FEDERAL RESERVE SYSTEM

FINANCIAL HOLDING COMPANY PROJECT

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I. EXECUTIVE SUMMARY

This paper summarizes the findings of the staff's Financial Holding Company project, which was established to explore ways that the FRS might improve the supervision and regulation of financial holding companies (FHCs) in light of recent regulatory and industry developments.

Over 2007, the FHC workgroup held a series of interviews with four firms with industry expertise plus the FRS central points of contact (CPCs) for five current or former FHCs. We also solicited input from FRS staff in various areas on their general experiences with FHC regulation and supervision, and on other discussions that they have had with current or potential FHCs. (Section IV, "About the Workgroup," lists the FRS staff consulted on this project.)

The overall feedback we received was that the burdens of becoming an FHC, in most cases, outweigh the perceived benefits, particularly given the other regulatory options available to firms. This is especially true for institutions that are not bank-dominated. Key concerns about the FHC structure raised in these meetings:

- For non-bank led firms, the biggest problem with the FHC structure is the "comprehensiveness" of our supervisory approach, particularly when compared to alternatives such as Office of Thrift Supervision (OTS) or Securities & Exchange Commission (SEC) holding company supervision. Concerns about the FRS supervisory approach relate to both its extent (reach into the broader holding company and unregulated subsidiaries) as well as nature (intrusiveness).

- While existing bank-led FHCs appear to be generally content with the extent of their powers and applicable regulations, a few exceptions relate to merchant banking, real estate, and commodities. More importantly, the FRS regulatory process in general was criticized as opaque and slow-moving.

- Both existing and potential FHCs believe that our current application of the consolidated Tier 1 leverage ratio is a significant, unattractive feature of operating under the FHC framework. Firms feel that the leverage ratio calculation overstates regulatory capital for activities they consider low-risk (especially securities financing transactions), making them less competitive to their peers.

The workgroup performed preliminary analysis on fourteen specific areas of concern that were identified from the interviews and which are described in the main text of this paper. Workgroup staff have developed a set of suggested modifications to the current FHC supervisory and regulatory program to address these issues. Some of these potential changes are currently being considered in connection with other ongoing Federal Reserve projects (e.g., consolidated supervision project, comprehensive Regulation Y revisions).

In addition, some issues raised by interviewees would require Congressional action. This paper notes these issues and describes the types of legislative changes that would be needed to address them. No recommendations are made with respect to these items.

While the suggested changes would address concerns raised by those interviewed, it should be noted that these individuals also indicated that these changes likely would not be sufficient, by themselves, to cause a significant number of non-bank firms to become a FHC in light of the other avenues available for such firms to provide (either directly or through third-party arrangements) most if not all desired banking products or services.

Key proposals include:

- As part of the System-wide Consolidated Supervision project being rolled out, the FRS should create a separate category for firms in which the bank depository institution is a small component of the overall entity. For this "non-bank led FHC" category, FRS supervision could rely more heavily on off-site monitoring and allow for supervisory judgment for individual firms on elements such as the nature of exam activities and the application of capital adequacy ratios.

- Improve our communication with firms and the marketplace in general by conducting an outreach program to explain the FRS approach to FHC supervision, targeting current and potential FHCs, consulting and legal firms, and rating agencies.

- Expedite processing procedures for new activity determinations in all three activities categories—"financial in nature," "incidental to financial activities," and "complementary to financial activities"—and support more activity requests.

- Apply more flexible Section 4(m) agreement requirements, especially for FHCs that become non-compliant due to special or extenuating circumstances, e.g., by acquiring troubled institutions.

- Modify the rules governing merchant banking investments to reflect developments in the financial markets, such as the growth of hedge funds and fund-of-fund structures.

- Expand the set of permissible commodity-related activities for FHCs.

- Modify, and provide additional public guidance on, the Board's views on control-related issues under the BHC Act.

- Revise the definition of the consolidated Tier 1 leverage ratio to exclude securities financing transactions from the denominator. Also, develop a plan to make public and explicit that there is no 5% leverage ratio floor for BHCs, formally or informally.

Each of these issues, as well as others raised in the interviews, is addressed in Section III, "Concerns & Potential Improvements." These proposals are not fully articulated plans for implementation, but rather high-level suggestions where changes might be made with

additional work. A summary of our suggestions—along with specific statutes, regulations, guidance, and practices that would need to be changed—can be found in Attachment (a).

I. INTRODUCTION & KEY THEMES FROM INTERVIEWS

The Financial Holding Company project was established to explore ways that the FRS might improve the supervision and regulation of FHCs. This initiative is set within the context of several regulatory and industry developments, including:

- The recent de-banking of three non-bank led FHCs: Manulife, Countrywide, and Schwab. Countrywide and Schwab have converted to thrift holding company status. Manulife de-banked in 2004 and does not now have a U.S. bank or a thrift subsidiary.

- The European Financial Conglomerates Committee's guidance to national supervisors in the European Union that the OTS, SEC, and New York State Banking Department would be acceptable consolidated comprehensive supervisors under the EU Financial Conglomerates Directive. This guidance created several internationally acceptable alternatives to the FHC structure, including the thrift holding company structure and the SEC's Consolidated Supervised Entity (CSE) designation.

- Several high-profile studies[1] advancing the theme that excessive regulatory burden is contributing to decreased competitiveness of the U.S. financial services industry relative to global capital markets.

- The Treasury Department's review of the regulatory structure associated with financial institutions and related request for public comments.

- The growing importance of addressing financial stability goals, including the upcoming IMF-World Bank Financial Sector Assessment Program (FSAP) of U.S. institutions.

To better understand the market's views on the advantages and disadvantages of FHC status, we held structured discussions with representatives from three law firms and one consulting firm and also with the CPCs for five current or former FHCs. See Attachment (b) for the questionnaire used.

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[1] Compiled by the: (i) Committee on Capital Markets Regulation (co-chaired by John Thornton of The Brookings Institution and Glenn Hubbard of Columbia Business School, under the aegis of Treasury Secretary Hank Paulson); (ii) McKinsey & Company, under the auspices of Mayor Michael Bloomberg and Senator Charles Schumer, *Sustaining New York's and the US' Global Financial Services Leadership*; (iii) Commission on the Regulation of U.S. Capital Markets in the 21st Century (organized by the U.S. Chamber of Commerce and co-chaired by William Daley of JPMorgan Chase and Arthur Culvahouse of O'Melveny & Myers); and (iv) Blue Ribbon Commission on Enhancing Financial Competitiveness (sponsored by the Financial Services Roundtable and co-chaired by Jamie Dimon of JPMorgan Chase and Richard Kovacevich of Wells Fargo).

Benefits of being an FHC

Interviewees told us that the FRS possesses credibility on both the international and domestic fronts. Overseas, the FRS is seen as the premier U.S. financial regulator; for a U.S. firm doing business internationally, the FRS carries greater weight as a holding company supervisor than other agencies. The FRS is viewed as constructive during crisis periods. Our actions during the market turbulence of recent months, such as our willingness to provide 23A relief to several FHCs borrowing from the discount window, continue as examples of this. The general perception is that the FRS is more independent and stable—less subject to policy swings—than agencies such as the OTS and OCC, which are housed within the Treasury Department. One former FHC that converted to a thrift holding company charter reported that one of the major ratings agencies said it considers the FRS to be a stronger regulator than the OTS. Attaining FHC status is associated with a certain prestige, particularly among foreign banks and smaller BHCs.

There is also a modest advantage in having a Section 3 bank rather than a thrift or industrial loan company (ILC). Banks, unlike thrifts, are not subject to limitations on the minimum percentage of their assets that are in the form of mortgages or the maximum percentage of their assets that are in the form of commercial loans. Banks, unlike ILCs, may offer demand deposits.[2] There may also be an increasing awareness—particularly given the recent financial market turmoil—of some of the advantages associated with banks, such as easier access to the discount window, a more diversified balance sheet, and more stable and less expensive liabilities.

Supervised entities also find value in the industry-wide perspective that Federal Reserve examiners can bring to their assessments of a firm's business activities and risk management programs, and in the expertise that the FRS has as an informed yet independent observer.

Costs of being an FHC

A number of concerns about the FHC framework were also raised during our interviews. They can be classified into three general categories.

1. Concerns about the FRS Supervisory Approach

For a non-bank led financial firm, the biggest concern about becoming an FHC is the "comprehensiveness" of our supervisory approach, particularly when compared to alternatives such as OTS or SEC holding company supervision. Concerns about the FRS supervisory approach relate to both the extent as well as nature of its supervision. (These concerns have also been raised by existing FHCs.) For most non-bank-led financial firms, these concerns outweigh others, such as capital or activities restrictions.

[2] This last limitation may not impose much of a constraint in practice. Many ILCs offer products that, although technically not demand deposits, are functionally similar.

First, FRS supervision is perceived as farther-reaching than that of other consolidated supervisors, who are thought to act minimally toward the broader holding company and unregulated subsidiaries. FRS supervision intrudes at the senior executive level of the parent company. In contrast, other consolidated supervisors still concentrate on the regulated subsidiaries (broker-dealers and thrifts), and tend to leave the top executives alone. This long arm extends not only to the top, but throughout the firm. Some interviewees felt that the FRS could do more to "take it on faith that functional regulators are doing their jobs." One industry expert noted that the FRS can "go wherever it wants" in a BHC, including into unregulated subsidiaries, although the GLB Act does place limits on its reach into functionally regulated entities.

In contrast, securities and insurance firms have historically been able to manage the extent of their supervision by putting into unregulated subsidiaries those businesses that don't need to be housed in a broker-dealer or a regulated insurance entity, respectively, and where there has been little oversight by the SEC, CFTC, or state insurance regulators. Industry perception that these agencies will continue to focus primarily on the regulated entities, and not on the parent company or other subsidiaries, is strong. The SEC's CSE program, however, is relatively new, and the potential adoption of a federal supervisory regime for insurance companies would obviously impact these views.

