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Part

CHAPTER II—Federal Reserve System 201

CROSS REFERENCES: Farmers Home Administration: See Agriculture, 7 CFR, chapter XVIII.
Office of Assistant Secretary for Housing—Federal Housing Commissioner, Department of Housing and Urban Development: See Housing and Urban Development, 24 CFR, chapter II.
Fiscal Service: See Money and Finance: Treasury, 31 CFR, chapter II.
Monetary Offices: See Money and Finance: Treasury, 31 CFR, chapter I.
Commodity Credit Corporation: See Agriculture, 7 CFR, chapter XIV.
Small Business Administration: See Business Credit and Assistance, 13 CFR, chapter I.
Rural Electrification Administration: See Agriculture, 7 CFR, chapter XVII.

CHAPTER II—FEDERAL RESERVE SYSTEM

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SUPPLEMENTAL PUBLICATIONS: *The Federal Reserve Act, as amended through December 31, 1976, with an Appendix containing provisions of certain other statutes affecting the Federal Reserve System. Rules of Organization and Procedure—Board of Governors of the Federal Reserve System.*

Regulations of the Board of Governors of the Federal Reserve System. The Federal Reserve System—Purposes and Functions. Annual Report. Federal Reserve Bulletin. Monthly. Federal Reserve Chart Book Quarterly; Historical Chart Book issued in September.

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

PART 201—EXTENSIONS OF CREDIT BY FEDERAL RESERVE BANKS (REGULATION A)

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AUTHORITY: 12 U.S.C. 343 *et seq.*, 347a, 347b, 347c, 347d, 348 *et seq.*, 357, 374, 374a and 461.

SOURCE: 45 FR 54010, Aug. 14, 1980, unless otherwise noted.

§ 201.1 Authority, scope and purpose.

(a) *Authority and scope.* This part is issued under the authority of sections 10A, 10B, 13, 13A, and 19 of the FRA (12 U.S.C. 347a, 347b, 343 *et seq.*, 347c, 348 *et seq.*, 374, 374a, and 461), other provisions of the FRA, and section 7(b) of the International Banking Act of 1978 (12 U.S.C. 347d) and relates to extensions of credit by Federal Reserve Banks to depository institutions and others.

(b) *Purpose.* This part establishes rules under which Federal Reserve Banks may extend credit to depository institutions and others. Extending credit to depository institutions to accommodate commerce, industry, and agriculture is a principal function of Federal Reserve Banks. While open market operations are the primary means of affecting the overall supply of reserves, the lending function of the Federal Reserve Banks is an effective method of supplying reserves to meet the particular credit needs of individual depository institutions. The lending functions of the Federal Reserve System are conducted with due regard to the basic objectives of monetary policy and the maintenance of a sound and orderly financial system.

[58 FR 68512, Dec. 28, 1993]

§ 201.2 Definitions.

For purposes of this part, the following definitions shall apply:

(a) *Appropriate Federal banking agency* has the same meaning as in section 3 of the FDI Act (12 U.S.C. 1813(q)).

(b) *Critically undercapitalized insured depository institution* means any insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813(c)(2)) that is deemed to be critically undercapitalized under section 38 of the FDI Act (12 U.S.C. 1831o(b)(1)(E)) and the implementing regulations.

(c)(1) *Depository institution* means an institution that maintains reservable transaction accounts or nonpersonal time deposits and is:

(i) An *insured bank* as defined in section 3 of the FDI Act (12 U.S.C. 1813(h)) or a bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(ii) A *mutual savings bank* as defined in section 3 of the FDI Act (12 U.S.C. 1813(f)) or a bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(iii) A *savings bank* as defined in section 3 of the FDI Act (12 U.S.C. 1813(g)) or a bank which is eligible to make application to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(iv) An *insured credit union* as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752(7)) or a credit

union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act (12 U.S.C. 1781);

(v) A *member* as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422(4)); or

(vi) A *savings association* as defined in section 3 of the FDI Act (12 U.S.C. 1813(b)) which is an insured depository institution as defined in section 3 of the Act (12 U.S.C. 1813(c)(2)) or is eligible to apply to become an insured depository institution under section 5 of the Act (12 U.S.C. 1815(a)).

(2) The term *depository institution* does not include a financial institution that is not required to maintain reserves under Regulation D (12 CFR part 204) because it is organized solely to do business with other financial institutions, is owned primarily by the financial institutions with which it does business, and does not do business with the general public.

(d) *Liquidation loss* means the loss that any deposit insurance fund in the FDIC would have incurred if the FDIC had liquidated the institution:

(1) In the case of an undercapitalized insured depository institution, as of the end of the later of:

(i) Sixty days:

(A) In any 120-day period;

(B) During which the institution was an undercapitalized insured depository institution; and

(C) During which advances or discounts were outstanding to the depository institution from any Federal Reserve Bank; or

(ii) The 60 calendar day period following the receipt by a Federal Reserve Bank of a written certification from the Chairman of the Board of Governors or the head of the appropriate Federal banking agency that the institution is viable.

(2) In the case of a critically undercapitalized insured depository institution, as of the end of the 5-day period beginning on the date the institution became a critically undercapitalized insured depository institution.

(e) *Increased loss* means the amount of loss to any deposit insurance fund in the FDIC that exceeds the liquidation loss due to:

(1) An advance under section 10B(1)(a) of the FRA that is outstanding to an undercapitalized or critically undercapitalized insured depository institution without payment having been demanded as of the end of the periods specified in paragraphs (d)(1) and (2) of this section; or

(2) An advance under section 10B(1)(a) of the Federal Reserve Act that is made after the end of such periods.

(f) *Excess loss* means the lesser of the increased loss or that portion of the increased loss equal to the lesser of:

(1) The loss the Board of Governors or any Federal Reserve Bank would have incurred on the amount by which advances under section 10B(1)(a) exceed the amount of advances outstanding at the end of the periods specified in paragraphs (d)(1) and (2) of this section if those increased advances had been unsecured; or

(2) The interest received on the amount by which the advances under section 10B(1)(a) exceed the amount of advances outstanding, if any, at the end of the periods specified in paragraphs (d)(1) and (2) of this section.

(g) *Transaction account and nonpersonal time deposit* have the meanings specified in Regulation D (12 CFR part 204).

(h) *Undercapitalized insured depository institution* means any insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813(c)(2)) that:

(1) Is not a critically undercapitalized insured depository institution; and

(2)(i) Is deemed to be undercapitalized under section 38 of the FDI Act (12 U.S.C. 1831o(b)(1)(C)) and the implementing regulations; or

(ii) Has received from its appropriate Federal banking agency a composite CAMEL rating of 5 under the Uniform Financial Institutions Rating System (or an equivalent rating by its appropriate Federal banking agency under a comparable rating system) as of the most recent examination of such institution.

(i) *Viable*, with respect to a depository institution, means that the Board of Governors or the appropriate Federal banking agency has determined,

giving due regard to the economic conditions and circumstances in the market in which the institution operates, that the institution is not critically undercapitalized, is not expected to become critically undercapitalized, and is not expected to be placed in conservatorship or receivership. Although there are a number of criteria that may be used to determine viability, the Board of Governors believes that ordinarily an undercapitalized insured depository institution is viable if the appropriate Federal banking agency has accepted a capital restoration plan for the depository institution under 12 U.S.C. 1831o(e)(2) and the depository institution is complying with that plan.

(j) *Eligible institution* means a depository institution that is in sound financial condition in the judgment of the lending Federal Reserve Bank.

(k) *Targeted federal funds rate* means the federal funds rate targeted by the Federal Open Market Committee.

[58 FR 68512, Dec. 28, 1993, as amended at 64 FR 41769, Aug. 2, 1999]

§ 201.3 Availability and terms.

(a) *Adjustment credit*. Federal Reserve Banks extend adjustment credit on a short-term basis to depository institutions to assist in meeting temporary requirements for funds or to cushion more persistent shortfalls of fundspending an orderly adjustment of a borrowing institution's assets and liabilities. Such credit generally is available only for appropriate purposes and after reasonable alternative sources of funds have been fully used, including credit from special industry lenders such as Federal Home Loan Banks, the National Credit Union Administration's Central Liquidity Facility, and corporate central credit unions. Adjustment credit is usually granted at the basic discount rate, but under certain circumstances a special rate or rates above the basic discount rate may be applied.

(b) *Seasonal credit*. Federal Reserve Banks extend seasonal credit for periods longer than those permitted under adjustment credit to assist smaller depository institutions in meeting regular needs for funds arising from expected patterns of movement in their deposits and loans. A special rate or rates at or above the basic discount rate may be applied to seasonal credit.

(1) Seasonal credit is only available if:

(i) The depository institution's seasonal needs exceed a threshold that the institution is expected to meet from other sources of liquidity (this threshold is calculated as certain percentages, established by the Board of Governors, of the institution's average total deposits in the preceding calendar year);

(ii) The Federal Reserve Bank is satisfied that the institution's qualifying need for funds is seasonal and will persist for at least four weeks; and

(iii) Similar assistance is not available from special industry lenders.

(2) The Board may establish special terms for seasonal credit when depository institutions are experiencing unusual seasonal demands for credit in a period of liquidity strain.

(c) *Extended credit*. Federal Reserve Banks extend credit to depository institutions under extended credit arrangements where similar assistance is not reasonably available from other sources, including special industry lenders. Such credit may be provided where there are exceptional circumstances or practices affecting a particular depository institution including sustained deposit drains, impaired access to money market funds, or sudden deterioration in loan repayment performance. Extended credit may also be provided to accommodate the needs of depository institutions, including those with longer term asset portfolios, that may be experiencing difficulties adjusting to changing money market conditions over a longer period, particularly at times of deposit disintermediation. A special rate or rates above the basic discount rate may be applied to extended credit.

(d) *Emergency credit for others*. In unusual and exigent circumstances, a Federal Reserve Bank may, after consultation with the Board of Governors, advance credit to individuals, partnerships, and corporations that are not depository institutions if, in the judgment of the Federal Reserve Bank, credit is not available from other sources and failure to obtain such credit would adversely affect the economy.

The rate applicable to such credit will be above the highest rate in effect for advances to depository institutions. Where the collateral used to secure such credit consists of assets other than obligations of, or fully guaranteed as to principal and interest by, the United States or an agency thereof, an affirmative vote of five or more members of the Board of Governors is required before credit may be extended.

(e) *Special liquidity facility for century date change.* Federal Reserve Banks may extend credit between and including October 1, 1999, and April 7, 2000, or such later date as determined by the Board, under a special liquidity facility to ease liquidity pressures during the century date change period. This type of credit is available only to eligible institutions. This type of credit is granted at a special rate above the basic discount rate and other market rates for funds, is available for the entire length of the period, and is not subject to the conditions regarding specific use or exhaustion of other liquidity sources as is adjustment credit under paragraph (a) of this section.

[58 FR 68513, Dec. 28, 1993, as amended at 64 FR 41769, Aug. 2, 1999]

§ 201.4 Limitations on availability and assessments.

(a) *Advances to or discounts for undercapitalized insured depository institutions.* A Federal Reserve Bank may make or have outstanding advances to or discounts for a depository institution that it knows to be an undercapitalized insured depository institution, only:

(1) If, in any 120-day period, advances or discounts from any Federal Reserve Bank to that depository institution are not outstanding for more than 60 days during which the institution is an undercapitalized insured depository institution; or

(2) During the 60 calendar days after the receipt of a written certification from the Chairman of the Board of Governors or the head of the appropriate Federal banking agency that the borrowing depository institution is viable; or

(3) After consultation with the Board of Governors.[1]

(b) *Advances to or discounts for critically undercapitalized insured depository institutions.* A Federal Reserve Bank may make or have outstanding advances to or discounts for a depository institution that it knows to be a critically undercapitalized insured depository institution only:

(1) During the 5-day period beginning on the date the institution became a critically undercapitalized insured depository institution; or

(2) After consultation with the Board of Governors.[2]

(c) *Assessments.* The Board of Governors will assess the Federal Reserve Banks for any amount that it pays to the FDIC due to any excess loss. Each Federal Reserve Bank shall be assessed that portion of the amount that the Board of Governors pays to the FDIC that is attributable to an extension of credit by that Federal Reserve Bank, up to one percent of its capital as reported at the beginning of the calendar year in which the assessment is made. The Board of Governors will assess all of the Federal Reserve Banks for the remainder of the amount it pays to the FDIC in the ratio that the capital of each Federal Reserve Bank bears to the total capital of all Federal Reserve Banks at the beginning of the calendar year in which the assessment is made, provided, however, that if any assessment exceeds 50 percent of the total capital and surplus of all Federal Reserve Banks, whether to distribute the excess over such 50 percent shall be made at the discretion of the Board of Governors.

