November 15, 2000

TO: Board of Governors

FROM: Legal Division
(Messrs. Alvarez and Fallon
and Ms. Threatt)

SUBJECT: Impact of Citigroup Inc.'s acquisition of Associates First Capital Corporation on Citigroup Inc.'s conduct of expanded financial activities.

ISSUE PRESENTED: Whether the Gramm-Leach-Bliley Act ("GLB Act") requires the Board to prohibit Citigroup Inc. ("Citigroup") from engaging in additional financial activities after Citigroup, in connection with its proposed acquisition of Associates First Capital Corporation ("Associates"), acquires an insured depository institution that received a less-than-satisfactory rating under the Community Reinvestment Act ("CRA") at its most recent examination. For the reasons discussed below, the Legal Division believes that the GLB Act and the Board's rules do not require the Board to prohibit Citigroup from commencing additional financial activities after the proposed acquisition.

BACKGROUND: Citigroup, a financial holding company within the meaning of the GLB Act, proposes to acquire Associates, a company that is engaged primarily in consumer and other lending activities both domestically and overseas. As a financial holding company, Citigroup may acquire the domestic and international nonbank operations of Associates without the Board's prior approval. [1]

[1] Associates also controls two foreign subsidiaries that are engaged in deposit-taking activities abroad, and Citigroup has provided the Board with prior notice under Regulation K to acquire these subsidiaries. The Regulation K aspects of the proposal, which represent a very small part of the overall transaction, are discussed in more detail in a memorandum dated November 15, 2000, from the Legal Division and the Division of Banking Supervision and Regulation.

Although Associates does not control a bank within the meaning of the Bank Holding Company Act, it does control three insured depository institutions that are subject to the CRA.[2] One of those institutions, Associates National Bank, is a credit card bank that received a "needs to improve" CRA rating at its most recent CRA performance evaluation as of March 1997. Several commenters have asserted that the Board must prohibit Citigroup from engaging in additional financial activities after Citigroup acquires Associates National Bank because the bank received a less-than-satisfactory CRA rating at its most recent examination.

DISCUSSION AND ANALYSIS:

The GLB Act provides that the Board "shall prohibit a financial holding company" from commencing any additional financial activity (whether de novo or by acquisition) "if any insured depository institution subsidiary of such financial holding company . . . has received" a less-than-satisfactory CRA rating at its most recent CRA examination.[3] This language was added to the statute to prevent a financial holding company engaged in financial activities newly authorized by the GLB Act from engaging in additional financial activities unless each insured depository institution controlled by that financial holding company maintained at least a satisfactory CRA rating.

The issue raised in this case is whether Citigroup, which is a financial holding company all of whose existing subsidiary insured depository

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[2] Citigroup has filed prior notices under the Change in Bank Control Act with the OCC and FDIC to acquire Associate's subsidiary insured depository institutions.

[3] 12 U.S.C. § 1843(*l*)(2). In this context, the term "financial activities" refers to those activities newly authorized by the GLB Act that may only be conducted by a bank holding company that has made an effective election to become a financial holding company, such as insurance underwriting and merchant banking.

institutions have satisfactory or better CRA ratings, would be prohibited from acquiring or establishing any additional company engaged in financial activities under the GLB Act immediately upon acquiring Associates, which controls an insured depository institution subsidiary that received a less-than-satisfactory CRA rating at its most recent examination. The GLB Act does not appear to require this result.

The language of the GLB Act strongly suggests that a financial holding company should be penalized for poor CRA performance only if an insured depository institution receives a less-than-satisfactory CRA rating while it is a subsidiary of the financial holding company. In accordance with this statutory interpretation, the Board's interim rule on financial holding company elections provides that the activity prohibitions become effective only when an insured depository institution controlled by a financial holding company receives notice of a poor CRA rating from the appropriate Federal banking agency or when the Board notifies the financial holding company that an institution it controls has received a poor CRA rating.[4]

Because Associates National Bank received its less-than-satisfactory CRA rating before becoming a subsidiary of Citigroup, the language of the GLB Act and the Board's interim rule does not prohibit Citigroup from engaging in additional financial activities on the date Citigroup acquires Associates. Citigroup did not control Associates National Bank when the bank received its poor CRA rating and thus Citigroup will not have "received notice" that the prohibitions apply within the meaning of the rule. However, under both the GLB Act and the rule, the Board would be required to impose the activity prohibitions on Citigroup if Associates National Bank or any other

[4] This provision is set forth at section 225.84(a) of Regulation Y, which became effective on an interim basis on March 11, 2000. See 65 Federal Register 3,785 (January 25, 2000).

insured depository institution subsidiary of Citigroup receives a less-than-satisfactory CRA rating at an examination occurring after consummation of this proposal.