Second, the manner in which FRS supervision is carried out was often labeled as intrusive. Interviewees alluded to a broad supervisory footprint (number and scope of exams) and a prudential approach perceived to be more involved with firm management decisions than the approaches taken by other agencies. By comparison, SEC examinations and requests for information at the holding company under its CSE program have to date been less frequent, more narrowly tailored, and less focused on decisions of holding company management. Similarly, OTS supervision at the holding company level is more limited. Neither agency has minimum capital requirements for holding companies[3] nor dedicates the amount of resources to consolidated supervision that the FRS does. Further, there was some feedback that the FRS could be more timely and comprehensive in sharing its broad industry perspectives, and that supervised entities do not therefore benefit as much as they could from Federal Reserve reviews of their operations.

Traditionally, banking supervision, although intrusive, was seen to be more informal. With increased focus on AML, banking regulators are perceived to have become more enforcement-oriented; one interviewee stated that "there is no such thing as a casual conversation with supervisors anymore." In contrast, securities firms have historically been subject to a regulatory culture under the SEC that, while more prescriptive and enforcement-oriented, left businesses alone as long as they complied with relatively clear

[3] The SEC and OTS do not impose any published, standardized consolidated capital requirements. While the SEC does require CSEs to calculate risk based capital levels, it does not mandate any minimum levels. The OTS does not feel it appropriate to have a standardized consolidated capital requirement, given the diversity of organization types that own thrifts. According to its Holding Company Handbook, "The OTS does not impose either consolidated or unconsolidated regulatory capital requirements on thrift holding companies. Although there is no specific numerical requirement (ratio), OTS-regulated holding companies should have a prudential level of capital to support their risk profile."

rules. Recent reports and panels have expressed a desire for more principles-based prudential supervision, and the experts' statements appear to reflect a concern that the FRS is moving towards a more enforcement-oriented approach to supervision without the benefit of clear rules to guide firms' behavior.

Non-FHCs also take note when existing FHCs are put into the "penalty box," restricted from acquisitions as a result of failing to meet capital standards or exam rating levels. Non-FHCs question whether they want a charter that brings with it the possibility of significant restrictions in implementing their business plans. The FRS' ability to remove directors was also cited as a concern for some firms considering adoption of the FHC structure.

2. Concerns about the FHC Regulatory Approach & Activities Restrictions

While existing bank-led FHCs appear to be generally content with the extent of their powers under existing statutes and regulations, there are a few specific exceptions that relate to merchant banking, real estate, and commodities. The activities restrictions applicable to FHCs also factor into the decision-making process of non-bank firms considering whether to become FHCs. For example, securities firms have traditionally been able to make investments through their holding companies essentially without regulatory limitations, and are hesitant to subject their investment decisions to any type of activity limitations. A detailed discussion of these issues can be found in Section III, "Concerns & Potential Improvements."

More importantly, the FRS regulatory process in general—which includes but is not limited to the applications process—is criticized as opaque (underlying regulatory policies are often difficult to discern) and slow-moving and, at times, insensitive to the concerns of private parties involved. Attempts at regulatory relief, on both the legislative and regulatory fronts, have tinkered at the edges but have not addressed the "big picture."

3. Concerns about Capital Requirements

Existing FHCs have expressed the view to FRS staff that our application of the consolidated Tier 1 leverage ratio standard makes them less competitive to U.S. investment firms and European banking peers. This same issue is cited by non-FHC securities firms as one major, unattractive feature of operating under the FHC framework. Firms feel that the leverage ratio calculation overstates regulatory capital for activities they consider low-risk, noting in particular the treatment of securities financing transactions. The U.S. implementation of the proposed Basel II framework was also criticized as slow and burdensome.

Firms' assessments of benefits and costs

Overall, the feedback we received was that for most non-bank firms the burdens of becoming an FHC would, in most cases, outweigh the perceived benefits; this is particularly true for institutions that are not and do not expect to be bank-dominated. For

non-bank led firms, the alternatives to the FHC structure provide too attractive an alternative. In particular, the European Union's approval of the SEC and OTS as equivalent consolidated supervisors has created a road map for U.S. non-bank led firms: the big securities firms can elect the SEC's consolidated supervision, while insurance companies and smaller investment banks can go with the OTS. The continued availability of ILC charters provides an additional option as well.

For a foreign banking organization (FBO) entering the U.S., establishing a branch or agency (which subjects the FBO to the BHC Act) is seen as more prestigious than opening a representative office or non-bank subsidiary. Prestige might, in fact, be the sole advantage of FHC status for some firms. Most FBOs—even those with branches—do not conduct those few activities that require a branch or agency license.

FBOs weigh this benefit against a few potential disadvantages. First, reporting requirements related to certain filings[4] to the FRS can present a significant burden. While these reports are required from all FBOs, whether FHCs or not, we were told that some foreign banks may limit their banking presence in U.S. markets because of the difficulties in completing or the transparency provided by these reports. Additionally, in determining whether to seek FHC status, FBOs take into consideration the risks they would face should they fail to remain well-managed or well-capitalized.

III. CONCERNS & POTENTIAL IMPROVEMENTS

From our discussions with industry experts, we identified fourteen areas that could present obstacles to a firm regulated, or considering being regulated, as an FHC. The remainder of this section details the suggestions of workgroup staff for possible modifications to the current FHC supervisory and regulatory program in these areas.

Each of the fourteen issues is first summarized below in a box describing the concerns raised by interviewees, with a discussion of the staff's suggestions following the box. In cases where implementing staff suggestions would require Congressional action, these are set forth separately at the end of the relevant sections. A summary of all potential changes—along with specific statutes, regulations, guidance, and practices that would need to changed—can be found in Attachment (a).

These recommendations may be viewed as a first step toward the maintenance of a viable framework for existing FHCs to retain their status. While these changes could make the FHC charter more attractive, there is no assurance that they—either individually or in the aggregate—would be sufficient to allow more securities, insurance, and other non-bank firms to seriously consider becoming FHCs.

Note that this paper does not provide detailed analyses of each recommendation, but rather suggests options that can be explored in greater depth, depending on the appetite

[4] Particularly the FR Y-7 (Annual Report of Foreign Banking Organizations).

for pursuing any particular improvement to the FHC regime.

The Federal Reserve's Supervisory & Regulatory Approach

This section discusses five of the fourteen issues. (It excludes capital regulation, which will be covered later.)

A – Our supervisory approach to holding companies
B – Duplication in the supervisory process between agencies
C – New activity approval process
D – Section 4(m) process
E – Regulatory reporting requirements (FR Y-7)

A. Our supervisory approach to holding companies

Relative to other consolidated supervisors' approaches, the FRS approach to umbrella supervision is perceived as being too far-reaching and intrusive.

Non-FHCs perceive consolidated supervision by the FRS as somewhat of an "unknown quantity." Some uncertainty exists in the marketplace about aspects of the FHC regulatory and supervisory framework.

Supervisors can add value to regulated entities by communicating to senior bank managers their broad perspectives on the institution and industry, as a consultant might.

#1. Create a new category under the consolidated supervision framework for the supervision of "non-bank led FHCs"

As part of the System-wide Consolidated Supervision project, the FRS can create a separate category for firms in which the bank depository institution is a small component of the overall entity, e.g., securities firms with small retail banks. For this "non-bank led FHC" category, FRS supervision could rely more heavily on off-site monitoring and surveillance and the work of primary bank and functional regulators. Guidance established could explicitly acknowledge that supervision of non-bank led FHCs should be conducted differently than for large bank-led firms, and allow for supervisory judgment to be applied to individual firms on elements such as some or all of the following:

- FRS examination activities, e.g., have a separate assessment of the appropriate number of examiners located on- and off-site; frequency and length of onsite target reviews; and nature of monitoring activities.

- FRS approach to unregulated subsidiaries, e.g., make an explicit presumption that, in the normal course of business, our supervision of non-regulated subsidiaries is to rely primarily on sources such as internal audit assessments, BHC reports, and publicly available information.

- Application of capital adequacy ratios, e.g., allow supervisory discretion to deemphasize total capital and leverage ratios (see later discussion in "N – Capital structure reliance on Tier 1 vs. Tier 2").

- BHC ratings, e.g., set out conditions that supervisors can consider in deciding whether a full RFI rating need be assigned to certain firms.

Triggers could be developed to define those entities eligible for this category, based on organizational characteristics such as:

- Size, e.g., where the absolute size of the bank subsidiary or the relative size of the bank to the consolidated organization is small.

- Risk profile and activities, taking into consideration risk criteria used in the LFI selection process and the nature of non-bank activities.

- Supervisory condition, e.g., whether supervisory ratings are satisfactory or whether there are outstanding supervisory actions.

- Organizational separability. The "non-bank led FHC" designation would be more suitable in cases where a bank's business operations are distinct from those of its affiliates. In contrast, it would likely not be suitable for a wholesale operation, where the bank and securities affiliate act as an integrated business unit with common employees and operations, albeit separate balance sheets.

In fashioning this program, the FRS also could consider exempting such BHCs from some of the regulatory capital rules. Additionally, it could study other agencies' consolidated supervision approaches to determine whether there are any practices the FRS would want to adopt.

#2. Conduct a FRS outreach program to the marketplace, targeting current and potential FHCs, consultancies, and rating agencies

The FRS could do a better job of communicating to the financial industry the positive aspects of FHC supervision, including emphasizing to senior management its important non-supervisory role as a central banker and in crisis management situations. Given the market turbulence of recent months, along with actions such as our willingness to provide 23A relief to several FHCs, this may be a particularly opportune time to conduct a proactive outreach program. Such a program would help enhance the transparency of the FHC supervisory process, as well as allow the FRS to obtain feedback from constituents on more consistent basis. This communication strategy could include some or all of the

following:

- Periodically visiting current and potential FHCs to develop relationships, advance their understanding of the FRS approach, and invite dialog in areas of mutual interest or concern.

- Having regularly scheduled contact with consultancies, such as law firms and consulting firms, that service the financial services industry.