(d) *Information.* Before extending credit a Federal Reserve Bank should ascertain if an institution is an undercapitalized insured depository institution or a critically undercapitalized insured depository institution.

[58 FR 68514, Dec. 28, 1993]

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[1] In unusual circumstances, when prior consultation with the Board is not possible, a Federal Reserve Bank should consult with the Board as soon as possible after extending credit that requires consultation under this paragraph.

[2] See footnote 1 in § 201.4(a)(3).

§ 201.5 Advances and discounts.

(a) Federal Reserve Banks may lend to depository institutions either through advances secured by acceptable collateral or through the discount of certain types of paper. Credit extended by the Federal Reserve Banks generally takes the form of an advance.

(b) Federal Reserve Banks may make advances to any depository institution if secured to the satisfaction of the Federal Reserve Bank. Satisfactory collateral generally includes United States government and Federal agency securities, and, if of acceptable quality, mortgage notes covering 1-4 family residences, State and local government securities, and business, consumer and other customer notes.

(c) If a Federal Reserve Bank concludes that a depository institution will be better accommodated by the discount of paper than by an advance, it may discount any paper endorsed by the depository institution that meets therequirements specified in the FRA.

§ 201.6 General requirements.

(a) *Credit for capital purposes.* Federal Reserve credit is not a substitute for capital.

(b) *Compliance with law and regulation.* All credit extended under this part shall comply with applicable requirements of law and of this part. Each Federal Reserve Bank:

(1) Shall keep itself informed of the general character and amount of the loans and investments of depository institutions with a view to ascertaining whether undue use is being made of depository institution credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and

(2) Shall consider such information in determining whether to extend credit.

(c) *Information.* A Federal Reserve Bank shall require any information it believes appropriate or desirable to insure that paper tendered as collateral for advances or for discount is acceptable and that the credit provided is used in a manner consistent with this part.

(d) *Indirect credit for others.* Except for depository institutions that receive credit under the Special Liquidity Facility described in § 201.3(e), no depository institution shall act as the medium or agent of another depository institution in receiving Federal Reserve credit except with the permission of the Federal Reserve bank extending credit.

[58 FR 68514, Dec. 28, 1993, as amended at 64 FR 41770, Aug. 2, 1999]

§ 201.7 Branches and agencies.

(a) Except as may be otherwise provided, this part shall be applicable to United States branches and agencies of foreign banks subject to reserve requirements under Regulation D (12 CFR part 204) in the same manner and to the same extent as depository institutions.

(b) This part applies to a United States branch or agency of a foreign bank in the same manner and to the same extent as an eligible institution if the foreign bank is in sound financial condition in the judgment of the lending Federal Reserve Bank.

[58 FR 68514, Dec. 28, 1993, as amended at 64 FR 41770, Aug. 2, 1999]

§ 201.8 Federal Intermediate Credit Banks.

A Federal Reserve Bank may discount for any Federal Intermediate Credit Bank agricultural paper or notes payable to and bearing the endorsement of the Federal Intermediate Credit Bank that cover loans or advances made under subsections (a) and (b) of section 2.3 of the Farm Credit Act of 1971 (12 U.S.C. 2074) and that are secured by paper eligible for discount by Federal Reserve Banks. Any paper so discounted shall have a period remaining to maturity at the time of discount of not more than nine months.

[58 FR 68514, Dec. 28, 1993]

§ 201.9 No obligation to make advances or discounts.

A Federal Reserve Bank shall have no obligation to make, increase, renew, or extend any advance or discount to any depository institution.

[58 FR 68514, Dec. 28, 1993]

§ 201.51 Adjustment credit for depository instituions.

The rates for adjustment credit provided to depository institutions under § 201.3(a) are:

Federal Reserve Bank	Rate	Effective
Boston	1.25	December 11, 2001
New York	1.25	December 11, 2001
Philadelphia	1.25	December 11, 2001
Cleveland	1.25	December 13, 2001
Richmond	1.25	December 13, 2001
Atlanta	1.25	December 13, 2001
Chicago	1.25	December 11, 2001
St. Louis	1.25	December 12, 2001
Minneapolis	1.25	December 13, 2001
Kansas City	1.25	December 13, 2001
Dallas	1.25	December 13, 2001
San Francisco	1.25	December 11, 2001

[Reg. A, 66 FR 65817, Dec. 21, 2001]

§ 201.52 Other credit for depository institutions.

(a) *Seasonal credit.* The rate for seasonal credit extended to depository institutions under § 201.3(b) is a flexible rate that takes into account rates on market sources of funds, but in no case will the rate charged be less than the rate for adjustment credit as set out in § 201.51.

(b) *Extended credit.* For extended credit to depository institutions under § 201.3(c), for credit outstanding for more than 30 days, a flexible rate will be charged that takes into account rates on market sources of funds, but in no case will the rate charged be less than the rate for adjustment credit, as set out in § 201.51, plus one-half percentage point. At the discretion of the Federal Reserve Bank, the 30-day time period may be shortened.

(c) *Special liquidity facility.* The rate for credit extended to eligible institutions under the special liquidity facility provisions in § 201.3(e) is equal to the targeted federal funds rate plus 1.5 percentage points on each day the credit is outstanding.

[Reg. A, 59 FR 29538, June 8, 1994, as amended at 59 FR 60700, Nov. 28, 1994; 64 FR 41770, Aug. 2, 1999]

INTERPRETATIONS

§ 201.104 Eligibility of consumer loans and finance company paper.

(a) The Board of Governors has clarified and modified its position with respect to the eligibility of consumer loans and finance company paper for discount with and as collateral for advances by the reserve banks.

(b) Section 13, paragraph 2, of the Federal Reserve Act authorizes a Federal Reserve Bank, under certain conditions, to discount for member banks

> * * * notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Board of Governors of the Federal Reserve System to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act.

(c) It continues to be the opinion of the Board that borrowing for the purpose of purchasing goods is borrowing for a commercial purpose, whether the borrower intends to use the goods himself or to resell them. Hence, loans made to enable consumers to purchase automobiles or other goods should be included under commercial, agricultural, and industrial paper within the meaning of the Federal Reserve Act, and as such are eligible for discounting with the Reserve Banks and as security for advances from the Reserve Banks under section 13, paragraph 8, of the Federal Reserve Act as long as they conform to requirements with respect to maturity and other matters. This applies equally to loans made directly

by banks to consumers and to paper accepted by banks from dealers or finance companies. It also applies to notes of finance companies themselves as long as the proceeds of such notes are used to finance the purchase of consumer goods or for other purposes which are eligible within the meaning of the Federal Reserve Act.

(d) If there is any question as to whether the proceeds of a note of a finance company have been or are to be used for a commercial, agricultural, or industrial purpose, a financial statement of the finance company reflecting an excess of notes receivable which appear eligible for rediscount (without regard to maturity) over total current liabilities (i.e., notes due within 1 year) may be taken as an indication of eligibility. Where information is lacking as to whether direct consumer loans by a finance company are for eligible purposes, it may be assumed that 50 percent of such loans are ''notes receivable which appear eligible for rediscount''. In addition, that language should be regarded as including notes given for the purchase of mobile homes that are acquired by a finance company from a dealer-seller of such homes.

(e) The principles stated above apply not only to notes of a finance company engaged in making consumer loans but also to notes of a finance company engaged in making loans for other eligible purposes, including business and agricultural loans. Under section 13a of the Federal Reserve Act, paper representing loans to finance the production, marketing, and carrying of agricultural products or the breeding, raising, fattening, or marketing of livestock is eligible for discount if the paper has a maturity of not exceeding 9 months. Consequently, a note of a finance company the proceeds of which are used by it to make loans for such purposes is eligible for discount or as security for a Federal Reserve advance, and such a note, unlike the note of a finance company making consumer loans, may have a maturity of up to 9 months.

[37 FR 4701, Mar. 4, 1972]

§ 201.107 Eligibility of demand paper for discount and as security for advances by Reserve Banks.

(a) The Board of Governors has reconsidered a ruling made in 1917 that demand notes are ineligible for discount under the provisions of the Federal Reserve Act. (1917 Federal Reserve Bulletin 378.)

(b) The basis of that ruling was the provision in the second paragraph of section 13 of the Federal Reserve Act that notes, drafts, and bills of exchange must have a maturity at the time of discount of not more than 90 days, exclusive of grace. The ruling stated that

> a demand note or bill is not eligible under the provisions of the act, since it is not in terms payable within the prescribed 90 days, but, at the option of the holder, may not be presented for payment until after that time.

(c) It is well settled as a matter of law, however, that demand paper is due and payable on the date of its issue. The generally accepted legal view is stated in Beutel's Brannan on Negotiable Instruments Law, at page 305, as follows:

> The words *on demand* serve the same purpose as words making instruments payable at a specified time. They fix maturity of the obligation and do not make demand necessary, but mean that the instrument is due, payable and matured when made and delivered.

(d) Accordingly, the Board has concluded that, since demand paper is due and payable on the date of its issue, it satisfies the maturity requirements of the statute. Demand paper which otherwise meets the eligibility requirements of the Federal Reserve Act and this part Regulation A, therefore, is eligible for discount and as security for advances by Reserve Banks.

[31 FR 5443, Apr. 16, 1966]

§ 201.108 Obligations eligible as collateral for advances.

(a) Section 3(a) of Pub. L. 90–505, approved September 21, 1968, amended the eighth paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 347) to authorize advances thereunder to member banks ''secured by such obligations as are eligible for purchase under section 14(b) of this Act.'' The relevant part of such paragraph had previously

referred only to ''notes * * * eligible * * * for purchase'', which the Board had construed as not including obligations generally regarded as securities. (See 1962 Federal Reserve Bulletin 690, § 201.103(d).)

(b) Under section 14(b) direct obligations of, and obligations fully guaranteed as to principal and interest by, the United States are eligible for purchase by Reserve Banks. Such obligations include certificates issued by the trustees of Penn Central Transportation Co. that are fully guaranteed by the Secretary of Transportation. Under section 14(b) direct obligations of, and obligations fully guaranteed as to principal and interest by, any agency of the United States are also eligible for purchase by Reserve Banks. Following are the principal agency obligations eligible as collateral for advances:

(1) Federal Intermediate Credit Bank debentures;

(2) Federal Home Loan Bank notes and bonds;

(3) Federal Land Bank bonds;

(4) Bank for Cooperative debentures;

(5) Federal National Mortgage Association notes, debentures and guaranteed certificates of participation;

(6) Obligations of or fully guaranteed by the Government National Mortgage Association;

(7) Merchant Marine bonds;

(8) Export-Import Bank notes and guaranteed participation certificates;

(9) Farmers Home Administration insured notes;

(10) Notes fully guaranteed as to principal and interest by the Small Business Administration;

(11) Federal Housing Administration debentures;

(12) District of Columbia Armory Board bonds;

(13) Tennessee Valley Authority bonds and notes;

(14) Bonds and notes of local urban renewal or public housing agencies fully supported as to principal and interest by the full faith and credit of the United States pursuant to section 302 of the Housing Act of 1961 (42 U.S.C. 1421a(c), 1452(c)).

(15) Commodity Credit Corporation certificates of interest in a price-support loan pool.

(16) Federal Home Loan Mortgage Corporation notes, debentures, and guaranteed certificates of participation.

(17) U.S. Postal Service obligations.

(18) Participation certificates evidencing undivided interests in purchase contracts entered into by the General Services Administration.

(19) Obligations entered into by the Secretary of Health, Education, and Welfare under the Public Health Service Act, as amended by the Medical Facilities Construction and Modernization Amendments of 1970.

(20) Obligations guaranteed by the Overseas Private Investment Corp., pursuant to the provisions of the Foreign Assistance Act of 1961, as amended.

(c) Nothing less than a full guarantee of principal and interest by a Federal agency will make an obligation eligible. For example, mortgage loans insured by the Federal Housing Administration are not eligible since the insurance contract is not equivalent to an unconditional guarantee and does not fully cover interest payable on the loan. Obligations of international institutions, such as the Inter-American Development Bank and the International Bank for Reconstruction and Development, are also not eligible, since such institutions are not agencies of the United States.

