the Board by OMB. The final rule contains requirements subject to the PRA. The reporting requirements are found in section 201.4(d)(5)(iv)(A). The Board indicated in the proposed rule that the reporting requirements associated with the Regulation A would be minimal and no PRA burden was taken. The Board received no comments on this aspect of the proposal. However, based on the comments received for clarifying the proposed rule to prohibit solvent firms from passing the proceeds of emergency loans on to insolvent firms and adopting a broader definition of insolvency, the Board will take reporting burden for this section.

The Board has a continuing interest in the public's opinions of collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551. A copy of the comments may also be submitted to the OMB desk officer (1) by mail to U.S. Office of Management and Budget, 725 17th Street NW., 10235, Washington, DC 20503; (2) by facsimile to 202–395–6974; or (3) by email to: *oira_submission@omb.eop.gov,* Attention, Federal Reserve Board Agency Desk Officer.

Proposed Information Collection

Title of Information Collection: Reporting Requirements Associated with Regulation A (Extensions of Credit by Federal Reserve Banks).

Frequency of Response: Event-generated.

Affected Public: Businesses, individuals or other persons.

Respondents: Any participant in a program or facility with broad-based eligibility.

Abstract: Sections 1101 and 1103 of the Dodd-Frank Act amend the emergency lending authorities provided in section 13(3) of the Federal Reserve Act. The amendments require the Board, in consultation with the Secretary of the Treasury, to establish by regulation policies and procedures with respect to such emergency lending. The purpose of the amendments to Regulation A in this final rule is to implement the Dodd-Frank Act revisions to the Board's emergency lending authority in section 13(3) of the Federal Reserve Act that limit the use of this authority to the provision of liquidity through broadly-based facilities for solvent firms in a time of crisis.

Reporting Requirements

Section 201.4(d)(5)(iv)(A) provides that a Federal Reserve Bank may rely on a written certification from the person or from the chief executive officer or other authorized officer of the entity, at the time the person or entity initially borrows under the program or facility, that the person or entity is not in bankruptcy, resolution under Title II of Public Law 111–203 (12 U.S.C. 5381 *et seq.*) or any other Federal or State insolvency proceeding, and has not failed to generally pay its undisputed debts as they become due during the 90 days preceding the date of borrowing under the program or facility, and is not borrowing for the purpose of lending the proceeds of the loan to a person or entity that is insolvent.

Estimated Burden per Response: 5 hours.

Number of Respondents: 10 (The Federal Reserve is not currently aware of any respondents, but for purposes of the PRA we will assume 10. If or when we receive any certifications we intend to update this data upon the next renewal of the information collection).

Total Estimated Annual Burden: 50 hours.

C. Invitation for Comments on Use of Plain Language

Section 722 of the Gramm-Leach Bliley Act of 1999 requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000.[21] The Board received no comments on these matters and believes that the final rule is written plainly and clearly.

List of Subjects in 12 CFR Part 201

Banks, Banking, Federal Reserve System, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth in the preamble, the Board amends 12 CFR part 201 (Regulation A) as follows:

PART 201—EXTENSIONS OF CREDIT BY FEDERAL RESERVE BANKS (REGULATION A)

■ 1. The authority citation for part 201 is revised to read as follows:

Authority: 12 U.S.C. 248(i)–(j) and (s), 343 *et seq.,* 347a, 347b, 347c, 348 *et seq.,* 357, 374, 374a, and 461.

■ 2. Section 201.3 paragraph (b) is revised to read as follows:

§ 201.3 Extensions of credit generally.

* * * * *

(b) *No obligation to make advances or discounts.* This section does not entitle any person or entity to obtain any credit or any increase, renewal or extension of maturity of any credit from a Federal Reserve Bank.

* * * * *

§ 201.109 [Amended]

■ 3. In § 201.109, redesignate footnotes 4 through 6 as footnotes 6 through 8.

§ 201.108 [Amended]

■ 4. In § 201.108, redesignate footnotes 2 and 3 as footnotes 4 and 5.

§ 201.51 [Amended]

■ 5. In § 201.51, redesignate footnote 1 as footnote 3.

■ 6. Section 201.4 paragraph (d) is revised to read as follows:

§ 201.4 Availability and terms of credit.

* * * * *

[21] 12 U.S.C. 4809.

(d) *Emergency credit for others*—(1) *Authorization to extend credit.* In unusual and exigent circumstances, the Board, by the affirmative vote of not less than five members,[1] may authorize any Federal Reserve Bank, subject to such conditions and during such periods as the Board may determine, to extend credit to any participant in a program or facility with broad-based eligibility established and operated in accordance with this paragraph (d).

(2) *Approval of the Secretary of the Treasury.* A program or facility may not be established under this paragraph (d) without obtaining the prior approval of the Secretary of the Treasury.