- Highlighting the FRS umbrella supervisory approach—including the "non-bank led FHC" category for a subset of FHCs, as discussed above—through various media such as speeches, conferences, and publications.

- Meeting with rating agencies to further understand their views on approaches to consolidated supervision by the various agencies.

#3: Share broad industry feedback and supervisory guidance in a timely and accessible manner

Define, enhance, and monitor the process of sharing peer perspectives

Create a Horizontal Feedback Taskforce to: (i) develop policies for the timely sharing with institutions of results of horizontal reviews and other cross-institutional information gathering exercises; and (ii) establish a project management framework to monitor the information-sharing process. Specifically, the FRS could:

- Incorporate information-sharing objectives when determining the optimal approach for obtaining data in horizontal and similar reviews, e.g., distribution of surveys to CPC teams or firms vs. simultaneous examinations at multiple institutions vs. the traditional horizontal schedule of consecutive exams at various institutions.

- Define a process for reviewing and clearing information for release, which could include:

    - An up-front protocol between participating regulators that covers: the type of data to be shared and with whom (e.g., whether participating firms should receive earlier or more detailed versions of results); expected timelines for sharing, pending completion of certain stages of work; mechanisms for communicating results (e.g., meetings/conference calls between relevant supervisors and institutions involved, either one-on-one or as a group, or publication of summary documents)

    - Establishing a project management framework to monitor the progress of information-sharing activities,[5] fostering accountability by holding project

[5] Monitoring could build on the comprehensive Monthly Status Report produced to track the status of LFI

managers accountable for performance measures.

- Set expectations to deliver increased peer perspective to institutions via the traditional supervisory process of continuous monitoring and examinations. Solicit industry input into the scope and goals of horizontal reviews.

- Aside from examination-specific perspectives, create mechanisms to deliver broad supervisory or industry observations in "hot topic" areas such as AML and subprime mortgages.

The taskforce could pilot this information-sharing initiative using a recent event, such as the formal subprime mortgage information-gathering exercise.

Improve the timeliness of supervisory guidance releases and make guidance more accessible to the public

- The FRS could begin by identifying current cases where supervisory guidance is delayed and then either allocate resources to complete the guidance or adjust the process to minimize these impediments going forward.

- The FRS should also create comprehensive, searchable indexed public databases of all public supervisory guidance, including SR Letters, interpretation letters, Board Orders on applications matters, public enforcement materials, etc.

#4: Explore where it may be feasible for the FRS, SEC, and OTS to adopt more consistent supervisory practices

In its March 2007 report,[6] the Government Accountability Office (GAO) recommends that the three federal consolidated supervisors promote supervisory consistency—particularly for firms that provide similar services—by fostering more systematic collaboration.

- Hold discussions with the three agencies to open a dialog around consolidated supervision. Options include sharing information on the agencies' current supervisory practices and exploring areas where it may be feasible to adopt more consistent supervisory practices, e.g., in some reporting requirements.

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horizontals.

[6] "Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration" GAO-07-154 (March, 2007).

B. Duplication in the supervisory process between agencies

Some interviewees noted a burdensome duplication of efforts between the FRS, as umbrella supervisor, and primary bank and functional regulators. There may be more overlap among prudential supervisors, such as the FRS and OCC, than in other cases.

#1. Agencies engaged in consolidated supervision can take a more systematic approach to strengthen collaboration and information-sharing

In its March 2007 report, the GAO recommends that consolidated supervisors, primary bank regulators, and functional regulators work together to clarify their supervisory roles and collaborate more systematically.

- The FRS could take the lead in this process by writing a preliminary proposal to lay out the agencies' roles and duties and appropriate mechanisms and processes to enhance collaboration, followed by inter-agency discussions. (Work along these lines is currently being considered as part of the consolidated supervision project.) This should include a review of which additional bilateral and multilateral information-sharing MOUs are needed, followed by steps to complete these agreements.

Another area for enhanced collaboration is in consumer compliance. For example, recent public anxiety surrounding subprime mortgage lending has led the FRS to discuss expanding its oversight of these activities to non-bank subsidiaries.

- To ensure that the burden of added oversight does not fall unduly on FHCs, the FRS should work with other supervisory agencies to develop a consistent approach to reviewing consumer compliance issues. In a current case, the FRS—with two other federal agencies and two associations of state regulators—is cooperating in a pilot project to conduct targeted consumer-protection compliance reviews of select non-depository lenders with significant subprime mortgage operations. Ideally, changes in supervisory oversight for mortgage activities should be uniformly applied across entities, no matter who regulates an entity.

FRS access to the supervisory information of U.S. bank regulators and functional regulators can also be enhanced.

- For example, FRS examiners do not have full access to OCC supervisory materials through BOND. Review whether the FRS should do more under SR 99-15 to communicate expectations for what materials will be shared electronically. Draft proposal to capture additional supervisory documents in repositories such as BOND and to improve the timeliness of posting exam documents to such repositories.

- Other regulators would also benefit from the existence of a database to provide industry with easier access to regulatory and supervisory decisions, as suggested in

the previous section "A - Our supervisory approach to holding companies."

#2. Streamline the FRS exam process to increase opportunities to conduct joint reviews with other regulators

- Review the possibility of conducting more single-event reviews, in which the separate planning phase is eliminated; how frequently vettings are needed for any given exam; and any other changes providing greater ability to coordinate joint reviews with the OCC or other regulators.

C. New activity approval process

The applications process for engaging in activities that are "financial in nature," "incidental to financial activities," and "complementary to financial activities" is seen as a potential roadblock for organizations considering the FHC structure and for FHCs seeking to engage in new activities.

#1. Expedite processing procedures for determinations in all three activities categories

To engage in an activity that has already been determined to be financial or incidental, the GLB Act permits an FHC to simply notify the Board within 30 days after commencing the activity. This lack of a prior approval requirement has been cited as a key benefit of being an FHC.

To engage in a complementary activity, the Act requires an FHC to submit a notice to the Board 60 days prior to engaging in the activity; the notice is considered approved unless the Board issues an order disapproving it. The Board may extend the 60-day period by 30 days (or 90 days, if the activity has not previously been approved by the Board by regulation) and may further extend the period with the agreement of the FHC. The Board may also issue regulations providing for a shorter notice period for particular activities.

- Begin by reviewing internal procedures for areas where processing time could be reduced. Identify changes in practices or regulation that could be made by the FRS acting alone.

- For complementary activities previously approved for other FHCs by Board order:

  - Issue regulations providing for shorter prior notice periods

  - Give Reserve Banks delegated authority to approve these activities

#2. Clarify that a complementary determination does not foreclose a future financial/incidental classification

The process for determining that a new activity is complementary is potentially easier and shorter than that for determining a new activity to be financial/incidental, given that the Board may make complementary decisions on its own without having to consult with the Treasury Department. Nonetheless, some FHCs may avoid seeking complementary determinations out of concern that such a determination forecloses a later determination that the activity is financial/incidental.

- The Board could take additional steps to clarify that a determination that an activity is complementary does not foreclose the possibility that it could later be determined to be financial/incidental.[7]

#3. Encourage more activity requests

- The Board could proactively determine (in consultation with Treasury) specific new activities to be financial or incidental, without waiting for FHCs to file determination requests. To do so, Board staff could survey existing BHCs and FHCs, other financial services firms, FRS bank examiners and research staffs, industry groups, and others for suggestions. (The proposal in "A – Our supervisory approach to holding companies" that the FRS conduct an outreach program targeting current and potential FHCs and consultancies could present one venue to do this.)

- The Board could signal its willingness to consider new activity determination requests in all three activity categories by actively soliciting them via speeches, press releases, industry meetings, or other appropriate avenues.

Actions Requiring Legislative Changes

To determine that a new activity is "financial in nature" or "incidental to a financial activity" for an FHC, the Board must currently consult with the Treasury Department (which has veto power). A similar process exists in reverse for making financial and incidental activity determinations for financial subsidiaries of a national bank; the Treasury must consult with the Board (which has veto power).

- The BHC Act could be amended to eliminate the need for the Board to consult with Treasury in making financial and incidental activity determinations for FHCs.[8]

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[7] The Board's initial order authorizing a FHC (Citigroup) to engage in physical commodity trading activities as a complementary activity noted that, based on the record then established, the Board did not believe that such commodity trading activities could be found to be financial in nature "at this time."

[8] If this was done, Treasury likely would seek removal of the similar "reverse" procedures for financial subsidiaries of national banks.

D. Section 4(m) process

Under the GLB Act, FHC status is linked to specific capital and management requirements. Violating these obligations requires that the FHC enter into a "Section 4(m) agreement" with the Federal Reserve. The possibility of being subjected to a 4(m) agreement is a deterrent to organizations considering FHC status, are concerned about the possibility of losing strategic flexibility to engage in new activities and acquire new companies.

For a U.S. BHC to be an FHC, all its depository institutions must remain well capitalized and well managed. For an FBO to be treated as an FHC, it (and also all its U.S. depository institutions) must remain well capitalized and well managed. An FHC that fails to continue to meet these requirements must enter into a Section 4(m) agreement with the Board, agreeing to return to compliance within a certain period of time, or drop its FHC status and conform its activities accordingly as a BHC.

The GLB Act permits the Board to impose limitations on the conduct or activities of a FHC as part of a 4(m) agreement. The Board's regulations provide that a company subject to such an agreement may not commence any additional activities—or acquire companies engaged in activities—permissible only for a FHC, without the Board's prior approval.[9]

Firms would like the flexibility for their depository institution subsidiaries to experience a temporary loss of well-capitalized or well-managed status (for example, due to acquisitions, temporary market fluctuations, etc.) without having to immediately enter into a 4(m) agreement. Similarly, they fear having to enter into a 4(m) agreement due to a drop in management ratings that the primary regulator may not upgrade until the next exam cycle, possibly one to two years after the problems have been resolved. Further, organizations may be unwilling to acquire troubled institutions (and attempt to turn them around) if doing so would require them to enter into a 4(m) agreement upon acquisition.