(d) Also eligible for purchase under section 14(b) are ''bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding 6 months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts.''[3] In determining the eligibility of such obligations as collateral for advances, but the Reserve Bank will satisfy itself that sufficient tax or other assured revenues earmarked for payment of such obligations will be available for that purpose at maturity, or

[3] Paragraph 3 of section 1 of the Federal Reserve Act (12 U.S.C. 221) defines *the continental United States* to mean ''the States of the United States and the District of Columbia'', thus including Alaska and Hawaii.

within 6 months from the date of the advance if no maturity is stated. Payments due from Federal, State or other governmental units may, in the Reserve Bank's discretion, be regarded as ''other assured revenues''; but neither the proceeds of a prospective issue of securities nor future tolls, rents or similar collections for the voluntary use of government property for nongovernmental purposes will normally be so regarded. Obligations with original maturities exceeding 1 year would not ordinarily be self-liquidating as contemplated by the statute, unless at the time of issue provision is made for a redemption or sinking fund that will be sufficient to pay such obligations at maturity.

[Reg. A, 33 FR 17231, Nov. 21, 1968, as amended at 34 FR 1113, Jan. 24, 1969; 34 FR 6417, Apr. 12, 1969; 36 FR 8441, May 6, 1971; 37 FR 24105, Nov. 14, 1972; 43 FR 53709, Nov. 17, 1978; 58 FR 68515, Dec. 28, 1993]

§ 201.109 Eligibility for discount of mortgage company notes.

(a) The question has arisen whether notes issued by mortgage banking companies to finance their acquisition and temporary holding of real estate mortgages are eligible for discount by Reserve Banks.

(b) Under section 13 of the Federal Reserve Act the Board has authority to define what are ''agricultural, industrial, or commercial purposes'', which is the statutory criterion for determining the eligibility of notes and drafts for discount. However, such definition may not include paper ''covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities''.

(c) The legislative history of section 13 suggests that Congress intended to make eligible for discount ''any paper drawn for a legitimate business purpose of any kind''[4] and that the Board, in determining what paper is eligible, should place a ''broad and adaptable construction''[5] upon the terms in section 13. It may also be noted that Congress apparently considered paper issued to carry investment securities as paper issued for a ''commercial purpose'', since it specifically prohibited the Board from making such paper eligible for discount. If ''commercial'' is broad enough to encompass investment banking, it would also seem to include mortgage banking.

(d) In providing for the discount of commercial paper by Reserve Banks, Congress obviously intended to facilitate the current financing of agriculture, industry, and commerce, as opposed to long-term investment.[6] In the main, trading in stocks and bonds is investment-oriented; most securities transactions do not directly affect the production or distribution of goods and services. Mortgage banking, on the other hand, is essential to the construction industry and thus more closely related to industry and commerce. Although investment bankers also perform similar functions with respect to newly issued securities, Congress saw fit to deny eligibility to all paper issued to finance the carrying of securities. Congress did not distinguish between newly issued and outstanding securities, perhaps covering the larger area in order to make certain that the area of principal concern (i.e., trading in outstanding stocks and bonds) was fully included. Speculation was also a major Congressional concern, but speculation is not a material element in mortgage banking operations. Mortgage loans would not therefore seem to be within the purpose underlying the exclusions from eligibility in section 13.

(e) Section 201.3(a) provides that a negotiable note maturing in 90 days or less is not eligible for discount if the proceeds are used ''for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other fixed capital purpose''. However, the proceeds of a mortgage company's commercial paper are not used by it for any permanent or fixed capital purpose, but only to carry temporarily an inventory of mortgage loans pending their ''packaging'' for sale to

[4] House Report No. 69, 63d Cong., p. 48.

[5] 50 Cong. Rec. 4675 (1913) (remarks of Rep. Phelan).

[6] 50 Cong. Rec. 5021 (1913) (remarks of Rep. Thompson of Oklahoma); 50 Cong. Rec. 4731–32 (1913) (remarks of Rep. Borland).

permanent investors that are usually recurrent customers.

(f) In view of the foregoing considerations the Board concluded that notes issued to finance such temporary ''warehousing'' of real estate mortgage loans are notes issued for an industrial or commercial purpose, that such mortgage loans do not constitute ''investment securities'', as that term is used in section 13, and that the temporary holding of such mortgages in these circumstances is not a permanent investment by the mortgage banking company. Accordingly, the Board held that notes having not more than 90 days to run which are issued to finance the temporary holding of mortgage loans are eligible for discount by Reserve Banks.

[35 FR 527, Jan. 15, 1970, as amended at 58 FR 68515, Dec. 28, 1993]

§ 201.110 Goods held by persons employed by owner.

(a) The Board has been asked to review an Interpretation it issued in 1933 concerning the eligibility for rediscount by a Federal Reserve Bank of bankers' acceptances issued against field warehouse receipts where the custodian of the goods is a present or former employee of the borrower. [¶ 1445 Published Interpretations, 1933 BULLETIN 188] The Board determined at that time that the acceptances were not eligible because such receipts do not comply with the requirement of section 13 of the Federal Reserve Act that a banker's acceptance be ''secured at the time of acceptance by a warehouse receipt or other such document *conveying or securing title* covering readily marketable staples,'' nor with the requirement of section XI of the Board's Regulation A that it be ''secured at the time of acceptance by a warehouse, terminal, or other similar receipt, conveying security title to such staples, *issued by a party independent of the customer*.''

The requirement that the receipt be ''issued by a party independent of the customer'' was deleted from Regulation A in 1973, and thus the primary issue for the Board's consideration is whether a field warehouse receipt is a document ''securing title'' to readily marketable staples.

(b) While bankers' acceptances secured by field warehouse receipts are rarely offered for rediscount or as collateral for an advance, the issue of ''eligibility'' is still significant. If an ineligible acceptance is discounted and then sold by a member bank, the proceeds are deemed to be ''deposits'' under § 204.1(f) of Regulation D and are subject to reserve requirements.

(c) In reviewing this matter, the Board has taken into consideration the changes that have occurred in commercial law and practice since 1933. Modern commercial law, embodied in the Uniform Commercial Code, refers to ''perfecting security interests'' rather than ''securing title'' to goods. The Board believes that if, under State law, the issuance of a field warehouse receipt provides the lender with a perfected security interest in the goods, the receipt should be regarded as a document ''securing title'' to goods for the purposes of section 13 of the Federal Reserve Act. It should be noted, however, that the mere existence of a perfected security interest alone is not sufficient; the Act requires that the acceptance be secured by a warehouse receipt or its equivalent.

(d) Under the U.C.C., evidence of an agreement between the secured party and the debtor must exist before a security interest can attach. [U.C.C. section 9–202.] This agreement may be evidence by: (1) A written security agreement signed by the debtor, or (2) the collateral being placed in the possession of the secured party or his agent [U.C.C. section 9–203]. Generally, a security interest is perfected by the filing of a financing statement, [U.C.C. section 9–302.] However, if the collateral is in the possession of a bailee, then perfection can be achieved by:

(1) Having warehouse receipts issued in the name of the secured party; (2) notifying the bailee of the secured party's interest; or (3) having a financing statement filed. [U.C.C. section 9–304(3).]

(e) If the field warehousing operation is properly conducted, a security interest in the goods is perfected when a warehouse receipt is issued in the name of the secured party (the lending bank). Therefore, warehouse receipts issued pursuant to a bona fide field

warehousing operation satisfy the legal requirements of section 13 of the Federal Reserve Act. Moreover, in a properly conducted field warehousing operation, the warehouse manager will be trained, bonded, supervised and audited by the field warehousing company. This procedure tends to insure that he will not be impermissibly controlled by his former (or sometimes present) employer, the borrower, even though he may look to the borrower for reemployment at some future time. A prudent lender will, of course, carefully review the field warehousing operation to ensure that stated procedures are satisfactory and that they are actually being followed. The lender may also wish to review the field warehousing company's fidelity bonds and legal liability insurance policies to ensure that they provide satisfactory protection to the lender.

(f) If the warehousing operation is not conducted properly, however, and the manager remains under the control of the borrower, the security interest may be lost. Consequently, the lender may wish to require a written security agreement and the filing of a financing statement to insure that the lender will have a perfected security interest even if it is later determined that the field warehousing operation was not properly conducted. It should be noted however, that the Federal Reserve Act clearly requires that the bankers' acceptance be secured by a warehouse receipt in order to satisfy the requirements of eligibility, and a written security agreement and a filed financing statement, while desirable, cannot serve as a substitute for a warehouse receipt.

(g) This Interpretation is based on facts that have been presented in regard to field warehousing operations conducted by established, professional field warehouse companies, and it does not necessarily apply to all field warehousing operations. Thus ¶1430 and ¶1440 of the Published Interpretations [1918 BULLETIN 31 and 1918 BULLETIN 862] maintain their validity with regard to corporations formed for the purpose of conducting limited field warehousing operations. Furthermore, the prohibition contained in ¶1435 Published Interpretations [1918 BULLETIN 634] that ''the borrower shall not have access to the premises and shall exercise no control over the goods stored'' retains its validity, except that access for inspection purposes is still permitted under ¶1450 [1926 BULLETIN 666]. The purpose for the acceptance transaction must be proper and cannot be for speculation [¶1400, 1919 BULLETIN 858] or for the purpose of furnishing working capital [¶1405, 1922 BULLETIN 52].

(h) This interpretation suspersedes only the previous ¶1445 of the Published Interpretations [1933 BULLETIN 188], and is not intended to affect any other Board Interpretation regarding field warehousing.

(12 U.S.C. 342 et seq.)

[43 FR 21434, May 18, 1978]

PART 202—EQUAL CREDIT OPPORTUNITY (REGULATION B)

REGULATION B (EQUAL CREDIT OPPORTUNITY)

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SUPPLEMENT I TO PART 202—OFFICIAL STAFF INTERPRETATIONS

AUTHORITY: 15 U.S.C. 1691–1691f.

SOURCE: Reg. B, 50 FR 48026, Nov. 20, 1985, unless otherwise noted.

REGULATION B (EQUAL CREDIT OPPORTUNITY)

§ 202.1 Authority, scope and purpose.

(a) *Authority and scope.* This regulation is issued by the Board of Governors of the Federal Reserve System pursuant to title VII (Equal Credit Opportunity Act) of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 *et seq.*). Except as otherwise provided herein, the regulation applies to all persons who are creditors, as defined in § 202.2(1). Information collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 *et seq.* and have been assigned OMB control number 7100–0201.

(b) *Purpose.* The purpose of this regulation is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The regulation prohibits creditor practices that discriminate on the basis of any of these factors. The regulation also requires creditors to notify applicants of action taken on their applications; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant's race and other personal characteristics in applications for certain dwelling-related loans; and to provide applicants with copies of appraisal reports used in connection with credit transactions.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 58 FR 65661, Dec. 16, 1993]

§ 202.2 Definitions.

For the purposes of this regulation, unless the context indicates otherwise, the following definitions apply.

(a) *Account* means an extension of credit. When employed in relation to an account, the word *use* refers only to open-end credit.

(b) *Act* means the Equal Credit Opportunity Act (title VII of the Consumer Credit Protection Act).

(c) *Adverse action.* (1) The term means:

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered;

(ii) A termination of an account or an unfavorable change in the terms of an account that does not affect all or a substantial portion of a class of the creditor's accounts; or

(iii) A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

(2) The term does not include: (i) A change in the terms of an account expressly agreed to by an applicant.

(ii) Any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that accounnt;

(iii) A refusal or failure to authorize an account transaction at a point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or a substantial portion of a class of the creditor's accounts, or when the refusal is a denial of an application for an increase in the amount of credit available under the account;

(iv) A refusal to extend credit because applicable law prohibits the creditor from extending the credit requested; or

(v) A refusal to extend credit because the creditor does not offer the type of credit or credit plan requested.

(3) An action that falls within the definition of both paragraphs (c)(1) and (c)(2) of this section is governed by paragraph (c)(2) of this section.

(d) *Age* refers only to the age of natural persons and means the number of fully elapsed years from the date of an applicant's birth.

(e) *Applicant* means any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit. For purposes of § 202.7(d), the term includes guarantors, sureties, endorsers and similar parties.

(f) *Application* means an oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested. The term does not include the use of an account or line of credit to obtain an amount of credit that is within a previously established credit limit. A *completed application* means an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested (including, but not limited to, credit reports, any additional information requested from the applicant, and any approvals or reports by governmental agencies or other persons that are necessary to guarantee, insure, or provide security for the credit or collateral). The creditor shall exercise reasonable diligence in obtaining such information.