(3) *Disclosure of justification and terms.* As soon as is reasonably practicable, and no later than 7 days after a program or facility is authorized under this paragraph (d), the Board and the authorized Federal Reserve Bank or Federal Reserve Banks, as appropriate, will make publicly available a description of the program or facility, a description of the market or sector of the financial system to which the program or facility is intended to provide liquidity, a description of the unusual and exigent circumstances that exist, the intended effect of the program or facility, and the terms and conditions for participation in the program or facility. In addition, within the same 7-day period, the Board will provide a copy of this information to the Committee on Banking, Housing and Urban Affairs of the U.S. Senate and the Committee on Financial Services of the U.S. House of Representatives.

(4) *Broad-based eligibility.* (i) A program or facility established under this paragraph (d) must have broad-based eligibility in accordance with terms established by the Board.

(ii) For purposes of this paragraph (d), a program or facility has broad-based eligibility only if the program or facility is designed to provide liquidity to an identifiable market or sector of the financial system;

(iii) A program or facility will not be considered to have broad-based eligibility for purposes of this paragraph (d) if:

(A) The program or facility is designed for the purpose of assisting one or more specific companies avoid bankruptcy, resolution under Title II of Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111–203, 12 U.S.C. 5381 *et seq.*), or any other Federal or State insolvency proceeding, including by removing assets from the

[1] Unless fewer are authorized pursuant to section 11(r) of the Federal Reserve Act. 12 U.S.C. 248(r).

balance sheet of one or more such company;

(B) The program or facility is designed for the purpose of aiding one or more failing financial companies; or

(C) Fewer than five persons or entities would be eligible to participate in the program or facility.

(iv) A Federal Reserve Bank may extend credit through a program or facility with broad-based eligibility established under this paragraph (d) through such mechanism or vehicle as the Board determines would facilitate the extension of such credit.

(5) *Insolvency.* (i) A Federal Reserve Bank may not extend credit through a program or facility established under this paragraph (d) to any person or entity that is insolvent or to any person or entity that is borrowing for the purpose of lending the proceeds of the loan to a person or entity that is insolvent.

(ii) Before extending credit through a program or facility established under this paragraph (d) to any person or entity, the Federal Reserve Bank must obtain evidence that the person or entity is not insolvent.

(iii) A person or entity is ''insolvent'' for purposes of this paragraph (d) if:

(A) The person or entity is in bankruptcy, resolution under Title II of Public Law 111–203 (12 U.S.C. 5381 *et seq.*) or any other Federal or State insolvency proceeding;

(B) The person or entity is generally not paying its undisputed debts as they become due during the 90 days preceding the date of borrowing under the program or facility; or

(C) The Board or Federal Reserve Bank otherwise determines that the person or entity is insolvent.

(iv) For purposes of meeting the requirements of this paragraph (d)(5), the Board or Federal Reserve Bank, as relevant, may rely on:

(A) A written certification from the person or from the chief executive officer or other authorized officer of the entity, at the time the person or entity initially borrows under the program or facility, that the person or entity is not in bankruptcy, resolution under Title II of Public Law 111–203 (12 U.S.C. 5381 *et seq.*) or any other Federal or State insolvency proceeding, and has not failed to generally pay its undisputed debts as they become due during the 90 days preceding the date of borrowing under the program or facility;

(B) Recent audited financial statements of the person or entity; or

(C) Other information that the Board or the Federal Reserve Bank may determine to be relevant.

(v) A person or officer (or successor of either) that submits a written certification under this subparagraph must immediately notify the lending Federal Reserve Bank if the information in the certification changes.

(vi) Upon a finding by the Board or a Federal Reserve Bank that a participant, including a participant that has provided a certification under this paragraph (d)(5), is or has become insolvent, that participant is not eligible for any new extension of credit from a program or facility established under this paragraph (d) until such time as the Board or a Federal Reserve Bank determines that such participant is no longer insolvent.

(vii) If a participant or person has provided a certification under this paragraph (d)(5) or paragraph (d)(8)(ii) of this section that includes a knowing material misrepresentation in the certification, all extensions of credit made pursuant to this paragraph (d) that are outstanding to the relevant participant shall become immediately due and payable, and all accrued interest, fees and penalties shall become immediately due and payable. The Board or the lending Federal Reserve Bank will also refer the matter to the relevant law enforcement authorities for investigation and action in accordance with applicable criminal and civil law.

(6) *Indorsement or other security.* (i) All credit extended under a program or facility established under this paragraph (d) must be indorsed or otherwise secured, in each case, to the satisfaction of the lending Federal Reserve Bank.