#1. Apply more flexible 4(m) agreement requirements, via Board actions alone

The FRS should consider ways to provide greater flexibility to FHCs required to enter into a 4(m) agreement in cases such as these. For example, the Board could:

- Eliminate its regulatory requirement that FHCs subject to 4(m) agreements must seek Board approval before engaging in new FHC activities or buying companies engaged in FHC activities. However, the Board would retain discretion to impose these approval requirements, or other conditions, as part of a 4(m) agreement (e.g., where

[9] In specific and limited cases, the Board has granted an FHC blanket approval to continue making acquisitions or commencing activities in accordance with its FHC powers as part of a 4(m) agreement, e.g., where non-compliance arises either due to an acquisition of another institution or from areas not material to the organization.

the FHC's lead bank subsidiary ceases to be well capitalized or well managed); or

- Modify the rule to clarify when the Board will waive the prior approval requirement, or grant an FHC a blanket approval, such as when a 4(m) agreement is required due to an FHC's acquisition of a troubled institution that is small relative to the FHC's overall banking assets.

#2. Discuss with SEC the reporting implications of a 4(m) agreement

Section 4(m) agreements are treated as "written agreements" under the FDI Act. However, the Board generally takes the position that publishing such agreements would not be in the public interest. We understand that there is some ambiguity on the part of firms as to when an FHC must disclose in its SEC filings that it is subject to a 4(m) agreement.

- The Board could discuss with the SEC whether and when it could be appropriate for FHCs to not disclose that they have entered into these agreements.[10]

Actions Requiring Legislative Changes

The suggestions under #1 above could be implemented by the Board, making only regulatory changes. An alternative approach would be to revise how the BHC Act's "well capitalized" and/or "well managed" requirements are applied, or else to revise the Act's definitions of these categories.

- The BHC Act could be amended to lower the standards for remaining an FHC, as compared to those for becoming an FHC

- The statutory "well capitalized" standard could be changed to an adequately capitalized standard or to a well capitalized average over a period of time standard. Similarly, the statutory "well managed" standard could be linked to findings of satisfactory operations, or improvements in operations, noted in exam reports rather than the composite CAMELS rating and the management component thereof.

E. Regulatory reporting requirements (FR Y-7)

While FR Y-7 reports are required from all FBOs, whether FHCs or not, our interviews indicated that some foreign banks may limit their banking presence in U.S. markets because of the burden associated with filing such reports, or concerns about the transparency provided by this report.

[10] Ultimately this SEC disclosure issue depends on whether the agreement is "material" to the FHC. The SEC has long held that what is "material" depends on particular facts and circumstances; it has historically not provided much clarity to external parties as to what "material" means.

Reduce FBO reporting burden

FBOs are required to file an Annual Report of Foreign Banking Organizations (FR Y-7) with the Federal Reserve, which presents financial and organizational information and must include an organizational chart showing the FBO's interests in specifically defined entities.[11]

Our interviews suggested that one of the most burdensome compliance requirements relates to reporting minority investments on the Y-7 report, including those in foreign companies engaged in activities in the U.S. Identifying whether the foreign company is doing business in the U.S. is very difficult when the FBO: (i) is only a minority investor and does not otherwise control the company, or (ii) invests in a chain of foreign companies and may not be able to easily access information necessary to determine whether these are engaged in activities in the U.S.[12]

- Simplify compliance for multi-tiered global organizations by requesting information on minority investments in foreign companies doing business in the U.S. for the top-tier level of these investments only. A more comprehensive solution would be to eliminate the requirement.

Activities Restrictions & Powers

Five of the fourteen issues involve specific activities restrictions on and the powers of FHCs. We have already discussed the new activity approval process, above. The discussion here concentrates on the substance of the activities.

F – Merchant banking
G – Real estate
H – Commodities
I – Control rules
J – Preemption powers

[11] These entities include (1) banking companies in which the FBO controls, owns, or holds more than 5% of any class of voting shares (2) U.S. companies & non-U.S. companies directly or indirectly engaged in business in the U.S. other than BHCs, U.S. banks, or FBOs that the FBO controls directly or indirectly, and (3) non-banking companies (both U.S. companies & non-U.S. companies engaged in business in the U.S.) in which the FBO controls more than 5% but less than 25% of the outstanding shares of any class of voting securities.

[12] European banks, in particular, have extensive portfolio investments, making the reporting of all Y-7 investments a significant undertaking and one they are not used to doing for their home country regulators.

F. Merchant banking

Our interviews identified merchant banking as the most significant of the activities restriction concerns. Some of these concerns arise from the nature of the activity restrictions applicable to FHCs in general. For example, many non-bank firms currently are able to structure their investment activities so that they are subject to little, if any, regulatory limitations. FHCs, on the other hand, are generally permitted to invest in a commercial company only if they keep the investment passive and small (less than 5% voting and less than 24.9% total equity) or the investment is a permissible merchant banking investment.

Other concerns arise from the nature of the limitations applicable to merchant banking investments (e.g., holding period, routine management, and cross-marketing limitations); the way in which the Board's rules implement these limitations; and the associated compliance burdens.

The GLB Act's merchant banking authority allows FHCs to acquire up to 100 percent of the voting shares of a nonfinancial company subject to certain conditions, the most important of which are limitations on the length of time FHCs may hold investments and a general prohibition on routine, day-to-day management of portfolio companies.

The Board's rules implement the holding period criterion by imposing a general limit of 10 years on the holding period for merchant banking investments, or 15 years for investments held through a "private equity fund," in each case with possible extensions from the Board. The Board's rules implement the routine management criterion by prohibiting certain senior management interlocks, creating a rebuttable presumption that junior officer and employee interlocks are prohibited, and prohibiting FHCs from having covenants or other contractual provisions that would allow the FHC to exercise control over the portfolio company's day-to-day business decisions and operations.

These rules were developed following interviews with large investment banks and were consistent with industry practice at the time they were adopted. Industry practice, however, has changed, with investments made through "private equity funds" gaining increased importance. FHCs now tend to invest through intermediaries, e.g., hedge funds, which often manage their investments directly.

FHCs find aggregating and reporting these positions and monitoring each investment for compliance burdensome, arguing that such requirements do not address the legitimate objectives of the regulations. In addition, some FHCs have indicated that it may be difficult to discern how the rules should be applied in complex structures, such as "fund-of-fund" investments. The level of FHC merchant banking investments is therefore relatively low.

#1: Make merchant banking rules more flexible and transparent, particularly in the context of fund investments

As part of the ongoing review of Regulation Y, the following steps could be taken:

- Expand the definition of a "private equity fund" to include funds that are managed by another investor, even if an FHC owns more than 25% of the fund's equity. This would broaden the universe of funds eligible to take advantage of the longer 15-year holding period in the rule.

- Improve the transparency of how the rules apply to, and the options that FHCs have in structuring their investments in, funds and real estate ventures.

Another approach would be to replace the current rules with more principles-based regulation.

- For example, the rules could develop a general description of the activity of merchant banking, and require the FHC to demonstrate to the FRS that it is in compliance with the regulatory principles. Such an approach could concentrate on the FHC's merchant banking *business*, and be relatively tolerant of individual investments.

#2: Review cross-marketing restrictions applicable to merchant banking investments

The GLB Act generally prohibits an FHC's subsidiary banks from cross-marketing the product or services of a nonfinancial company held by the FHC under the merchant banking authority. Similarly, the nonfinancial company cannot cross-market the products or services of the FHC's subsidiary banks. (This restriction, intended to separate banking and commerce, does not apply to nonbanking affiliates of merchant banking affiliates.)

The Board's rules provide that these restrictions do not apply to companies in which the FHC owns no more than 5% pursuant to merchant banking authority (since these investments could be held under section 4(c)(6) which does not have a similar cross-marketing limitation). In addition, the rules contain another significant exception; the cross-marketing restrictions do not apply to "portfolio companies held by a private equity fund that the FHC does not control."

The Board has proposed that the Congress modify the cross-marketing limitations applicable to merchant banking investments in certain respects, and the Congress did grant limited relief in the Financial Services Regulatory Relief Act of 2006.[13] Even without further legislative change, the Board could:

- Permit cross-marketing activities with entities that are held by an FHC through other

[13] Specifically, Congress permitted an FHC's subsidiary banks to engage, with Board approval, in cross-marketing activities through Internet websites and statement stuffers with companies held by the FHC under merchant banking authority.

types of funds (such as hedge funds) that the FHC does not control.

- Allow cross-marketing activities with entities that the FHC could hold under other authorities besides 4(c)(6), such as under SBIC or Regulation K investment authority.

G. Real estate

Real estate brokerage, management, and development activities are generally not permitted for FHCs, and opposition from the real estate broker and agent industry and from Congress continues to be strong. In December 2007, Congress passed appropriations legislation prohibiting the FRS from approving real estate brokerage or management activities as financial, incidental, or complementary for the next two years.

While recognizing the long-standing history surrounding, and current political environment toward, proposals to expand FHCs' real estate authority, there continues to be widespread interest among FHCs—and anecdotally, potential FHCs—to conduct these activities. Additionally, at least one former FHC (insurance-led) de-banked in part due to a lack of clarity around permissibility of its real estate management activities.[14] Non-FHC insurance companies have much broader ability than FHCs to engage in real estate activities.

Continue to monitor and pursue available avenues for expanding the real estate-related powers of FHCs

- Analyze, in connection with the ongoing Regulation Y revision, changes that can be made to the merchant banking rules to facilitate real estate investment activities of FHCs. [Note: Board Legal is already working on changes to the rules to clarify how FHCs can invest in real estate without running afoul of the restrictions on routine management.]