(g) *Business credit* refers to extensions of credit primarily for business or commercial (including agricultural) purposes, but excluding extensions of credit of the types described in § 202.3 (a), (b), and (d).

(h) *Consumer credit* means credit extended to a natural person primarily for personal, family, or household purposes.

(i) *Contractually liable* means expressly obligated to repay all debts arising on an account by reason of an agreement to that effect.

(j) *Credit* means the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.

(k) *Credit card* means any card, plate, coupon book, or other single credit device that may be used from time to time to obtain money, property, or services on credit.

(l) *Creditor* means a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit. The term includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of §§ 202.4 and 202.5(a), the term also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violation of the act or this regulation committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.

(m) *Credit transaction* means every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit (including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures).

(n) *Discriminate against an applicant* means to treat an applicant less favorably than other applicants.

(o) *Elderly* means age 62 or older.

(p) *Empirically derived and other credit scoring systems*—(1) *A credit scoring system* is a system that evaluates an applicant's creditworthiness mechanically, based on key attributes of the applicant and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the applicant, whether an applicant is deemed creditworthy. To qualify as an *empirically derived, demonstrably and statistically sound, credit scoring system,* the system must be:

(i) Based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;

(ii) Developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor utilizing the system (including, but not limited to, minimizing bad debt losses and operating expenses in accordance with the creditor's business judgment);

(iii) Developed and validated using accepted statistical principles and methodology; and

(iv) Periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(2) A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring system obtained from another person or may obtain credit experience from which to develop such a system. Any such system must satisfy the criteria set forth in paragraphs (p)(1) (i) through (iv) of this section; if the creditor is unable during the development process to validate the system based on its own credit experience in accordance with paragraph (p)(1) of this section, the system must be validated when sufficient credit experience becomes available. A system that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring system for that creditor.

(q) *Extend credit* and *extension of credit* mean the granting of credit in any form (including, but not limited to, credit granted in addition to any existing credit or credit limit; credit granted pursuant to an open-end credit plan; the refinancing or other renewal of credit, including the issuance of a new credit card in place of an expiring credit card or in substitution for an existing credit card; the consolidation of two or more obligations; or the continuance of existing credit without any special effort to collect at or after maturity).

(r) *Good faith* means honesty in fact in the conduct or transaction.

(s) *Inadvertent error* means a mechanical, electronic, or clerical error that a creditor demonstrates was not intentional and occurred notwithstanding the maintenance of procedures reasonably adapted to avoid such errors.

(t) *Judgmental system of evaluating applicants* means any system for evaluating the creditworthiness of an applicant other than an empirically derived, demonstrably and statistically sound, credit scoring system.

(u) *Marital status* means the state of being unmarried, married, or separated, as defined by applicable state law. The term *unmarried* includes persons who are single, divorced, or widowed.

(v) *Negative factor or value*, in relation to the age of elderly applicants, means utilizing a factor, value, or weight that is less favorable regarding elderly applicants than the creditor's experience warrants or is less favorable than the factor, value, or weight assigned to the class of applicants that are not classified as elderly and are most favored by a creditor on the basis of age.

(w) *Open-end credit* means credit extended under a plan under which a creditor may permit an applicant to make purchases or obtain loans from time to time directly from the creditor or indirectly by use of a credit card, check, or other device.

(x) *Person* means a natural person, corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association.

(y) *Pertinent element of creditworthiness*, in relation to a judgmental system of evaluating applicants, means any information about applicants that a creditor obtains and considers and that has a demonstrable relationship to a determination of creditworthiness.

(z) *Prohibited basis* means race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant's income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law upon which an exemption has been granted by the Board.

(aa) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 50485, Dec. 7, 1989]

§ 202.3 Limited exceptions for certain classes of transactions

(a) *Public utilities credit*—(1) *Definition*. Public utilities credit refers to extensions of credit that involve public utility services provided through pipe, wire, or other connected facilities, or radio or similar transmission (including extensions of such facilities), if the charges for service, delayed payment, and any discount for prompt payment are filed with or regulated by a government unit.

(2) *Exceptions*. The following provisions of this regulation do not apply to public utilities credit:

(i) Section 202.5(d)(1) concerning information about marital status;

(ii) Section 202.10 relating to furnishing of credit information; and

(iii) Section 202.12(b) relating to record retention.

(b) *Securities credit*—(1) *Definition*. Securities credit refers to extensions of credit subject to regulation under section 7 of the Securities Exchange Act of 1934 or extensions of credit by a broker or dealer subject to regulation as a broker or dealer under the Securities Exchange Act of 1934.

(2) *Exceptions*. The following provisions of this regulation do not apply to securities credit:

(i) Section 202.5(c) concerning information about a spouse or former spouse;

(ii) Section 202.5(d)(1) concerning information about marital status;

(iii) Section 202.5(d)(3) concerning information about the sex of an applicant;

(iv) Section 202.7(b) relating to designation of name, but only to the extent necessary to prevent violation of rules regarding an account in which a broker or dealer has an interest, or rules necessitating the aggregation of accounts of spouses for the purpose of determining controlling interests, beneficial interests, beneficial ownership, or purchase limitations and restrictions;

(v) Section 202.7(c) relating to action concerning open-end accounts, but only to the extent the action taken is on the basis of a change of name or marital status;

(vi) Section 202.7(d) relating to the signature of a spouse or other person;

(vii) Section 202.10 relating to furnishing of credit information; and

(viii) Section 202.12(b) relating to record retention.

(c) *Incidental credit*. (1) *Definition*. Incidental credit refers to extensions of consumer credit other than credit of the types described in paragraphs (a) and (b) of this section:

(i) That are not made pursuant to the terms of a credit card account;

(ii) That are not subject to a finance charge (as defined in Regulation Z, 12 CFR 226.4); and

(iii) That are not payable by agreement in more than four installments.

(2) *Exceptions*. The following provisions of this regulation do not apply to incidental credit:

(i) Section 202.5(c) concerning information about a spouse or former spouse;

(ii) Section 202.5(d)(1) concerning information about marital status;

(iii) Section 202.5(d)(2) concerning information about income derived from alimony, child support, or separate maintenance payments;

(iv) Section 202.5(d)(3) concerning information about the sex of an applicant, but only to the extent necessary for medical records or similar purposes;

(v) Section 202.7(d) relating to the signature of a spouse or other person;

(vi) Section 202.9 relating to notifications;

(vii) Section 202.10 relating to furnishing of credit information; and

(viii) Section 202.12(b) relating to record retention.

(d) *Government credit*—(1) *Definition*. Government credit refers to extensions of credit made to governments or governmental subdivisions, agencies, or instrumentalities.

(2) *Applicability of regulation*. Except for § 202.4, the general rule prohibiting discrimination on a prohibited basis, the requirements of this regulation do not apply to government credit.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 50485, Dec. 7, 1989]

§ 202.4 General rules.

(a) *Rule prohibiting discrimination*. A creditor shall not discriminate against

an applicant on a prohibited basis regarding any aspect of a credit transaction.

(b) *Foreign language disclosures.* Disclosures may be made in languages other than English, provided they are available in English upon request.

[Reg. B, 66 FR 17785, Apr. 4, 2001]

§ 202.5 Rules concerning taking of applications.

(a) *Discouraging applications.* A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.

(b) *General rules concerning requests for information.* (1) Except as provided in paragraphs (c) and (d) of this section, a creditor may request any information in connection with an application.[1]

(2) *Required collection of information.* Notwithstanding paragraphs (c) and (d) of this section, a creditor shall request information for monitoring purposes as required by § 202.13 for credit secured by the applicant's dwelling. In addition, a creditor may obtain information required by a regulation, order, or agreement issued by, or entered into with, a court or an enforcement agency (including the Attorney General of the United States or a similar state official) to monitor or enforce compliance with the act, this regulation, or other federal or state statute or regulation.

(3) *Special purpose credit.* A creditor may obtain information that is otherwise restricted to determine eligibility for a special purpose credit program, as provided in § 202.8 (c) and (d).

(c) *Information about a spouse or former spouse.* (1) Except as permitted in this paragraph, a creditor may not request any information concerning the spouse or former spouse of an applicant.

(2) *Permissible inquiries.* A creditor may request any information concerning an applicant's spouse (or former spouse under paragraph (c)(2)(v) of this section) that may be requested about the applicant if:

(i) The spouse will be permitted to use the account;

(ii) The spouse will be contractually liable on the account;

(iii) The applicant is relying on the spouse's income as a basis for repayment of the credit requested;

(iv) The applicant resides in a community property state or property on which the applicant is relying as a basis for repayment of the credit requested is located in such a state; or

(v) The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

(3) *Other accounts of the applicant.* A creditor may request an applicant to list any account upon which the applicant is liable and to provide the name and address in which the account is carried. A creditor may also ask the names in which an applicant has previously received credit.

(d) *Other limitations on information requests*—(1) *Marital status.* If an applicant applies for individual unsecured credit, a creditor shall not inquire about the applicant's marital status unless the applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested. If an application is for other than individual unsecured credit, a creditor may inquire about the applicant's marital status, but shall use only the terms *married*, *unmarried*, and *separated*. A creditor may explain that the category *unmarried* includes single, divorced, and widowed persons.

(2) *Disclosure about income from alimony, child support, or separate maintenance.* A creditor shall not inquire whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the creditor discloses to the applicant that such income need not be revealed if the applicant does not want the creditor to consider it in determining the applicant's creditworthiness.

[1] This paragraph does not limit or abrogate any federal or state law regarding privacy, privileged information, credit reporting limitations, or similar restrictions on obtainable information.

(3) *Sex*. A creditor shall not inquire about the sex of an applicant. An applicant may be requested to designate a title on an application form (such as Ms., Miss, Mr., or Mrs.) if the form discloses that the designation of a title is optional. An application form shall otherwise use only terms that are neutral as to sex.

(4) *Childbearing, childrearing*. A creditor shall not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A creditor may inquire about the number and ages of an applicant's dependents or about dependent-related financial obligations or expenditures, provided such information is requested without regard to sex, marital status, or any other prohibited basis.

(5) *Race, color, religion, national origin*. A creditor shall not inquire about the race, color, religion, or national origin of an applicant or any other person in connection with a credit transaction. A creditor may inquire about an applicant's permanent residence and immigration status.

(e) *Written applications*. A creditor shall take written applications for the types of credit covered by § 202.13(a), but need not take written applications for other types of credit.

§ 202.5a Rules on providing appraisal reports.

(a) *Providing appraisals*. A creditor shall provide a copy of the appraisal report used in connection with an application for credit that is to be secured by a lien on a dwelling. A creditor shall comply with either paragraph (a)(1) or (a)(2) of this section.

(1) *Routine delivery*. A creditor may routinely provide a copy of the appraisal report to an applicant (whether credit is granted or denied or the application is withdrawn).

(2) *Upon request*. A creditor that does not routinely provide appraisal reports shall provide a copy upon an applicant's written request.

(i) *Notice*. A creditor that provides appraisal reports only upon request shall notify an applicant in writing of the right to receive a copy of an appraisal report. The notice may be given at any time during the application process but no later than when the creditor provides notice of action taken under § 202.9 of this part. The notice shall specify that the applicant's request must be in writing, give the creditor's mailing address, and state the time for making the request as provided in paragraph (a)(2)(ii) of this section.

(ii) *Delivery*. A creditor shall mail or deliver a copy of the appraisal report promptly (generally within 30 days) after the creditor receives an applicant's request, receives the report, or receives reimbursement from the applicant for the report, whichever is last to occur. A creditor need not provide a copy when the applicant's request is received more than 90 days after the creditor has provided notice of action taken on the application under § 202.9 of this part or 90 days after the application is withdrawn.

(b) *Credit unions*. A creditor that is subject to the regulations of the National Credit Union Administration on making copies of appraisals available is not subject to this section.

(c) *Definitions*. For purposes of paragraph (a) of this section, the term *dwelling* means a residential structure that contains one to four units whether or not that structure is attached to real property. The term includes, but is not limited to, an individual condominium or cooperative unit, and a mobile or other manufactured home. The term *appraisal report* means the document(s) relied upon by a creditor in evaluating the value of the dwelling.

[58 FR 65661, Dec. 16, 1993]

§ 202.6 Rules concerning evaluation of applications.