(ii) In determining whether an extension of credit under any program or facility established under this paragraph (d) is secured to its satisfaction, a Federal Reserve Bank must, prior to or at the time the credit is initially extended, assign a lendable value to all collateral for the program or facility, consistent with sound risk management practices and to ensure protection for the taxpayer.

(7) *Penalty rate and fees.* (i) The Board will determine the interest rate to be charged on any credit extended through a program or facility established under this section in accordance with this paragraph (d) and the provisions of section 14, subdivision (d) of the Federal Reserve Act (12 U.S.C. 357). The Board may determine the interest rate by auction or such other method as the Board determines in accordance with section 14, subdivision (d) of the Federal Reserve Act (12 U.S.C. 357).

(ii) The interest rate established for credit extended through a program or facility established under this section will be set at a penalty level that:

(A) Is a premium to the market rate in normal circumstances;

(B) Affords liquidity in unusual and exigent circumstances; and

(C) Encourages repayment of the credit and discourages use of the program or facility as the unusual and exigent circumstances that motivated the program or facility recede and economic conditions normalize.

(iii) In determining the rate, the Board will consider the condition of affected markets and the financial system generally, the historical rate of interest for loans of comparable terms and maturity during normal times, the purpose of the program or facility, the risk of repayment, the collateral supporting the credit, the duration, terms and amount of the credit, and any other factor that the Board determines to be relevant to ensuring that the taxpayer is appropriately compensated for the risks associated with the credit extended under the program or facility and the purposes of this paragraph (d) are fulfilled.

(iv) In addition to the rate established and charged under this paragraph (d)(7), the Board may require the payment of any fees, penalties, charges or other consideration the Board determines to be appropriate to protect and appropriately compensate the taxpayer for the risks associated with the credit extended under the program or facility.

(8) *Evidence regarding unavailability of adequate credit accommodation.* (i) Each lending Federal Reserve Bank must obtain evidence that, under the prevailing circumstances, participants in a program or facility established under this paragraph (d) are unable to secure adequate credit accommodations from other banking institutions.

(ii) Evidence required under this paragraph (d)(8) may be based on economic conditions in the market or markets intended to be addressed by the program or facility, a written certification from the person or from the chief executive officer or other authorized officer of the entity at the time the person or entity initially borrows under the program or facility, or other evidence from participants or other sources.

(9) *Termination of program or facility.* (i) A program or facility established under this paragraph (d) shall cease extending new credit no later than one year after the date of the first extension of credit under the program or facility or the date of any extension of the program or facility by the Board under paragraph (d)(9)(ii) of this section.

(ii) A program or facility may be renewed upon the vote of not less than five members of the Board [2] that unusual and exigent circumstances continue to exist and the program or facility continues to appropriately provide liquidity to the financial system, and the approval of the Secretary of the Treasury.

(iii) The Board shall make the disclosures required under paragraph (d)(3) of this section to the public and the relevant congressional committees no later than 7 days after renewing a program or facility under this paragraph (d)(9).

(iv) The Board may at any time terminate a program or facility established under this paragraph (d). To ensure that the program or facility under this paragraph (d) is terminated in a timely and orderly fashion, the Board will periodically review, no less frequently than once every 6 months, the existence of unusual and exigent circumstances, the extent of usage of the program or facility, the extent to which the continuing authorization of the program or facility facilitates restoring or sustaining confidence in the identified financial markets, the ongoing need for the liquidity support provided by such program or facility, and such other factors as the Board may deem to be appropriate. The Board will terminate lending under a program or facility promptly upon finding that conditions no longer warrant the continuation of the program or facility or that continuation of the program or facility is no longer appropriate.

(v) A program or facility that has been terminated will cease extending new credit and will collect existing loans pursuant to the applicable terms and conditions.

(10) *Reporting requirements.* The Board will comply with the reporting requirements of 12 U.S.C. 248(s) and 12 U.S.C. 343(3)(C) pursuant to their terms.

(11) *No obligation to extend credit.* This paragraph (d) does not entitle any person or entity to obtain any credit or any increase, renewal or extension of maturity of any credit from a Federal Reserve Bank.

(12) *Participation in programs and facilities and vendor selection.* (i) Participation in any program or facility under this paragraph (d) shall not be limited or conditioned on the basis of any legally prohibited basis, such as the race, religion, color, gender, national origin, age or disability of the borrower.

(ii) The selection of any third-party vendor used in the design, marketing or implementation of any program or facility under this paragraph (d) shall be without regard to the race, religion, color, gender, national origin, age or disability of the vendor or any principal shareholder of the vendor, and, to the extent possible and consistent with law, shall involve a process designed to support equal opportunity and diversity.