[14] Manulife became an FHC when it acquired John Hancock Financial Services in 2004. The change in control triggered by this acquisition caused Hancock's subsidiary, First Signature, to lose its grandfathered nonbank bank status under CEBA. The Board's FHC approval order for Manulife stipulated that some of the firm's real estate investment, development, and management activities would need to be brought into conformance with Reg. Y within 2 years (or up to 5 years, subject to Board extension). Manulife requested guidance on whether it could continue to engage in certain activities (owning and managing timber properties) and still meet the requirement in the Board Order. Approximately a year after its FHC declaration became effective, this guidance was still not provided. The firm informally cited the discomfort of operating in a state of uncertainty over its compliance status, combined with the bank's small size and low relevance to Manulife's core business lines, as its reason to de-bank.

- Continue to monitor the political and industry environment for opportunities to expand FHCs' abilities to engage in real estate brokerage and/or management after the Congressional prohibition on these activities expires in two years.

H. Commodities

Currently FHCs may not engage in certain commodities-related activities (including some pertaining to the energy markets) that their non-FHC investment banking peers are active in.

Progress is being made in lowering barriers to full FHC participation in the commodities trading area. Permissible activities include commodities repurchase agreements; volumetric payment for energy; physical commodities trading; and, most recently, energy management agreements. The first two activities fit into the Regulation Y "laundry list," making them "financial in nature" activities that FHCs may engage in without prior Board approval (only a post-notice is required).

The Board has permitted several FHCs to either trade in physical commodities or provide energy management services, as activities that are "complementary" to their commodity derivative businesses. Applications by FHCs to engage in these activities require case-by-case approval for individual FHCs.

#1. Move physical commodity trading activities to the "financial in nature" or "incidental" category from the complementary category.

- The Board, working with Treasury, could find that the approved physical commodity trading activities are "financial" or "incidental", which would allow FHCs to engage in these activities using only a post-notice procedure.

#2. Research and approve applications for other new relevant commodities activities, e.g., ones similar to energy management agreements and energy tolling agreements, but for commodities other than energy.

In December 2007, the Board approved a new complementary activity of engaging in Energy Management Agreements, in which the FHC advises on market strategy, provides administrative services, and acts as intermediary for input and output of power plants.

Additionally, the FRS has researched the possibility of approving Energy Tolling Agreements, in which an FHC would provide fuel in return for an option to buy the power plant's output, for possible future FHC applicants. (The FRS has received many FHC inquiries but currently has no pending applications.) If approved, this additional expansion of authority should make FHCs more competitive with non-FHC providers of this service.

- Similar to the proposal for the Energy Management Agreement activity, the Energy Tolling Agreement proposal for complementary authority can be achieved by Board Order. The FRS could expedite subsequent approvals for future FHCs wishing to perform these activities.

- Approve applications for other relevant activities, e.g., those similar to energy management agreements and energy tolling agreements, but for commodities other than energy. It may be worthwhile to do pro-active research on new areas, such as is being doing now for energy tolling agreements, to be ready for potential new applications. The FRS could also proactively issue guidance to FHCs on the kind of activities that the Board might approve.

In approving new activities, the FRS should be wary of being overly conservative in placing limits on those activities, so that it doesn't impose restrictions that are onerous in comparison to the actual legal requirements or safety and soundness risks involved.

I. Control rules

The Federal Reserve's control interpretations are frequently criticized by industry as being excessively strict, ad hoc, and lacking in transparency. Industry experts particularly mentioned difficulties complying with what firms consider unnecessarily complex control rules in the context of fund investments.

Approve proposed Regulation Y amendments enhancing the transparency and consistency of control rules

In connection with its on-going project to overhaul Regulation Y, Board staff is developing proposed amendments that will help enhance the transparency and consistency of the FRS's control views, including on control of investment funds, especially liberalizing views on control of company and control of shares.

A number of the control interpretations are thought by industry to be too strict.[15]

[15] Control interpretations most criticized as too strict include: (i) a company controls another company if the first company controls 25% of the total equity of another company; (ii) a company controls another company if the first company controls 10-24.9% of the voting stock of the other company and has (a) a director, officer, or employee interlock with the other company, (b) business relationships with the other company, or (c) contractual veto rights over important policies or actions of the other company; (iii) a company controls another company if the first company used to control the other company and the first company currently controls more than 5% of the voting stock of the other company; (iv) a company controls an investment fund if the company advises the fund and owns 5% or more of the equity interests of the fund; and (v) a company controls voting stock of another company if the first company has options, warrants or convertible securities that convert into voting stock of the other company at the option of the holder – even if the convertible instrument is not convertible for several years or is only convertible upon

Industry also criticized the perceived ad hoc nature of control-related decision-making. The FRS employs a variety of written and unwritten rules, some of which consist of rules of thumb or rebuttable presumptions (control is assumed if certain criteria are met, unless evidence is provided to the contrary by private parties). While this approach enhances flexibility to address the many nuances of controlling influence fact patterns and to prevent some forms of regulatory arbitrage, it reduces the predictability and clarity of the FRS's application of BHC Act control provisions. It can also delay resolution of issues, as staff collects and analyzes case facts. Particular criticism has been leveled against the FRS's case-by-case approach to determining whether a company controls an investment fund and whether to attribute to a company shareholdings of its officers and directors.

Additionally, industry complains about the allegedly private nature of the FRS's control rulings. While control issues are addressed by the BHC Act (defining control of a company), Regulation Y (rebuttable presumptions of control), and scores of Board interpretations over the past 25 years, many other FRS views on control are not written in publicly available documents. In the past 10 years or so, control decisions have been typically conveyed to interested parties by telephone.

As part of its Regulation Y overhaul project, Board staff is developing proposed amendments that it believes are an important first step in enhancing the transparency and consistency of the Board's treatment of control under the BHC Act. If adopted, they will make public, in regulatory form, the FRS's principal control views and subject them to comment. The principal amendments being considered include:

- Incorporation of the 25% of total equity test as a rebuttable presumption of control and inclusion of a regulatory exception to the 25% of total equity test;
- Incorporation and liberalization of the passivity commitments applicable to 10-24.9% investors;
- Incorporation and liberalization of the Board's positions on "prior control";
- Incorporation of a significant amount of interpretive material about how to calculate what percentage of the total equity of an investee is controlled by an investor;
- Increased clarity about control of investment funds;
- Increased clarity about the treatment of options, warrants, and convertibles;
- Increased clarity about the attribution of shareholdings by officers and directors to their companies; and
- Increased clarity about the treatment of tiered investments (i.e., investments by an investor in both a parent of the target and a subsidiary of the target).

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the occurrence of a remote contingency.

J. Preemption powers

The OTS historically has been viewed as having stronger preemption powers with respect to federal savings associations than the OCC has had with respect to national banks. The OCC's recent preemption rules, which were upheld by the Supreme Court in 2007, have weakened the OTS's perceived "lead" in this area. Nevertheless, the OTS's longstanding and strong preemption rules have been cited as one reason why some firms prefer owning a thrift over a bank. The OTS and OCC preemption authority applies only to federal savings associations and national banks, respectively; they do not apply at the holding company level.

The FRS generally does not have the power to preempt state laws as they apply to FHCs, and thus there is little the FRS can do directly in this area. BHCs (and state member banks)—as well as thrift holding companies—are chartered under the laws of the states, not the federal government, and thus generally are subject to state law unless Congress affirmatively provides otherwise.

Nevertheless, there are some changes that could be made to enhance the powers of FHCs and non-FHC BHCs in relation to what their national bank subsidiaries can do, although they would not preempt state law. The range of activities permissible for the bank subsidiaries of a BHC is not static. The OCC, for example, may continue to expand the range of activities that are considered "part of the business of bank" or incidental thereto under the National Bank Act, and thus permissible for a national bank to conduct.

Adopt a "wildcard" rule for FHC activities

- The Board, with Treasury consultation, could adopt a "wildcard" rule finding that any activity authorized for a national bank is "financial in nature" and thus permissible for FHCs to conduct.

Issues Requiring Congressional Action

Restrictions on Activities Permissible for BHCs that are not FHCs

The GLB Act "closed" the scope of activities permissible for BHCs that do not qualify and elect to become an FHC. Specifically, the act does not allow the Board to determine that additional activities are "closely related to banking" under section 4(c)(8) of the BHC Act and thus permissible for all BHCs. Instead, non-FHC BHCs are permitted to engage only in those activities that the Board had determined by order or regulation to be "closely related to banking" as of November 12, 1999 (the date of enactment of the GLB Act).

These restrictions—when combined with the aforementioned fact that the range of activities permissible for bank subsidiaries is not static—mean that the bank subsidiaries

of BHCs currently may engage in some activities that BHCs cannot (e.g., many insurance sales activities, finder activities). The disparity between the activities permissible for a non-FHC BHC itself and its national bank subsidiary is likely to grow over time.

- Congress could amend the BHC Act to "re-open" the Board's ability to determine that activities are "closely related to banking" and permissible for all BHCs. The Board proposed such an amendment in connection with the Financial Services Regulatory Relief Act of 2006, but this amendment ultimately was not adopted.

- If Congress were to amend the BHC Act in this manner, the Board could consider adopting a "wildcard" rule finding that any activity authorized for a national bank is "closely related to banking" for purposes of section 4(c)(8).

Capital Issues

Four of the fourteen issues involve capital regulation:

K – Consolidated Tier 1 leverage ratio requirements
L – Capital issue that will not be addressed by Basel II implementation
M – Capital issues prior to the implementation of Basel II
N – Capital structure reliance on Tier 1 vs. Tier 2

K. Consolidated Tier 1 leverage ratio requirements

The FRS requires all BHCs to meet a minimum 3 or 4 percent Tier 1 leverage ratio – that is, a ratio of Tier 1 capital to total on-balance sheet assets. Industry sentiment is that the Tier 1 leverage capital requirements are punitive for low-risk activities, e.g., matched books of securities financing transactions. A related issue is that the market perceives that the FRS holds BHCs to an informal 5% leverage ratio floor to be deemed well-capitalized.[16]

Both existing FHCs and non-FHCs have expressed the opinion that the application of the above-mentioned leverage ratio standards makes BHCs less competitive against their peers.