(a) *General rule concerning use of information*. Except as otherwise provided in the Act and this regulation, a creditor may consider any information obtained, so long as the information is not used to discriminate against an applicant on a prohibited basis.[2]

[2]The legislative history of the Act indicates that the Congress intended an ''effects test'' concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs* v. *Duke Power Co.*, 401 U.S. 424 (1971), and *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405 (1975), to be applicable to a creditor's determination of creditworthiness.

(b) *Specific rules concerning use of information.* (1) Except as provided in the act and this regulation, a creditor shall not take a prohibited basis into account in any system of evaluating the creditworthiness of applicants.

(2) *Age, receipt of public assistance.* (i) Except as permitted in this paragraph (b)(2), a creditor shall not take into account an applicant's age (provided that the applicant has the capacity to enter into a binding contract) or whether an applicant's income derives from any public assistance program.

(ii) In an empirically derived, demonstrably and statistically sound, credit scoring system, a creditor may use an applicant's age as a predictive variable, provided that the age of an elderly applicant is not assigned a negative factor or value.

(iii) In a judgmental system of evaluating creditworthiness, a creditor may consider an applicant's age or whether an applicant's income derives from any public assistance program only for the purpose of determining a pertinent element of creditworthiness.

(iv) In any system of evaluating creditworthiness, a creditor may consider the age of an elderly applicant when such age is used to favor the elderly applicant in extending credit.

(3) *Childbearing, childrearing.* In evaluating creditworthiness, a creditor shall not use assumptions or aggregate statistics relating to the likelihood that any group of persons will bear or rear children or will, for that reason, receive diminished or interrupted income in the future.

(4) *Telephone listing.* A creditor shall not take into account whether there is a telephone listing in the name of an applicant for consumer credit, but may take into account whether there is a telephone in the applicant's residence.

(5) *Income.* A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension, or other retirement benefit; a creditor may consider the amount and probable continuance of any income in evaluating an applicant's creditworthiness. When an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, the creditor shall consider such payments as income to the extent that they are likely to be consistently made.

(6) *Credit history.* To the extent that a creditor considers credit history in evaluating the creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:

(i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;

(ii) On the applicant's request, any information the applicant may present that tends to indicate that the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness; and

(iii) On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.

(7) *Immigration status.* A creditor may consider whether an applicant is a permanent resident of the United States, the applicant's immigration status, and any additional information that may be necessary to ascertain the creditor's rights and remedies regarding repayment.

(c) *State property laws.* A creditor's consideration or application of state property laws directly or indirectly affecting creditworthiness does not constitute unlawful discrimination for the purposes of the Act or this regulation.

§ 202.7 Rules concerning extensions of credit.

(a) *Individual accounts.* A creditor shall not refuse to grant an individual account to a creditworthy applicant on the basis of sex, marital status, or any other prohibited basis.

(b) *Designation of name.* A creditor shall not refuse to allow an applicant to open or maintain an account in a birth-given first name and a surname that is the applicant's birth-given surname, the spouse's surname, or a combined surname.

(c) *Action concerning existing open-end accounts*—(1) *Limitations*. In the absence of evidence of the applicant's inability or unwillingness to repay, a creditor shall not take any of the following actions regarding an applicant who is contractually liable on an existing open-end account on the basis of the applicant's reaching a certain age or retiring or on the basis of a change in the applicant's name or marital status:

(i) Require a reapplication, except as provided in paragraph (c)(2) of this section;

(ii) Change the terms of the account; or

(iii) Terminate the account.

(2) *Requiring reapplication*. A creditor may require a reapplication for an open-end account on the basis of a change in the marital status of an applicant who is contractually liable if the credit granted was based in whole or in part on income of the applicant's spouse and if information available to the creditor indicates that the applicant's income may not support the amount of credit currently available.

(d) *Signature of spouse or other person*—(1) *Rule for qualified applicant*. Except as provided in this paragraph, a creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested.

(2) *Unsecured credit*. If an applicant requests unsecured credit and relies in part upon property that the applicant owns jointly with another person to satisfy the creditor's standards of creditworthiness, the creditor may require the signature of the other person only on the instrument(s) necessary, or reasonably believed by the creditor to be necessary, under the law of the state in which the property is located, to enable the creditor to reach the property being relied upon in the event of the death or default of the applicant.

(3) *Unsecured credit—community property states*. If a married applicant requests unsecured credit and resides in a community property state, or if the property upon which the applicant is relying is located in such a state, a creditor may require the signature of the spouse on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the community property available to satisfy the debt in the event of default if:

(i) Applicable state law denies the applicant power to manage or control sufficient community property to qualify for the amount of credit requested under the creditor's standards of creditworthiness; and

(ii) The applicant does not have sufficient separate property to qualify for the amount of credit requested without regard to community property.

(4) *Secured credit*. If an applicant requests secured credit, a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default, for example, an instrument to create a valid lien, pass clear title, waive inchoate rights or assign earnings.

(5) *Additional parties*. If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the extension of the credit requested, a creditor may request a cosigner, guarantor, or the like. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party.

(6) *Rights of additional parties*. A creditor shall not impose requirements upon an additional party that the creditor is prohibited from imposing upon an applicant under this section.

(e) *Insurance*. A creditor shall not refuse to extend credit and shall not terminate an account because credit life, health, accident, disability, or other credit-related insurance is not available on the basis of the applicant's age.

§ 202.8 Special purpose credit programs.

(a) *Standards for programs*. Subject to the provisions of paragraph (b) of this section, the act and this regulation

permit a creditor to extend special purpose credit to applicants who meet eligibility requirements under the following types of credit programs:

(1) Any credit assistance program expressly authorized by federal or state law for the benefit of an economically disadvantaged class of persons;

(2) Any credit assistance program offered by a not-for-profit organization, as defined under section 501(c) of the Internal Revenue Code of 1954, as amended, for the benefit of its members or for the benefit of an economically disadvantaged class of persons; or

(3) Any special purpose credit program offered by a for-profit organization or in which such an organization participates to meet special social needs, if:

(i) The program is established and administered pursuant to a written plan that identifies the class of persons that the program is designed to benefit and sets forth the procedures and standards for extending credit pursuant to the program; and

(ii) The program is established and administered to extend credit to a class of persons who, under the organization's customary standards of creditworthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants applying to the organization for a similar type and amount of credit.

(b) *Rules in other sections.* (1) *General applicability.* All of the provisions of this regulation apply to each of the special purpose credit programs described in paragraph (a) of this section unless modified by this section.

(2) *Common characteristics.* A program described in paragraph (a)(2) or (a)(3) of this section qualifies as a special purpose credit program only if it was established and is administered so as not to discriminate against an applicant on any prohibited basis; however, all program participants may be required to share one or more common characteristics (for example, race, national origin, or sex) so long as the program was not established and is not administered with the purpose of evading the requirements of the act or this regulation.

(c) *Special rule concerning requests and use of information.* If participants in a special purpose credit program described in paragraph (a) of this section are required to possess one or more common characteristics (for example, race, national origin, or sex) and if the program otherwise satisfies the requirements of paragraph (a) of this section, a creditor may request and consider information regarding the common characteristic(s) in determining the applicant's eligibility for the program.

(d) *Special rule in the case of financial need.* If financial need is one of the criteria under a special purpose program described in paragraph (a) of this section, the creditor may request and consider, in determining an applicant's eligibility for the program, information regarding the applicant's martial status; alimony, child support, and separate maintenance income; and the spouse's financial resources. In addition, a creditor may obtain the signature of an applicant's spouse or other person on an application or credit instrument relating to a special purpose program if the signature is required by Federal or State law.

§ 202.9 Notifications.

(a) *Notification of action taken, ECOA notice, and statement of specific reasons*—(1) *When notification is required.* A creditor shall notify an applicant of action taken within:

(i) 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application;

(ii) 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;

(iii) 30 days after taking adverse action on an existing account; or

(iv) 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

(2) *Content of notification when adverse action is taken.* A notification given to an applicant when adverse action is taken shall be in writing and shall contain: a statement of the action taken; the name and address of the creditor; a statement of the provisions of section

701(a) of the Act; the name and address of the Federal agency that administers compliance with respect to the creditor; and either:

(i) A statement of specific reasons for the action taken; or

(ii) A disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving a written request for confirmation from the applicant.

(3) *Notification to business credit applicants.* For business credit, a creditor shall comply with the requirements of this paragraph in the following manner:

(i) With regard to a business that had gross revenues of $1,000,000 or less in its preceding fiscal year (other than an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit), a creditor shall comply with paragraphs (a) (1) and (2) of this section, except that:

(A) The statement of the action taken may be given orally or in writing, when adverse action is taken;

(B) Disclosure of an applicant's right to a statement of reasons may be given at the time of application, instead of when adverse action is taken, provided the disclosure is in a form the applicant may retain and contains the information required by paragraph (a)(2)(ii) of this section and the ECOA notice specified in paragraph (b)(1) of this section;

(C) For an application made solely by telephone, a creditor satisfies the requirements of this paragraph by an oral statement of the action taken and of the applicant's right to a statement of reasons for adverse action.

(ii) With regard to a business that had gross revenues in excess of $1,000,000 in its preceding fiscal year or an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit, a creditor shall:

(A) Notify the applicant, orally or in writing, within a reasonable time of the action taken; and

(B) Provide a written statement of the reasons for adverse action and the ECOA notice specified in paragraph (b)(1) of this section if the applicant makes a written request for the reasons within 60 days of being notified of the adverse action.

(b) *Form of ECOA notice and statement of specific reasons*—(1) *ECOA notice.* To satisfy the disclosure requirements of paragraph (a)(2) of this section regarding section 701(a) of the Act, the creditor shall provide a notice that is substantially similar to the following:

The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A of this regulation).

(2) *Statement of specific reasons.* The statement of reasons for adverse action required by paragraph (a)(2)(i) of this section must be specific and indicate the principal reason(s) for the adverse action. Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant failed to achieve the qualifying score on the creditor's credit scoring system are insufficient.

(c) *Incomplete applications*—(1) *Notice alternatives.* Within 30 days after receiving application that is incomplete regarding matters that an applicant can complete, the creditor shall notify the applicant either:

(i) Of action taken, in accordance with paragraph (a) of this section; or

(ii) Of the incompleteness, in accordance with paragraph (c)(2) of this section.

(2) *Notice of incompleteness*. If additional information is needed from an applicant, the creditor shall send a written notice to the applicant specifying the information needed, designating a reasonable period of time for the applicant to provide the information, and informing the applicant that failure to provide the information requested will result in no further consideration being given to the application. The creditor shall have no further obligation under this section if the applicant fails to respond within the designated time period. If the applicant supplies the requested information within the designated time period, the creditor shall take action on the application and notify the applicant in accordance with paragraph (a) of this section.

(3) *Oral request for information*. At its option, a creditor may inform the applicant orally of the need for additional information; but if the application remains incomplete the creditor shall send a notice in accordance with paragraph (c)(1) of this section.

(d) *Oral notifications by small-volume creditors*. The requirements of this section (including statements of specific reasons) are satisified by oral notifications in the case of any creditor that did not receive more than 150 applications during the preceding calendar year.

(e) *Withdrawal of approved application*. When an applicant submits an application and the parties contemplate that the applicant will inquire about its status, if the creditor approves the application and the applicant has not inquired within 30 days after applying, the creditor may treat the application as withdrawn and need not comply with paragraph (a)(1) of this section.

(f) *Multiple applicants*. When an application involves more than one applicant, notification need only be given to one of them, but must be given to the primary applicant where one is readily apparent.

(g) *Applications submitted through a third party*. When an application is made on behalf of an applicant to more than one creditor and the applicant expressly accepts or uses credit offered by one of the creditors, notification of action taken by any of the other creditors is not required. If no credit is offered or if the applicant does not expressly accept or use any credit offered, each creditor taking adverse action must comply with this section, directly or through a third party. A notice given by a third party shall disclose the identify of each creditor on whose behalf the notice is given.

(h) *Duties of third parties*. A third party may use electronic communication in accordance with the requirements of § 202.17, as applicable, to comply with the requirements of paragraph (g) of this section on behalf of a creditor.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 50485, Dec. 7, 1989; 66 FR 17785, Apr. 4, 2001]

§ 202.10 Furnishing of credit information.