This interpretation of the GLB Act and the interim rule would serve the public policy of allowing a financial holding company to acquire an insured depository institution with a poor CRA rating without losing the ability to take full advantage of its financial holding company status. At the same time, the acquiring financial holding company would be obliged to address the CRA problems at the newly acquired insured depository institution prior to the next CRA examination of that institution.[5] If the newly acquired institution fails to achieve a satisfactory CRA rating at that examination, the financial holding company then would become subject to the activity prohibitions upon receiving notice of that examination result. Accordingly, a financial holding company that acquires a poorly rated institution must improve the institution's CRA rating within the next examination cycle.

In addition to promoting the public policy of allowing a well-run organization to acquire a poorly rated insured depository institution and improve its rating, interpreting the activity prohibition provision of the GLB Act in the manner suggested above also is consistent with a related provision of the GLB Act. In particular, the GLB Act provides that, when evaluating whether a bank holding company's election to become a financial holding company is effective, the Board may exclude the CRA rating of any insured depository institution acquired by the bank holding company in the 12 months

[5] An alternative reading of the relevant statutory language, which would require the Board to restrict the activities of a financial holding company that acquires an institution with a less-than-satisfactory CRA rating, would discourage a financial holding company with well-rated CRA programs from acquiring and improving institutions with less-than-satisfactory programs.

before the company submitted its financial holding company declaration.[6] This allows a bank holding company that has recently acquired a bank with a poor CRA rating an opportunity to address the problems at the bank without losing the opportunity to become a financial holding company and engage in the activities newly authorized for financial holding companies. In this case, Citigroup could use this explicit exclusion to avoid the activity prohibitions by decertifying itself as a financial holding company immediately prior to acquiring Associates and then submitting a new financial holding company declaration after the acquisition. If Citigroup pursued this course of action, the GLB Act would exclude the poor CRA rating of Associates National Bank for purposes of Citigroup's new financial holding company declaration and would not impose the activity prohibitions for a period of 12 months after Citigroup acquired the bank.

As noted above, the Board's interim rule on financial holding company elections provides that the Board itself may notify a financial holding company that it is subject to the activity prohibitions.[7] However, staff believes that the Board should not at this time affirmatively notify Citigroup that the prohibitions apply when Citigroup acquires Associates. Neither the GLB Act nor the Board's rules requires that the Board act within a specified time to apply the prohibitions, and, as explained above, the appropriate Federal banking agency has not given notice to Citigroup regarding the CRA rating of

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[6] See 12 U.S.C. § 2903(c)(2). To take advantage of this exclusion, the bank holding company must submit an affirmative plan that is acceptable to the newly acquired institution's appropriate Federal banking agency to improve the institution's CRA rating at its next examination.

[7] Staff is reviewing whether the provision allowing the Board to provide notice should remain in the regulation and will present this issue to the Board in more detail in connection with the proposed final rule governing financial holding company elections and activities.

Associates National Bank because the bank was not a subsidiary of Citigroup at the time the institution received a poor rating. Importantly, Citigroup has proposed a comprehensive plan to address the CRA performance of Associates National Bank that was developed in consultation with the OCC, which is the appropriate Federal banking agency for Associates National Bank. Also, as discussed in detail above, a grace period in this case would be consistent with the related provision of the GLB Act that allows a 12-month period before holding a company accountable for the CRA rating of a recently acquired institution.

RECOMMENDATION: Based on the foregoing, Legal Division staff recommends that the Board not at this time prohibit Citigroup from engaging in additional financial activities under the GLB Act after its proposed acquisition of Associates.