Concerned that the traditional calculation of the leverage ratio put it at a disadvantage relative to competitors, Citigroup recently decided to target a 5% "modified" leverage ratio that excludes securities financing assets[17] from the denominator and a minimum 4% "ordinary" leverage ratio that includes securities financing assets. JPMC is discussing

[16] BHCs are technically not subject to a leverage ratio minimum as a requirement of being well-capitalized.
[17] Reverse repurchase agreements and securities borrowings collateralized by cash.

making a similar modification to its leverage ratio target. U.S. securities firms and European banking peers, which engage more heavily in securities financing transactions, are not subject to any regulatory leverage ratio requirement.

Separately, a large securities firm has told FRS staff that the perceived 5% leverage ratio floor is a significant impediment to seeking FHC status, noting the issue again in the context of securities financing assets.

Make two improvements concerning application of the consolidated leverage ratio standards, to apply to all BHCs

The recent Citigroup case illustrates an example where the FRS was able to use the flexibility in the FHC framework to address concerns raised by a firm. However, there are improvements that the FRS could make that would be more broadly applicable to BHCs as a whole:

- Revise the definition of the leverage ratio for all BHCs to exclude securities financing transactions from the denominator.

- Make public and explicit that there is no 5% leverage ratio floor for BHCs, and that falling below that level would not necessarily reflect negatively on a supervised entity, depending on the reasons for the decrease and taking into account other supervisory factors.

In the longer term, the FRS could also consider eliminating the leverage ratio entirely at the holding company level for some or all BHCs or excluding other low-risk assets from the denominator.

L. Capital issue that will not be addressed by Basel II implementation

Some FRS risk-based capital standards for BHCs result in regulatory capital treatment disparities where similar activities are conducted in banking and non-bank firms. Some of these will persist, even beyond Basel II implementation (and the improvements provided by Basel II will only come into effect years from now and for only a select set of institutions).

An issue that will persist revolves around the treatment of deferred tax liabilities. The current deduction from Tier 1 capital of goodwill acquired in a nontaxable purchase business combination does not allow for netting of associated deferred tax liabilities, resulting in an effective double deduction. Other bank regulatory agencies agree this treatment is inappropriate, although years of interagency discussions have not led to a resolution.

Revise the consolidated Capital Adequacy Guidelines for goodwill

- Revise the Capital Adequacy Guidelines for BHCs to permit netting of associated deferred tax liabilities when goodwill that is acquired in a nontaxable purchase business combination is deducted from Tier 1 capital.

M. Capital issues prior to the implementation of Basel II

As noted, some FRS risk-based capital standards for BHCs result in regulatory capital treatment disparities where similar activities are conducted in banking and non-bank firms. Some of these differences will no longer be relevant for a subset of firms once the Basel II and New Market Risk Rule frameworks are implemented. However, the improvements provided by Basel II will only come into effect years from now (with implementation occurring over the course of 2009-2012).

Revise certain capital standards to be more consistent with improvements that firms are expected to have under Basel II

- Repurchase & reverse repurchase agreements: Adjust the risk-based capital charges on repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions collateralized by corporate bonds and equities, so that their treatment is more risk-based and consistent with rules for non-BHCs.
    - Too much capital is assessed against reverse repurchase agreements on agency securities and corporate debt and equity, and on securities lending transactions collateralized by corporate bonds and equities. Repurchase agreements pose equivalent risk yet incur no capital charges.
    - Under Basel II, banks will have the option of calculating capital for these transactions through either the adjusted LGD approach or adjusted EAD approach.
    - *The FRS could revise the Basel I treatment of these transactions by permitting, under Basel I capital rules, some of the simpler Basel II approaches to these transactions – such as standard supervisory haircuts, own-estimates of haircuts, or VaR models.*
- Margin loans made by broker-dealers: Substantially decrease the risk weight on Regulation T margin loans made by securities broker-dealers.
    - The 100% risk weight on Reg. T margin loans made by securities broker-dealers is very high and is arguably the most disproportionate relative to risk under the current capital framework, in light of the collateralization associated with these assets.

- Basel II will allow firms to calculate risk-based capital requirements for margin loans using several options. Many sources predict a significant decrease in the resulting effective risk weight, with estimates in the 0-20% range for risk weights.

- *The FRS could revise the Basel I treatment of these transactions by lowering their risk weight to 10%, consistent with several exemptions that the FRS has already provided Citigroup and Wachovia.*

- Securities fails: Exempt securities fails from a capital charge in the first five days after fail and, after that, risk weighting or deducting the current positive exposure.

  - Securities fails treatment is perceived as stringent, with the full notional amount of securities fails risk weighted from the first day of fail.

  - Once Basel II is effective, treatment of securities fails will be the same under both bank/BHC and securities firm capital rules: after a 5-business day grace period, the positive current exposure (difference between the transaction valued at the agreed settlement price vs. at current market price) will be assessed a capital charge based on how much time has lapsed since the contractual settlement date. There will be no capital charge during the first 5 business days after the fail.

  - *The FRS could revise the Basel I treatment of these transactions to conform to the simple, less punitive, more risk sensitive Basel II treatment.*

- Exposures to certain securities broker-dealers: Expand the universe of securities broker-dealers whose exposures are eligible to have a 20% risk weight applied.

  - Under the FRS's existing risk-based capital rules for banks and BHCs, a 20% risk weight on exposures to securities broker-dealers can be applied only if: (i) the broker-dealer itself is rated at least A by an NRSRO, or (ii) its parent has at least an A rating by an NRSRO and guarantees the specific claim.

  - Under Basel II, risk weighted assets for exposures to broker-dealers will depend on the risk parameters associated with that obligor.

  - *The FRS could revise the Basel I treatment of these claims by providing the 20% risk weight to: (i) all claims on SEC-registered broker-dealers (and foreign equivalents), and (ii) all claims on SEC-registered broker-dealers (and foreign equivalents) that have a parent with an A rating from an NRSRO.*

These standards, as detailed above, should be revised in the interim before Basel II takes effect. Any changes would preferably be achieved through the interagency capital rule-making process, although unilateral FRS action might be considered if it deems the interagency process is not functioning expeditiously or at all.

N. Capital structure reliance on Tier 1 vs. Tier 2

Some industry participants contend that non-bank led FHCs are at a disadvantage to bank-led FHCs, since the latter rely more on cheaper Tier 2 capital such as subordinated debt. For example, one non-bank led FHC reported that its reliance on Tier 1 capital (equity) put it at a funding disadvantage relative to competitors. The appropriateness of BHC reliance on Tier 2 capital elements to meet regulatory capital requirements has been questioned.

Revise the consolidated Capital Adequacy Guidelines for non-bank led FHCs

- For the "non-bank led FHC" category of the Consolidated Supervision framework (suggested under section "A - Our supervisory approach to holding companies"), the FRS could explore the option of primarily evaluating capital adequacy at non-bank led FHCs based on Tier 1 capital levels and ratios (i.e., deemphasize or eliminate total capital ratio and leverage ratio requirements) and communicate this approach publicly.

IV. ABOUT THE WORKGROUP

Process

The workgroup held its kick-off meeting in December 2006, eventually drawing on the expertise of 36 participants drawn from the FRBNY, Board, and FRBSF in areas such as Bank Supervision, Legal, and Research and Statistics.

We began by reviewing previous related studies done within the FRS to ensure that our work leveraged and built upon existing knowledge:

- 2006 FRBNY Policy memos with preliminary work on impediments to FHC status and alternative legal structures
- 2005 Board Research and Statistics project on FHC status
- 2001 FRBNY regulatory burden project
- 2001 FRBNY Legal memos comparing regulatory and supervisory schemes for a bank, BHC, broker-dealer, & software company
- 2000 FRBNY Research & Statistics (Philip Strahan) memo on mixing financial and non-financial activities
- 2000 FRBNY Legal memos on supervision and regulation of insured banks, BHCs, and registered broker-dealers

We next held meetings with the following representatives to better understand areas where the FRS may make meaningful improvements to its FHC oversight:

- Industry experts from three law firms (Cleary Gottlieb, Shearman & Sterling, and Sullivan & Cromwell) plus one consulting firm (Ernst & Young)

- The CPCs for five current or former FHCs (Countrywide, Franklin Resources, Manulife, MetLife, and Schwab) [18]

A list of questions was provided to each in advance – see Attachment (b). The information learned from these interviews enabled us to identify fourteen areas of concern pertaining to our FHC program, ranging from supervisory and regulatory topics to capital issues to matters relating to activities restrictions. The discussions also provided a sense of which areas were *not* high priority to industry and thus where we should not focus our efforts at this time – see Attachment (c).

The workgroup subsequently broke into subcommittees to perform additional analysis and to develop recommendations that form the basis of this report and are summarized in Attachment (a).

[18] Richard Shershenovich (Countrywide), Lee Kapos (Franklin Resources), Kara Sulmasy (Manulife), Kara Sulmasy with Elise Liebers (MetLife), and Bill Andrews (Schwab).