(a) *Designation of accounts*. A creditor tht furnishes credit information shall designate:

(1) Any new account to reflect the participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account (other than as a guarantor, surety, endorser, or similar party); and

(2) Any existing account to reflect such participation, within 90 days after receiving a written request to do so from one of the spouses.

(b) *Routine reports to consumer reporting agency*. If a creditor furnishes credit information to a consumer reporting agency concerning an account designated to reflect the participation of both spouses, the creditor shall furnish the information in a manner that will enable the agency to provide access to the information in the name of each spouse.

(c) *Reporting in response to inquiry*. If a creditor furnishes credit information in response to an inquiry concerning an account designated to reflect the participation of both spouses, the creditor shall furnish the information in the name of the spouse about whom the information is requested.

§ 202.11 Relation to state law.

(a) *Inconsistent state laws*. Except as otherwise provided in this section, this regulation alters, affects, or preempts

only those state laws that are inconsistent with the act and this regulation and then only to the extent of the inconsistency. A state law is not inconsistent if it is more protective of an applicant.

(b) *Preempted provisions of state law.* (1) A state law is deemed to be inconsistent with the requirements of the Act and this regulation and less protective of an applicant within the meaning of section 705(f) of the Act to the extent that the law:

(i) Requires or permits a practice or act prohibited by the Act or this regulation;

(ii) Prohibits the individual extension of consumer credit to both parties to a marriage if each spouse individually and voluntarily applies for such credit;

(iii) Prohibits inquiries or collection of data required to comply with the act or this regulation;

(iv) Prohibits asking or considering age in an empirically derived, demonstrably and statistically sound, credit scoring system to determine a pertinent element of creditworthiness, or to favor an elderly applicant; or

(v) Prohibits inquiries necessary to establish or administer as special purpose credit program as defined by § 202.8.

(2) A creditor, state, or other interested party may request the Board to determine whether a state law is inconsistent with the requirements of the Act and this regulation.

(c) *Laws on finance charges, loan ceilings.* If married applicants voluntarily apply for and obtained individual accounts with the same creditor, the accounts shall not be aggregated or otherwise combined for purposes of determining permissible finance charges or loan ceilings under any federal or state law. Permissible loan ceiling laws shall be construed to permit each spouse to become individually liable up to the amount of the loan ceilings, less the amount for which the applicant is jointly liable.

(d) *State and Federal laws not affected.* This section does not alter or annul any provision of state property laws, laws relating to the disposition of decedents' estates, or Federal or state banking regulations directed only toward insuring the solvency of financial institutions.

(e) *Exemption for state-regulated transactions*—(1) *Applications.* A state may apply to the Board for an exemption from the requirements of the Act and this regulation for any class of credit transactions within the state. The Board will grant such an exemption if the Board determines that:

(i) The class of credit transactions is subject to state law requirements substantially similar to the Act and this regulation or that applicants are afforded greater protection under state law; and

(ii) There is adequate provision for state enforcement.

(2) *Liability and enforcement.* (i) No exemption will extend to the civil liability provisions of section 706 or the administrative enforcement provisions of section 704 of the Act.

(ii) After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by Federal law) will constitute the requirements of the Act and this regulation.

§ 202.12 Record retention.

(a) *Retention of prohibited information.* A creditor may retain in its files information that is prohibited by the Act or this regulation in evaluating applications, without violating the Act or this regulation, if the information was obtained:

(1) From any source prior to March 23, 1977;

(2) From consumer reporting agencies, an applicant, or others without the specific request of the creditor; or

(3) As required to monitor compliance with the Act and this regulation or other Federal or state statutes or regulations.

(b) *Preservation of records*—(1) *Applications.* For 25 months (12 months for business credit) after the date that a creditor notifies an applicant of action taken on an application or of incompleteness, the creditor shall retain in original form or a copy thereof:

(i) Any application that it receives, any information required to be obtained concerning characteristics of the applicant to monitor compliance with the Act and this regulation or

other similar law, and any other written or recorded information used in evaluating the application and not returned to the applicant at the applicant's request;

(ii) A copy of the following documents if furnished to the applicant in written form (or, if furnished orally, any notation or memorandum made by the creditor):

(A) The notification of action taken; and

(B) The statement of specific reasons for adverse action; and

(iii) Any written statement submitted by the applicant alleging a violation of the Act or this regulation.

(2) *Existing accounts.* For 25 months (12 months for business credit) after the date that a creditor notifies an applicant of adverse action regarding an existing account, the creditor shall retain as to that account, in original form or a copy thereof:

(i) Any written or recorded information concerning the adverse action; and

(ii) Any written statement submitted by the applicant alleging a violation of the act or this regulation.

(3) *Other applications.* For 25 months (12 months for business credit) after the date that a creditor receives an application for which the creditor is not required to comply with the notification requirements of § 202.9, the creditor shall retain all written or recorded information in its possession concerning the applicant, including any notation of action taken.

(4) *Enforcement proceedings and investigations.* A creditor shall retain the information specified in this section beyond 25 months (12 months for business credit) if it has actual notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation of the act or this regulation by the Attorney General of the United States or by an enforcement agency charged with monitoring that creditor's compliance with the act and this regulation, or if it has been served with notice of an action filed pursuant to section 706 of the Act and § 202.14 of this regulation. The creditor shall retain the information until final disposition of the matter, unless an earlier time is allowed by order of the agency or court.

(5) *Special rule for certain business credit applications.* With regard to a business with gross revenues in excess of $1,000,000 in its preceding fiscal year, or an extension of trade credit, credit incident to a factoring agreement or other similar types of business credit, the creditor shall retain records for at least 60 days after notifying the applicant of the action taken. If within that time period the applicant requests in writing the reasons for adverse action or that records be retained, the creditor shall retain records for 12 months.

(6) *Self-tests.* For 25 months after a self-test (as defined in § 202.15) has been completed, the creditor shall retain all written or recorded information about the self-test. A creditor shall retain information beyond 25 months if it has actual notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation, or if it has been served with notice of a civil action. In such cases, the creditor shall retain the information until final disposition of the matter, unless an earlier time is allowed by the appropriate agency or court order.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 50486, Dec. 7, 1989; 62 FR 66419, Dec. 18, 1997]

§ 202.13 Information for monitoring purposes.

(a) *Information to be requested.* A creditor that receives an application for credit primarily for the purchase or refinancing of a dwelling occupied or to be occupied by the applicant as a principal residence, where the extension of credit will be secured by the dwelling, shall request as part of the application the following information regarding the applicant(s):

(1) Race or national origin, using the categories American Indian or Alaskan Native; Asian or Pacific Islander; Black; White; Hispanic; Other (Specify);

(2) Sex;

(3) Marital status, using the categories married, unmarried, and separated; and

(4) Age.

Dwelling means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes, but is

not limited to, an individual condominium or cooperative unit, and a mobile or other manufactured home.

(b) *Obtaining of information.* Questions regarding race or national origin, sex, marital status, and age may be listed, at the creditor's option, on the application form or on a separate form that refers to the application. The applicant(s) shall be asked but not required to supply the requested information. If the applicant(s) chooses not to provide the information or any part of it, that fact shall be noted on the form. The creditor shall then also note on the form, to the extent possible, the race or national origin and sex of the applicant(s) on the basis of visual observation or surname.

(c) *Disclosure to applicant(s).* The creditor shall inform the applicant(s) that the information regarding race or national origin, sex, marital status, and age is being requested by the Federal government for the purpose of monitoring compliance with Federal statutes that prohibit creditors from discriminating against appliants on those bases. The creditor shall also inform the applicant(s) that if the applicant(s) chooses note to provide the information, the creditor is required to note the race or national origin and sex on the basis of visual observation or surname.

(d) *Substitute monitoring program.* A monitoring program required by an agency charged with administrative enforcement under section 704 of the Act may be substituted for the requirements contained in paragraphs (a), (b), and (c).

§ 202.14 Enforcement, penalties and liabilities.

(a) *Administrative enforcement.* (1) As set forth more fully in section 704 of the Act, administrative enforcement of the Act and this regulation regarding certain creditors is assigned to the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Board of Directors of the Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, Interstate Commerce Commission, Secretary of Agriculture, Farm Credit Administration, Securities and Exchange Commission, Small Business Administration, and Secretary of Transportation.

(2) Except to the extent that administrative enforcement is specifically assigned to other authorities, compliance with the requirements imposed under the act and this regulation is enforced by the Federal Trade Commission.

(b) *Penalties and liabilities.* (1) Sections 706 (a) and (b) and 702(g) of the Act provide that any creditor that fails to comply with a requirement imposed by the Act or this regulation is subject to civil liability for actual and punitive damages in individual or class actions. Pursuant to sections 704 (b), (c), and (d) and 702(g) of the Act, violations of the Act or regulations also constitute violations of other Federal laws. Liability for punitive damages is restricted to nongovernmental entities and is limited to $10,000 in individual actions and the lesser of $500,000 or 1 percent of the creditor's net worth in class actions. Section 706(c) provides for equitable and declaratory relief and section 706(d) authorizes the awarding of costs and reasonable attorney's fees to an aggrieved applicant in a successful action.

(2) As provided in section 706(f), a civil action under the Act or this regulation may be brought in the appropriate United States district court without regard to the amount in controversy or in any other court of competent jurisdiction within two years after the date of the occurrence of the violation, or within one year after the commencement of an administrative enforcement proceeding or of a civil action brought by the Attorney General of the United States within two years after the alleged violation.

(3) If an agency responsible for administrative enforcement is unable to obtain compliance with the act or this part, it may refer the matter to the Attorney General of the United States. In addition, if the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration has reason to believe that one or more creditors engaged in a pattern or practice of discouraging or denying applications in violation of the act or this part, the agency shall refer the matter to the

Attorney General. Furthermore, the agency may refer a matter to the Attorney General if the agency has reason to believe that one or more creditors violated section 701(a) of the act.

(4) On referral, or whenever the Attorney General has reason to believe that one or more creditors engaged in a pattern or practice in violation of the act or this regulation, the Attorney General may bring a civil action for such relief as may be appropriate, including actual and punitive damages and injunctive relief.

(5) If the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration has reason to believe (as a result of a consumer complaint, conducting a consumer compliance examination, or otherwise) that a violation of the act or this part has occurred which is also a violation of the Fair Housing Act, and the matter is not referred to the Attorney General, the agency shall notify:

(i) The Secretary of Housing and Urban Development; and

(ii) The applicant that the Secretary of Housing and Urban Development has been notified and that remedies for the violation may be available under the Fair Housing Act.

(c) *Failure of compliance.* A creditor's failure to comply with §§ 202.6(b)(6), 202.9, 202.10, 202.12 or 202.13 is not a violation if it results from an inadvertent error. On discovering an error under §§ 202.9 and 202.10, the creditor shall correct it as soon as possible. If a creditor inadvertently obtains the monitoring information regarding the race or national origin and sex of the applicant in a dwelling-related transaction not overed by § 202.13, the creditor may act on and retain the application without violating the regulation.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 53539, Dec. 29, 1989; 58 FR 65662, Dec. 16, 1993]

§ 202.15 Incentives for self-testing and self-correction.

(a) *General rules*—(1) *Voluntary self-testing and correction.* The report or results of the self-test that a creditor voluntarily conducts (or authorizes) are privileged as provided in this section. Data collection required by law or by any governmental authority is not a voluntary self-test.

(2) *Corrective action required.* The privilege in this section applies only if the creditor has taken or is taking appropriate corrective action.

(3) *Other privileges.* The privilege created by this section does not preclude the assertion of any other privilege that may also apply.

(b) *Self-test defined*—(1) *Definition.* A self-test is any program, practice, or study that:

(i) Is designed and used specifically to determine the extent or effectiveness of a creditor's compliance with the act or this regulation; and

(ii) Creates data or factual information that is not available and cannot be derived from loan or application files or other records related to credit transactions.

(2) *Types of information privileged.* The privilege under this section applies to the report or results of the self-test, data or factual information created by the self-test, and any analysis, opinions, and conclusions pertaining to the self-test report or results. The privilege covers workpapers or draft documents as well as final documents.

(3) *Types of information not privileged.* The privilege under this section does not apply to:

(i) Information about whether a creditor conducted a self-test, the methodology used or the scope of the self-test, the time period covered by the self-test, or the dates it was conducted; or

(ii) Loan and application files or other business records related to credit transactions, and information derived from such files and records, even if it has been aggregated, summarized, or reorganized to facilitate analysis.