(13) *Short-term emergency credit secured solely by United States or agency obligations.* In unusual and exigent circumstances and after consultation with the Board, a Federal Reserve Bank may extend credit under section 13(13) of the Federal Reserve Act if the collateral used to secure such credit consists solely of obligations of, or obligations fully guaranteed as to principal and interest by, the United States or an agency thereof. Prior to extending credit under this paragraph (d)(13), the Federal Reserve Bank must obtain evidence that credit is not available from other sources and failure to obtain such credit would adversely affect the economy. Credit extended under this paragraph (d)(13) may not be extended for a term exceeding 90 days, must be extended at a rate above the highest rate in effect for advances to depository institutions as determined in accordance with section 14(d) of the Federal Reserve Act, and is subject to such limitations and conditions as provided by the Board.

* * * * *

By order of the Board of Governors of the Federal Reserve System, November 30, 2015.

Robert deV. Frierson,

Secretary of the Board.

[FR Doc. 2015–30584 Filed 12–17–15; 8:45 am]

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[2] Unless fewer are authorized pursuant to section 11(r) of the Federal Reserve Act. 12 U.S.C. 248(r).

SMALL BUSINESS ADMINISTRATION

13 CFR Part 105

Standards of Conduct and Employee Restrictions and Responsibilities

CFR Correction

In Title 13 of the Code of Federal Regulations, revised as of January 1, 2015, on page 34, in § 105.401, in paragraph (b)(3), remove ''Director of Human Resources'' and add in its place ''Chief Human Capital Officer''.

[FR Doc. 2015–31738 Filed 12–17–15; 8:45 am]

BILLING CODE 1505–01–D

SMALL BUSINESS ADMINISTRATION

13 CFR Part 120

Business Loans

CFR Correction

In Title 13 of the Code of Federal Regulations, revised as of January 1, 2015, on page 307, in § 120.802, in the definition of *Priority CDC,* remove the first instance of ''504'' and add ''504'' before the word ''program''.

[FR Doc. 2015–31739 Filed 12–17–15; 8:45 am]

BILLING CODE 1505–01–D

SMALL BUSINESS ADMINISTRATION

13 CFR Part 136

Enforcement of Nondiscrimination on the Basis of Handicap in Programs or Activities Conducted by the Small Business Administration

CFR Correction

■ In Title 13 of the Code of Federal Regulations, revised as of January 1, 2015, on pages 658 and 659, in § 136.170, remove ''Director, OEEOC'' each time it appears in paragraphs (h)(1) and (j)(1) and (2) and add, in its place, ''AA/EEOCCR''.

[FR Doc. 2015–31740 Filed 12–17–15; 8:45 am]

BILLING CODE 1505–01–D

SMALL BUSINESS ADMINISTRATION

13 CFR Part 140

Debt Collection

CFR Correction

In Title 13 of the Code of Federal Regulations, revised as of January 1, 2015, on page 665, in § 140.11, in paragraph (i)(3)(ii), remove the term ''the SBA'' and add ''the Agency'' in its place.

[FR Doc. 2015–31745 Filed 12–17–15; 8:45 am]

BILLING CODE 1505–01–D

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Docket No. FAA–2015–1139; Airspace Docket No. 15–AWP–4]

Establishment of Class E Airspace; Los Angeles, CA

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

Simplified Unconsolidated FutureBank and FutureBroker Balance Sheets

FutureBank Balance Sheet
($ millions)

Assets		Liabilities	
Cash and balances due from depository institutions	12,450	Deposits	747,000
Federal Funds sold and securities purchased under agreements to resell	58,472	Federal Funds purchased and securities sold under agreements to repurchase	14,256
Securities	290,450	Trading liabilities	38,788
Loans and lease financing receivables	471,930	Other borrowed money	110,372
Trading assets	105,245	Subordinated notes and debentures	8,561
Premises and fixed assets	4,890	Other liabilities	43,245
Other real estate owned	854	**Total liabilities**	**962,222**
Intangible assets	5,220	Total equity capital	60,271
Other assets	72,982		
Total assets	**1,022,493**	**Total liabilities and equity capital**	**1,022,493**

FutureBroker Balance Sheet
($ millions)

Assets		Liabilities	
Cash	2,187	Short-term borrowing	3
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	15,100	Financial Instruments sold, not yet purchased, at fair value	19,357
		Obligation to return securities received as collateral, at fair value	17,984
Financial instruments owned at fair value	75,443	Securities sold under agreements to repurchase	80,098
Securities received as collateral, at fair value	19,825	Securities loaned	17,358
Securities purchased under agreements to resell	61,317	Other secured financing	13,456
Securities borrowed	88,228	Payables	134,578
Receivables	15,422	Other liabilities and accrued expenses	9,875
Other assets	24,633	Long-term borrowings	6,245
		Total liabilities	298,954
		Total members' equity	3,201
Total assets	**302,155**	**Total liabilities and members' equity**	**302,155**