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Attachment (a)

SUGGESTED CHANGES TO OUR FHC PROGRAM

	Potential Improvement	Change in Statute, Regulation,Guidance or Practice?	Related Issue	Page of Main Report
1	Amend BHC Act to eliminate need for the Board to consult with Treasury in determining new financial/incidental activities.	Statutory	C – New activity approval process	16
2	Amend BHC Act to lower the standards for remaining (but not for becoming) an FHC.	Statutory (12 USC § 1843(m)) or regulatory (12 CFR § 225.83)	D – Section 4(m) process	18
3	Revise BHC Act's definitions of "well capitalized" (to adequately capitalized or a well capitalized average over a period of time) and "well managed" (to link to findings in exam reports rather than composite CAMELS & management component ratings).	Statutory	D – Section 4(m) process	18
4	Amend the BHC Act to "re-open" the Board's ability to determine that activities are "closely related to banking" and permissible for *all BHCs.* Subsequently, adopt a "wildcard" rule finding that any activity authorized for a national bank is "closely related to banking" and thus permissible for all BHCs.	Statutory	J – Preemption powers	26
5	Review internal procedures to reduce processing time for determinations in all three FHC activity categories (financial, incidental, complementary).	Regulation (12 CFR §225.88-89) and practice.	C – New activity approval process	15
6	Shorten prior notice periods for complementary activities previously approved for other FHCs.	Regulatory (12 CFR § 225.89)	C – New activity approval process	15
7	Give Reserve Banks delegated authority to approve complementary activities previously approved for other FHCs.	Regulatory (12 CFR § 225.89, 265.11(c))	C – New activity approval process	15

Attachment (a) SUGGESTED CHANGES TO OUR FHC PROGRAM				
	Potential Improvement	**Change in Statute, Regulation,Guidance or Practice?**	**Related Issue**	**Page of Main Report**
8	Eliminate regulatory requirement that FHCs under 4(m) agreements must seek Board approval before engaging in new FHC activities or buying companies engaged in FHC activities. Board retains discretion to impose these and other conditions. Alternatively, modify the rule to clarify cases in which the Board could waive the prior approval requirement, or grant an FHC a blanket approval.	Regulatory. 12 CFR § 225.83(d)(2).	D – Section 4(m) process	17
9	Expand definition of "private equity fund" to include funds managed by another investor, even if an FHC owns more than 25% of the fund's equity *[part of the ongoing Reg. Y review].*	Regulatory	F – Merchant banking	21
10	Improve transparency of how merchant banking rules apply to, and the options that FHCs have in structuring their investments in, funds and real estate ventures *[part of the ongoing Reg. Y review].*	Regulatory	F – Merchant banking	21
11	Adopt a principles-based merchant banking framework in which firms must demonstrate compliance with the regulatory principles.	Regulatory. 12 CFR §§ 225.170-71.	F – Merchant banking	21
12	Permit cross-marketing activities with entities held by an FHC through other types of funds (such as hedge funds) that the FHC does not control.	Regulatory	F – Merchant banking	22
13	Allow cross-marketing activities with entities that an FHC could hold under other authorities besides 4(c)(6), such as under SBIC or Reg. K investment authority.	Regulatory	F – Merchant banking	22

Attachment (a) SUGGESTED CHANGES TO OUR FHC PROGRAM				
	Potential Improvement	**Change in Statute, Regulation,Guidance or Practice?**	**Related Issue**	**Page of Main Report**
14	Analyze possible changes to merchant banking rules to facilitate real estate investment activities of FHCs *[part of the ongoing Reg. Y review].*	Regulatory	G – Real estate	22
15	Continue to monitor political and industry environment for opportunities to expand FHCs' abilities to engage in real estate brokerage and/or management after the Congressional prohibition on these activities expires in two years.	Regulatory, possibly in consultation with Treasury.	G – Real estate	23
16	Move physical commodity trading to the "financial in nature" or "incidental" category from the complementary category, working with Treasury.	Regulatory, in consultation with Treasury. (The statutory provision that gives the Board this authority is in Section 4(k)(1) of the BHC Act.)	H – Commodities	23
17	Approve expansion of complementary authority for energy tolling agreements. Expedite subsequent approvals for future FHCs wishing to perform commodity-related complementary activities.	Regulation and practice.	H – Commodities	24
18	Research and approve applications for new relevant commodities activities, e.g., ones similar to energy management agreements and energy tolling agreements, but for commodities other than energy.	Regulation and practice. (The statutory provision that gives the Board this authority is in Sec. 4(k)(1) of the BHC Act.) This may also involve proactive guidance to FHCs on the kind of activities that the Board might approve of.	H – Commodities	24
19	Approve proposed Reg. Y amendments enhancing the transparency and consistency of the FRS's control views, including on control of investment funds, and especially liberalizing views on control of company and control of shares *[part of the ongoing Reg. Y review].*	Regulatory. 12 CFR §§ 225.31(d),(e).	I – Control rules	24

Attachment (a)

SUGGESTED CHANGES TO OUR FHC PROGRAM

	Potential Improvement	Change in Statute, Regulation,Guidance or Practice?	Related Issue	Page of Main Report
20	Adopt a "wildcard" rule finding that any activity authorized for a national bank is "financial in nature" and thus permissible for FHCs.	Regulatory change (12 CFR § 225.86(d)) and likely consultation with Treasury.	J – Preemption powers	26
21	Revise definition of leverage ratio for BHCs to exclude secured financing transactions from the denominator.	Regulatory. 12 C.F.R. § 225 App. B.	K – Consolidated Tier 1 leverage ratio requirements	28
22	Create a "non-bank led FHCs" category (within the Consolidated Supervision framework) for firms where the bank DI is a small component of the overall entity. FRS supervision could rely more heavily on off-site monitoring and allow for supervisory judgment for individual firms on elements such as the nature of exam activities and application of capital adequacy ratios.	Guidance, including that for consolidated supervision and potentially including SR 04-18 (Bank Holding Company Rating System).	A – Our supervisory approach to holding companies	10
23	Clarify that a complementary determination does not foreclose a future financial/incidental classification.	Guidance: either issue an interpretation or guideline, or add specific language to orders approving activities as complementary.	C – New activity approval process	16
24	Request FR Y-7 information for only the top-tier level of minority investments in foreign companies doing business in the U.S.	Guidance (although may also require revising related control provisions of Regulation K)	E – Regulatory reporting requirements	19
25	Revise BHC Capital Adequacy Guidelines to permit netting of associated deferred tax liabilities when goodwill acquired in a nontaxable purchase business combination is deducted from Tier 1 capital.	Guidance. 12 C.F.R. § 225 App. A.	L – Capital issue that will not be addressed by Basel II implementation	29

Attachment (a) SUGGESTED CHANGES TO OUR FHC PROGRAM				
	Potential Improvement	**Change in Statute, Regulation,Guidance or Practice?**	**Related Issue**	**Page of Main Report**
26	Revise certain capital standards in the interim before Basel II takes effect by: (i) adjusting the capital charges on repurchase agreements, reverse repos, and securities lending & borrowing collateralized by corporate bonds and equities; (ii) decreasing the risk weight on Reg. T margin loans made by broker dealers; (iii) exempting securities fails from a capital charge in the first five days after fail and, after that, risk weighting or deducting the current positive exposure; and (iv) expanding the universe of securities broker-dealers whose exposures are eligible to have a 20% risk weight applied.	Guidance.	M – Capital issues prior to the implementation of Basel II	29
27	For the "non-bank led FHC" category of the Consolidated Supervision framework (suggested above), explore primarily evaluating capital adequacy at non-bank led FHCs based on Tier 1 capital levels and ratios (deemphasize total capital ratios and leverage ratios) and communicate this approach publicly.	Guidance. 12 C.F.R. § 225 App. A, B.	N – Capital structure reliance on Tier 1 vs. Tier 2	31
28	Develop an outreach program that targets current and potential FHCs, consultancies (law firms and consulting companies), and rating agencies, to explain FHC status and FRS approach to supervision.	Practice.	A – Our supervisory approach to holding companies	11
29	Create a Horizontal Feedback Taskforce to define and monitor the process whereby the FRS shares peer perspectives. Responsible for establishing a project management framework to monitor information-sharing, and creating mechanisms to deliver "hot topic" sheets to industry.	Practice.	A – Our supervisory approach to holding companies	12
30	Develop formal protocols between regulators to share with industry our feedback from horizontals and other cross-institutional information gathering exercises.	Practice, agreements.	A – Our supervisory approach to holding companies	12

Attachment (a)

SUGGESTED CHANGES TO OUR FHC PROGRAM

	Potential Improvement	Change in Statute, Regulation,Guidance or Practice?	Related Issue	Page of Main Report
31	Investigate current cases of delayed supervisory guidance and either allocate resources to complete them or adjust the process to minimize these impediments.	Practice.	A – Our supervisory approach to holding companies	13
32	Make supervisory guidance more accessible by creating searchable indexed public databases of all public supervisory guidance.	Practice.	A – Our supervisory approach to holding companies	13
33	Hold discussions with FRS, SEC, and OTS about consolidated supervisory practices and more consistent practices in areas, e.g., reporting requirements.	Practice, reporting requirements.	A – Our supervisory approach to holding companies	13
34	Create a preliminary proposal laying out agencies' roles and duties, and develop mechanisms to reduce duplication. Follow with inter-agency discussions. This should include a review of which additional bilateral and multilateral information-sharing MOUs are needed.	Practice, agreements.	B – Duplication in the supervisory process between agencies	14
35	Work with other agencies to develop a consistent approach to reviewing consumer protection issues, to ensure that the burden of added oversight does not fall unduly on FHCs. The interagency pilot project to improve supervision of subprime mortgage lenders is one forum for this.	Practice.	B – Duplication in the supervisory process between agencies	14
36	Draft proposal to improve FRS access to supervisory information of primary bank and functional regulators through repositories such as BOND. Review whether FRS should do more under SR 99-15 to communicate expectations for what materials will be shared electronically.	Practice.	B – Duplication in the supervisory process between agencies	14

Attachment (a)

SUGGESTED CHANGES TO OUR FHC PROGRAM

	Potential Improvement	Change in Statute, Regulation,Guidance or Practice?	Related Issue	Page of Main Report
37	Review possibility of more single-event reviews, in which the separate planning phase is eliminated; whether full LFIT vettings are needed after each review; and any other changes facilitating possible joint reviews with OCC or other regulators.	Practice.	B – Duplication in the supervisory process between agencies	15
38	Board staff could actively seek activity determination requests and proactively make activity determinations.	Practice.	C – New activity approval process	16
39	Discuss with the SEC whether and when it could be appropriate for FHCs to not disclose that they have entered into 4(m) agreements.	Practice, agreements.	D – Section 4(m) process	18
40	Make public and explicit that there is no 5% leverage ratio floor for BHCs, formally or informally.	Practice. Could also be done by amending regulations at 12 C.F.R. § 225 App. B.	K – Consolidated Tier 1 leverage ratio requirements	28

Attachment (b)

INDUSTRY QUESTIONNAIRE

I. Regulation & Supervision of Financial Holding Companies (FHCs)

A. What are the primary reasons that few non-FHC financial firms are interested in electing FHC status?

B. What do you perceive as the primary advantages to being an FHC as compared to alternative structures?

C. What do you perceive as the primary disadvantages to FHC status?

D. Activities that are impermissible or subject to restrictions for FHCs

- Are there any impermissible activities or limitations on permissible activities for FHCs that are important in considering whether or not to adopt FHC status?