(c) *Appropriate corrective action*—(1) *General requirement.* For the privilege in this section to apply, appropriate corrective action is required when the self-test shows that it is more likely than not that a violation occurred, even though no violation has been formally adjudicated.

(2) *Determining the scope of appropriate corrective action.* A creditor must take corrective action that is reasonably likely to remedy the cause and effect of a likely violation by:

(i) Identifying the policies or practices that are the likely cause of the violation; and

(ii) Assessing the extent and scope of any violation.

(3) *Types of relief*. Appropriate corrective action may include both prospective and remedial relief, except that to establish a privilege under this section:

(i) A creditor is not required to provide remedial relief to a tester used in a self-test;

(ii) A creditor is only required to provide remedial relief to an applicant identified by the self-test as one whose rights were more likely than not violated; and

(iii) A creditor is not required to provide remedial relief to a particular applicant if the statute of limitations applicable to the violation expired before the creditor obtained the results of the self-test or the applicant is otherwise ineligible for such relief.

(4) *No admission of violation*. Taking corrective action is not an admission that a violation occurred.

(d)(1) *Scope of privilege*. The report or results of a privileged self-test may not be obtained or used:

(i) By a government agency in any examination or investigation relating to compliance with the act or this regulation; or

(ii) By a government agency or an applicant (including a prospective applicant who alleges a violation of § 202.5(a)) in any proceeding or civil action in which a violation of the act or this regulation is alleged.

(2) *Loss of privilege*. The report or results of a self-test are not privileged under paragraph (d)(1) of this section if the creditor or a person with lawful access to the report or results):

(i) Voluntarily discloses any part of the report or results, or any other information privileged under this section, to an applicant or government agency or to the public;

(ii) Discloses any part of the report or results, or any other information privileged under this section, as a defense to charges that the creditor has violated the act or regulation; or

(iii) Fails or is unable to produce written or recorded information about the self-test that is required to be retained under § 202.12(b)(6) when the information is needed to determine whether the privilege applies. This paragraph does not limit any other penalty or remedy that may be available for a violation of § 202.12.

(3) *Limited use of privileged information*. Notwithstanding paragraph (d)(1) of this section, the self-test report or results and any other information privileged under this section may be obtained and used by an applicant or government agency solely to determine a penalty or remedy after a violation of the act or this regulation has been adjudicated or admitted. Disclosures for this limited purpose may be used only for the particular proceeding in which the adjudication or admission was made. Information disclosed under this paragraph (d)(3) remains privileged under paragraph (d)(1) of this section.

[62 FR 66419, Dec. 18, 1997]

§ 202.16 [Reserved]

§ 202.17 Requirements for electronic communication.

(a) *Definition*. *Electronic communication* means a message transmitted electronically between a creditor and an applicant in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor.

(b) *General rule*. In accordance with the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) (15 U.S.C. 7001 *et seq.*) and the rules of this part, a creditor may provide by electronic communication any disclosure required by this part to be in writing. Disclosures provided by electronic communication must be provided in a clear and conspicuous manner and in a form the applicant may retain.

(c) *When consent is required*. For disclosures required by this part to be in writing, a creditor shall obtain an applicant's affirmative consent in accordance with the requirements of the E-Sign Act. Disclosures under §§ 202.5a(a)(2)(i), 202.9(a)(3)(i)(B), and 202.13(a) are not subject to this requirement if provided on or with the application.

(d) *Address or location to receive electronic communication*. A creditor that

uses electronic communication to provide disclosures required by this part shall:

(1) Send the disclosure to the applicant's electronic address; or

(2) Make the disclosure available at another location such as an Internet web site; and

(i) Alert the applicant of the disclosure's availability by sending a notice to the applicant's electronic address (or to a postal address, at the creditor's option). The notice shall identify the account involved and the address of the Internet web site or other location where the disclosure is available; and

(ii) Make the disclosure available for at least 90 days from the date the disclosure first becomes available or from the date of the notice alerting the applicant of the disclosure, whichever comes later.

(3) *Exceptions*. A creditor need not comply with paragraph (d)(2)(i) and (ii) of this section for the disclosure required by § 202.13(a).

(e) *Redelivery*. When a disclosure provided by electronic communication is returned to a creditor undelivered, the creditor shall take reasonable steps to attempt redelivery using information in its files.

(f) *Electronic signatures*. An electronic signature as defined under the E-Sign Act satisfies any requirement under this part for an applicant's signature or initials.

[Reg. B, 66 FR 17785, Apr. 4, 2001]

APPENDIX A TO PART 202—FEDERAL ENFORCEMENT AGENCIES

The following list indicates the federal agencies that enforce Regulation B for particular classes of creditors. Any questions concerning a particular creditor should be directed to its enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

National Banks, and Federal Branches and Federal Agencies of Foreign Banks

Office of the Comptroller of the Currency, Customer Assistance Unit, 1301 McKinney Avenue, Suite 3710, Houston, Texas 77010.

State Member Banks, Branches and Agencies of Foreign Banks (other than federal branches, federal agencies, and insured state branches of foreign banks), Commercial Lending Companies Owned or Controlled by Foreign Banks, and Organizations Operating under Section 25 or 25A of the Federal Reserve Act

Federal Reserve Bank serving the district in which the institution is located.

Nonmember Insured Banks and Insured State Branches of Foreign Banks

Federal Deposit Insurance Corporation Regional Director for the region in which the institution is located.

Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered saving banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund).

Office of Thrift Supervision Regional Director for the region in which the institution is located.

Federal Credit Unions

Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.

Air Carriers

Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, SW, Washington, DC 20590.

Creditors Subject to Interstate Commerce Commission

Office of Proceedings, Interstate Commerce Commission, Washington, DC 20523.

Creditors Subject to Packers and Stockyards Act

Nearest Packers and Stockyards Administration area supervisor.

Small Business Investment Companies

U.S. Small Business Administration, 1441 L Street, NW., Washington, DC 20416.

Brokers and Dealers

Securities and Exchange Commission, Washington, DC 20549.

Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations

Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.

Retailers, Finance Companies, and All Other Creditors Not Listed Above

FTC Regional Office for region in which the creditor operates or Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 53539, Dec. 29, 1989; 56 FR 51322, Oct. 11, 1991; 57 FR 20399, May 13, 1992; 63 FR 16394, Apr. 3, 1998]

APPENDIX B TO PART 202—MODEL APPLICATION FORMS

This appendix contains five model credit application forms, each designated for use in a particular type of consumer credit transaction as indicated by the bracketed caption on each form. The first sample form is intended for use in open-end, unsecured transactions; the second for closed-end, secured transactions; the third for closed-end transactions, whether unsecured or secured; the fourth in transactions involving community property or occurring in community property states; and the fifth in residential mortgage transactions. The appendix also contains a model disclosure for use in complying with §202.13 for certain dwelling-related loans. All forms contained in this appendix are models; their use by creditors is optional.

The use or modification of these forms is governed by the following instructions. A creditor may change the forms: by asking for additional information not prohibited by §202.5; by deleting any information request; or by rearranging the format without modifying the substance of the inquiries. In any of these three instances, however, the appropriate notices regarding the optional nature of courtesy titles, the option to disclose alimony, child support, or separate maintenance, and the limitation concerning marital status inquiries must be included in the appropriate places if the items to which they relate appear on the creditor's form.

If a creditor uses an appropriate Appendix B model form, or modifies a form in accordance with the above instructions, that creditor shall be deemed to be acting in compliance with the provisions of paragraphs (c) and (d) of §202.5 of this regulation.

[Open end, unsecured credit]

CREDIT APPLICATION

IMPORTANT: Read these Directions before completing this Application.

Check Appropriate Box

☐ If you are applying for an individual account in your own name and are relying on your own income or assets and not the income or assets of another person as the basis for repayment of the credit requested, complete only Sections A and D.

☐ If you are applying for a joint account or an account that you and another person will use, complete all Sections, providing information in B about the joint applicant or user.

☐ If you are applying for an individual account, but are relying on income from alimony, child support, or separate maintenance or on the income or assets of another person as the basis for repayment of the credit requested, complete all Sections to the extent possible, providing information in B about the person on whose alimony, support, or maintenance payments or income or assets you are relying.

SECTION A—INFORMATION REGARDING APPLICANT

Full Name (Last, First, Middle): ..... Birthdate: / /

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Previous Street Address: ..... Years there: .....

City: ..... State: ..... Zip: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... . No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... . Source(s) of other income: .....

Is any income listed in this Section likely to be reduced in the next two years?
☐ Yes (Explain in detail on a separate sheet.) No ☐

Have you ever received credit from us? ..... When? ..... Office: .....

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with you: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION B—INFORMATION REGARDING JOINT APPLICANT, USER, OR OTHER PARTY (Use separate sheets if necessary.)

Full Name (Last, First, Middle): ..... Birthdate: / /

Relationship to Applicant (if any): .....

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... . No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... . Source(s) of other income: .....

Is any income listed in this Section likely to be reduced in the next two years?
☐ Yes (Explain in detail on a separate sheet.) ☐ No

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with Joint Applicant, User, or Other Party: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION C—MARITAL STATUS
(Do not complete if this is an application for an individual account.)

Applicant: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)
Other Party: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)

SECTION D—ASSET AND DEBT INFORMATION (If Section B has been completed, this Section should be completed giving information about both the Applicant and Joint Applicant, User, or Other Person. Please mark Applicant-related information with an "A." If Section B was not completed, only give information about the Applicant in this Section.)

ASSETS OWNED (Use separate sheet if necessary.)

Description of Assets	Value	Subject to Debt? Yes/No	Name(s) of Owner(s)
Cash	$		
Automobiles (Make, Model, Year)			
Cash Value of Life Insurance (Issuer, Face Value)			
Real Estate (Location, Date Acquired)			
Marketable Securities (Issuer, Type, No. of Shares)			
Other (List)			
Total Assets	$		

OUTSTANDING DEBTS (Include charge accounts, instalment contracts, credit cards, rent, mortgages, etc. Use separate sheet if necessary.)

Creditor	Type of Debt or Acct. No.	Name in Which Acct. Carried	Original Debt	Present Balance	Monthly Payments	Past Due? Yes/No
1. (Landlord or Mortgage Holder)	☐ Rent Payment ☐ Mortgage		$ (Omit rent)	$ (Omit rent)	$	
2.						
3.						
4.						
5.						
6.						
Total Debts			$	$	$	

(Credit References) Date Paid

1. $

2.

Are you a co-maker, endorser, or guarantor on any loan or contract? Yes ☐ No ☐ If "yes" for whom? To whom?

Are there any unsatisfied judgments against you? Yes ☐ No ☐ Amount $ If "yes" to whom owed?

Have you been declared bankrupt in the last 14 years? Yes ☐ No ☐ If "yes" where? Year

Other Obligations—(E.g., liability to pay alimony, child support, separate maintenance. Use separate sheet if necessary.)

Everything that I have stated in this application is correct to the best of my knowledge. I understand that you will retain this application whether or not it is approved. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Applicant's Signature Date Other Signature (Where Applicable) Date

[Closed end, secured credit]

CREDIT APPLICATION

IMPORTANT: Read these Directions before completing this Application.

Check Appropriate Box

☐ If you are applying for individual credit in your own name and are relying on your own income or assets and not the income or assets of another person as the basis for repayment of the credit requested, complete Sections A, C, D, and E, omitting B and the second part of C.

☐ If this is an application for joint credit with another person, complete all Sections, providing information in B about the joint applicant.

☐ If you are applying for individual credit, but are relying on income from alimony, child support, or separate maintenance or on the income or assets of another person as the basis for repayment of the credit requested, complete all Sections to the extent possible, providing information in B about the person on whose alimony, support, or maintenance payments or income or assets you are relying.

Amount Requested Payment Date Desired Proceeds of Credit

$ ..... To be Used For.....

SECTION A—INFORMATION REGARDING APPLICANT

Full Name (Last, First, Middle): ..... Birthdate: / /

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Previous Street Address: ..... Years there: .....

City: ..... State: ..... Zip: .....

Present Employer ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $..... per ..... Source(s) of other income: .....

.....

Is any income listed in this Section likely to be reduced before the credit requested is paid off?
☐ Yes (Explain in detail on a separate sheet.) No ☐

Have you ever received credit from us? ..... When? ..... Office: .....

Checking Account No. ..... Institution and Branch: .....

Savings Account No. ..... Institution and Branch: .....