- Would approval of any new activities or removal of limitations on any currently permissible activities meaningfully improve the FHC regulatory regime?

E. Currently, firms may conduct similar/equivalent activities through legal entities subject to different regulatory or supervisory regimes (banking, securities, insurance).

- For each of these activities, what are the significant advantages or disadvantages of different legal vehicles?

- In the context of these advantages and disadvantages, which particular regulations are especially burdensome, inefficient, or ineffective and why?

    - What are your suggestions for alternative approaches to achieve the purposes that these regulations are intended to accomplish?

F. Is the Fed's consolidated supervision beneficial to FHCs? How is it most beneficial? Are there ways it could be improved?

- Please identify any positive or negative experiences that you have had with – or strengths or weaknesses you see in – the Federal Reserve's FHC rulemaking, applications, and supervisory processes (including, if applicable, with the annual Federal Reserve supervisory plan process).

- Do firms find the SEC's or OTS' consolidated supervision beneficial? What are the principal respects in which SEC or OTS consolidation supervision is better than or worse than Fed consolidated supervision?

II. FHC Consolidated Capital Rules

G. How could the Fed's FHC consolidated regulatory capital rules be improved?

- Do you believe that the Federal Reserve's existing risk-based capital charges for any exposure type exceed the risk associated with the exposure type to such an extent that they materially impair the ability of FHCs to grow those exposures?
- Are there capital instruments for which the Fed should give FHCs greater tier 1 or tier 2 capital credit?
- Is the leverage ratio a concern? In what respects?
- Do the Fed's total risk-based capital requirements for FHCs serve as a material impediment to adopting FHC status for firms that historically have not issued instruments that would qualify as tier 2 capital under the Fed's FHC capital rules?

III. Alternatives to FHC Status

H. What would be the major reasons a firm would choose to structure itself as one of the following rather than as an FHC?

- A thrift holding company under OTS supervision?
- A consolidated supervised entity (CSE) under SEC supervision?
- A parent of an ILC under FDIC supervision?

IV. Any additional thoughts?

Attachment (c) ISSUES NOT PURSUED		
Potential Area of Concern	**Potential Improvement**	**Why Not Pursuing**
Banking-commerce separation • Review separation as a fundamental first principle. 12 USC 1843 • How far have we already gone down the slippery slope in light of our current regs? Given this, is there any rationale for banking & commerce separation? • Think through our rhetoric, e.g., our speeches on ILCs are defensive of the separation.		Not identified as an issue in industry expert interviews.
Capital rulemaking: interagency process • Issues not considered priority by all agencies—e.g., capital issues for FHC activities not conducted in banks—may languish in rulemaking process. • OTS doesn't have specified minimum consolidated capital requirement for THCs. [19] SEC provides, to broker-dealers owned by CSEs, capital benefits under alternative net capital regime.		Not identified as an issue in industry expert interviews.
Derivatives • Restrictions on the types of derivatives transactions that BHCs can participate in.		These restrictions pertain to BHCs that are *not* FHCs and do not have a Section 20 subsidiary (but not to FHCs).

[19] Countrywide's CPC team noted a statement in the firm's Capital Structure document that, as a THC, it will be required to maintain capital sufficient to support its business operations but will no longer be subject to detailed & prescriptive risk-based capital requirements at the holding company level, as is the case for BHCs. In addition, Countrywide will not have explicit Tier I capital requirements nor will its Tier II capital be explicitly limited to 100% of its Tier I capital. Furthermore, the document notes that Basel II applies to thrifts but not to their holding companies. For banks, Basel II applies to both.

Attachment (c) ISSUES NOT PURSUED		
Potential Area of Concern	**Potential Improvement**	**Why Not Pursuing**
DPC (debt previously contracted) property • A nonbanking acquisition of property acquired in foreclosure does not require prior Board approval if it's sold within 2 years. Board can approve extensions for up to 3 extra years & additional extensions for up to 5 years. 12 CFR 225.22(d) • Can the 2+3+5 be simplified? • The reg has received differing interpretations.		A statutory issue that no one complains much about. Not identified as an issue in industry expert interviews.
Enforcement of rules applicable to BHCs • *CRE* (commercial real estate) guidance: almost no large institutions are concerned about this. *Non-traditional mortgage* guidance: impacts large institutions more than CRE guidance. Both guidances are aimed at banks but apply also to BHCs. • *BSA/AML:* Rigidity of law leaves less room for reg/supe flexibility. Tim Geithner priority (Strategic Objectives Conference).	• *BSA/AML:* Separately, FRBNY BSG is reviewing its AML supervisory program.	• Not identified as issues in industry expert interviews. • BSA/AML is an issue about US competitiveness vs. rest of world, not FHCs relative to securities firms.
Enforcement of DI-level rules: inconsistent enforcement among agencies • *Anti-tying:* BHC Act imposes a more stringent anti-tying standard on BHCs compared with other financial service firms. 12 USC 1971. Exists for thrifts [12 USC 1464(q)] but is apparently limited to retail insurance. IBs favor strong anti-tying rules, believing they put FHCs at disadvantage. Community banks possibly also favor strong rules, believing that makes them more competitive with full-service banks. • *CRA* & other consumer regulations: (i) application process & reporting infrastructure noted as burdensome; (ii) truth-in-lending & disclosure of annual percentage rates regulations noted as excessive (both from FRBNY 2001 Regulatory Burden Project). • *Reg. O:* A thought posed in a 2/20/01 Legal memo: Is Reg. O necessary, or are extensions of credit by banks to insiders adequately "regulated" by fiduciary duty & market discipline? Reg O applies to small banks. (SOX has rules consistent w/ Reg O.) • *Reg. W*	• *Anti-tying:* See 68 *Federal Register* 51938 & 52024 (8/29/2003). [Draft interpretive statement clarifying rules; never finally acted upon.]	• Not identified as issues in industry expert interviews. • Anti-tying & Reg. O noted as having no FHC-specific connection.

Attachment (c) ISSUES NOT PURSUED		
Potential Area of Concern	**Potential Improvement**	**Why Not Pursuing**
Interstate branching • Thrifts have greater branching powers than banks and ILCs.		Not considered a significant concern today.
Push-out rule being promulgated by SEC & FRS • Per FRBNY 2001 Regulatory Burden Project: The GLB Act provision that banks register as broker-dealers for non-exempt securities activities raises operational risk. Banks that don't want to be B-Ders will retain exempt securities activities while non-exempt securities activities will be pushed out to B-D affiliates. • SEC's rulemaking process criticized for being inefficient & not providing enough opportunity for public comment.		• No FHC-specific connection. • Our views have already been stated, and the rule is almost done.
Reg. K • FRBNY 2001 Regulatory Burden Project noted this reg as burdensome. (QFBO definition doesn't count insurance activities as part of business of banking & prior notice/approval requirements on domestic banking organizations are burdensome). However, the report noted the Board had just approved comprehensive Reg. K revisions. • 2007 Naylor memo summarizes QFBO activities.	• Board currently working on Reg K revisions.	Not identified as an issue in industry expert interviews.

Attachment (c) ISSUES NOT PURSUED		
Potential Area of Concern	**Potential Improvement**	**Why Not Pursuing**
Reg. W (issues impacting mostly foreign banks) • 23A attribution rule: If a bank provides proceeds to a third-party that then go to a bank affiliate, this is considered the same as if the bank gave the proceeds to its affiliate. See Shearman & Sterling minutes: this problem will only get bigger. • FRBNY 2001 Regulatory Burden Project questioned purpose of applying 23A to FBOs that don't rely on insured domestic deposits as a source of funds. Counter-argument: 23A only applies to FBOs in merchant banking & a few other activities. The theory is competitive advantage: why should an FBO affiliate have unlimited access to a bank's balance sheet while a domestic FHC affiliate does not?	2001 project suggested, as possible work: • Explore extent to which competitive inequality would exist if 23A were no longer applied to FBOs without insured deposits. (Look at their funding sources & apply market insight as to how these sources might change were 23A rescinded.) • Examine extent to which 23A requirements result in complex/convoluted funding patterns that may contribute to lack of transparency or additional risk to firm. The attribution rule provision is in the statute, but Board has authority to liberalize the rule.	• 23A attribution rule: No FHC-specific connection. • The second area of concern was not identified as an issue in industry expert interviews.
SARS filing • Noted as burdensome in the FRBNY 2001 Regulatory Burden Project.		• Filing requirements apply to all financial institutions, so there would seem to be no change that would uniquely benefit FHCs. • Does not appear to be a factor in whether firms become or remain an FHC.
SR letters • SR letters can take on *de facto* regulatory status. • These letters accumulate. Do we ever withdraw any? • One industry expert noted that he possesses old SR letters that are no longer available on our public website.	• What specific SR letters/guidance are onerous? • Which SR letters: (i) need withdrawal or consolidation; or (ii) should become substantive regulation?	A group at Board is supposed to review body of SR letters. (Board website is not string searchable, making this difficult.)

Attachment (c) ISSUES NOT PURSUED		
Potential Area of Concern	**Potential Improvement**	**Why Not Pursuing**
Subjectivity of well-managed requirement & FDIC power • Subjectivity of this requirement at the DI level adds uncertainty & risk and puts FHCs at the mercy of FDIC. See E&Y and Shearman & Sterling minutes.	• Work with FDIC to set more specific parameters or defined methods for their ratings?	An issue for small, not big, FHCs.