Name of nearest relative not living with you: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION B—INFORMATION REGARDING JOINT APPLICANT OR OTHER PARTY (Use separate sheets if necessary.)

Full Name (Last, First, Middle): ..... Birthdate: / /

Relationship to Applicant (if any): .....

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $..... per ..... Source(s) of other income: .....

.....

Is any income listed in this Section likely to be reduced before the credit requested is paid off?
☐ Yes (Explain in detail on a separate sheet.) No ☐

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with Joint Applicant or Other Party: .....

Relationship: ..... Address: .....

SECTION C—MARITAL STATUS

Applicant: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)
Other Party: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)

SECTION D—ASSET AND DEBT INFORMATION (If Section **B** has been completed, this Section should be completed giving information about both the Applicant and Joint Applicant or Other Person. Please mark Applicant-related information with an "A." If Section **B** was not completed, only give information about the Applicant in this Section.)

ASSETS OWNED (Use separate sheet if necessary.)

Description of Assets	Value	Subject to Debt? Yes/No	Name(s) of Owner(s)
Cash	$		
Automobiles (Make, Model, Year)			
Cash Value of Life Insurance (Issuer, Face Value)			
Real Estate (Location, Date Acquired)			
Marketable Securities (Issuer, Type, No. of Shares)			
Other (List)			
Total Assets	$		

OUTSTANDING DEBTS (Include charge accounts, instalment contracts, credit cards, rent, mortgages, etc. Use separate sheet if necessary.)

Creditor	Type of Debt or Acct. No.	Name in Which Acct. Carried	Original Debt	Present Balance	Monthly Payments	Past Due? Yes/No
1. (Landlord or Mortgage Holder)	☐ Rent Payment ☐ Mortgage		$ (Omit rent)	$ (Omit rent)	$	
2.						
3.						
Total Debts			$	$	$	

(Credit References) Date Paid

1. $

2.

Are you a co-maker, endorser, or guarantor on any loan or contract? Yes ☐ No ☐ If "yes" for whom? To whom?

Are there any unsatisfied judgments against you? Yes ☐ No ☐ Amount $ If "yes" to whom owed?

Have you been declared bankrupt in the last 14 years? Yes ☐ No ☐ If "yes" where? Year

Other obligations—(E.g., liability to pay alimony, child support, separate maintenance. Use separate sheet if necessary.)

SECTION E—SECURED CREDIT Briefly describe the property to be given as security:

and list names and addresses of all co-owners of the property:

Name Address

If the security is real estate, give the full name of your spouse (if any):

Everything that I have stated in this application is correct to the best of my knowledge. I understand that you will retain this application whether or not it is approved. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Applicant's Signature Date Other Signature (Where Applicable) Date

[Closed end, unsecured/secured credit]

CREDIT APPLICATION

IMPORTANT: Read these Directions before completing this Application.

Check Appropriate Box

☐ If you are applying for individual credit in your own name and are relying on your own income or assets and not the income or assets of another person as the basis for repayment of the credit requested, complete only Sections A and D. If the requested credit is to be secured, also complete the first part of Section C and Section E.

☐ If you are applying for joint credit with another person, complete all Sections except E, providing information in B about the joint applicant. If the requested credit is to be secured, then complete Section E.

☐ If you are applying for individual credit, but are relying on income from alimony, child support, or separate maintenance or on the income or assets of another person as the basis for repayment of the credit requested, complete all Sections except E to the extent possible, providing information in B about the person on whose alimony, support, or maintenance payments or income or assets you are relying. If the requested credit is to be secured, then complete Section E.

Amount Requested Payment Date Desired Proceeds of Credit

$..... To be Used For .....

SECTION A—INFORMATION REGARDING APPLICANT

Full Name (Last, First, Middle): ..... Birthdate: / /

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Previous Street Address: ..... Years there: .....

City: ..... State: ..... Zip: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... Source(s) of other income: .....

Is any income listed in this Section likely to be reduced before the credit requested is paid off?

☐ Yes (Explain in detail on separate sheet.) ☐ No

Have you ever received credit from us? ..... When? ..... Office .....

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with you: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION B—INFORMATION REGARDING JOINT APPLICANT OR OTHER PARTY (Use separate sheets if necessary.)

Full Name (Last, First, Middle): ..... Birthdate: / /

Relationship to Applicant (if any): .....

Present Street Address: ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... Source(s) of other income: .....

Is any income listed in this Section likely to be reduced before the credit requested is paid off?

☐ Yes (Explain in detail on separate sheet.) ☐ No

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with Joint Applicant or Other Party: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION C—MARITAL STATUS
(Do not complete if this is an application for individual unsecured credit.)
Applicant: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)
Other Party: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, and widowed)

SECTION D—ASSET AND DEBT INFORMATION (If Section B has been completed, this Section should be completed giving information about both the Applicant and Joint Applicant or Other Person. Please mark Applicant-related information with an "A." If Section B was not completed, only give information about the Applicant in this Section.)

ASSETS OWNED (Use separate sheet if necessary.)

Description of Assets	Value	Subject to Debt? Yes, No	Name(s) of Owner(s)
Cash	$		
Automobiles (Make, Model, Year)			
Cash Value of Life Insurance (Issuer, Face Value)			
Real Estate (Location, Date Acquired)			
Marketable Securities (Issuer, Type, No. of Shares)			
Other (List)			
Total Assets	$		

OUTSTANDING DEBTS (Include charge accounts, installment contracts, credit cards, rent, mortgages, etc. Use separate sheet if necessary.)

Creditor	Type of Debt or Acct. No.	Name in Which Acct. Carried	Original Debt	Present Balance	Monthly Payments	Past Due? Yes/No
1. (Landlord or Mortgage Holder)	☐ Rent Payment ☐ Mortgage		$ (Omit rent)	$ (Omit rent)	$	
2.						
3.						
Total Debts			$	$	$	

(Credit References) Date Paid
1. $
2.

Are you a co-maker, endorser, or guarantor on any loan or contract? Yes ☐ No ☐ If "Yes," for whom? To whom?
Are there any unsatisfied judgments against you? Yes ☐ No ☐ Amount $ If "Yes," to whom owed?
Have you been declared bankrupt in the last 14 years? Yes ☐ No ☐ If "Yes," where? Year
Other obligations—(E.g., liability to pay alimony, child support, separate maintenance. Use separate sheet if necessary.)

SECTION E—SECURED CREDIT (Complete only if credit is to be secured.) Briefly describe the property to be given as security:

and list names and addresses of all co-owners of the property:

Name Address

If the security is real estate, give the full name of your spouse (if any):

Everything that I have stated in this application is correct to the best of my knowledge. I understand that you will retain this application whether or not it is approved. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Applicant's Signature Date Other Signature (Where Applicable) Date

[Community property]

CREDIT APPLICATION

IMPORTANT: Read these Directions before completing this Application.

Check Appropriate Box

☐ If you are applying for individual credit in your own name, are not married, and are not relying on alimony, child support, or separate maintenance payments or on the income or assets of another person as the basis for repayment of the credit requested, complete only Sections A and D. If the requested credit is to be secured, also complete Section E.

☐ In all other situations, complete all Sections except E, providing information in B about your spouse, a joint applicant or user, or the person on whose alimony, support, or maintenance payments or income or assets you are relying. If the requested credit is to be secured, also complete Section E.

Amount Requested $..... Payment Date Desired ..... Proceeds of Credit To be Used For .....

SECTION A—INFORMATION REGARDING APPLICANT

Full Name (Last, First, Middle): ..... Birthdate: / /

Present Street Address ..... Years there: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Previous Street Address: ..... Years there: .....

City: ..... State: ..... Zip: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... Source(s) of other income: .....

Is any income listed in this Section likely to be reduced in the next two years or before the credit requested is paid off?
☐ Yes (Explain in detail on a separate sheet.) No ☐

Have you ever received credit from us? ..... When? ..... Office: .....

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with you ..... Telephone: .....

Relationship: ..... Address: .....

***SECTION B*—INFORMATION REGARDING SPOUSE, JOINT APPLICANT, USER, OR OTHER PARTY (Use separate sheets if necessary.)**

Full Name (Last, First, Middle): ..... Birthdate: / /

Relationship to Applicant (if any): ..... Years there: .....

Present Street Address: .....

City: ..... State: ..... Zip: ..... Telephone: .....

Social Security No.: ..... Driver's License No.: .....

Present Employer: ..... Years there: ..... Telephone: .....

Position or title: ..... Name of supervisor: .....

Employer's Address: .....

Previous Employer: ..... Years there: .....

Previous Employer's Address: .....

Present net salary or commission: $ ..... per ..... No. Dependents: ..... Ages: .....

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Alimony, child support, separate maintenance received under: court order ☐ written agreement ☐ oral understanding ☐

Other income: $ ..... per ..... Source(s) of other income: .....

Is any income listed in this Section likely to be reduced in the next two years or before the credit requested is paid off?
☐ Yes (Explain in detail on a separate sheet.) ☐ No

Checking Account No.: ..... Institution and Branch: .....

Savings Account No.: ..... Institution and Branch: .....

Name of nearest relative not living with Spouse, Joint Applicant, User, or other Party: ..... Telephone: .....

Relationship: ..... Address: .....

SECTION C—MARITAL STATUS

Applicant: ☐ Married [ ] Separated ☐ Unmarried (including single, divorced, and widowed)
Other Party: ☐ Married ☐ Separated ☐ Unmarried (including single, divorced, widowed)

SECTION D—ASSET AND DEBT INFORMATION (If Section B has been completed, this Section should be completed giving information about both the Applicant and Spouse, Joint Applicant, User, or Other Person. Please mark Applicant-related information with an "A." If Section B was not completed, only give information about the Applicant in this Section.)

ASSETS OWNED (Use separate sheet if necessary.)

Description of Assets	Value	Subject to Debt? Yes/No	Name(s) of Owner(s)
Cash	$		
Automobiles (Make, Model, Year)			
Cash Value of Life Insurance (Issuer, Face Value)			
Real Estate (Location, Date Acquired)			
Marketable Securities (Issuer, Type, No. of Shares)			
Other (List)			
Total Assets	$		

OUTSTANDING DEBTS (Include charge accounts, instalment contracts, credit cards, rent, mortgages, etc. Use separate sheet if necessary.)

Name of Creditor	Type of Debt or Acct. No.	Name in Which Acct. Carried	Original Debt	Present Balance	Monthly Payments	Past Due? Yes/No
1. (Landlord or Mortgage Holder)	☐ Rent Payment ☐ Mortgage		$ (Omit rent)	$ (Omit rent)	$	
2.						
3.						
Total Debts			$	$	$	

(Credit References) Date Paid

1. $

2.

Are you a co-maker, endorser, or guarantor on any loan or contract? Yes ☐ No ☐ If "yes," for whom? To whom?

Are there any unsatisfied judgments against you? Yes ☐ No ☐ Amount $ If "yes," to whom owed?

Have you been declared bankrupt in the last 14 years Yes ☐ No ☐ If "yes," where? Year

Other obligations—(E.g., Liability to pay alimony, child support, separate maintenance. Use separate sheet if necessary.)

SECTION E—SECURED CREDIT (Complete only if credit is to be secured.) Briefly describe the property to be given as security:

and list names and addresses of all co-owners of the property:

Name Address

Everything that I have stated in this application is correct to the best of my knowledge. I understand that you will retain this application whether or not it is approved. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Applicant's Signature Date Other Signature (Where Applicable) Date

[Residential real estate mortgage loan]

RESIDENTIAL LOAN APPLICATION

MORTGAGE APPLIED FOR ☐ Conventional ☐ FHA ☐ VA ☐ | Amount $ | Interest Rate % | No. of Months | Monthly Payment Principal & Interest $ | Escrow/Impounds (to be collected monthly) ☐ Taxes ☐ Hazard Ins. ☐ Mtg. Ins. ☐

Prepayment Option

1. SUBJECT PROPERTY

Property Street Address | City | County | State | Zip | No. Units

Legal Description (Attach description if necessary.) | Year Built

Purpose of Loan: ☐ Purchase ☐ Construction-Permanent ☐ Construction ☐ Refinance ☐ Other (Explain)

Complete this line if Construction-Permanent or Construction Loan. | Lot Value Data: Year Acquired, Original Cost $ | Present Value (a) $ | Cost of Improv. (b) $ | Total (a + b) $ | ENTER TOTAL AS PURCHASE PRICE IN DETAILS OF PURCHASE

Complete this line if a Refinance Loan | Year Acquired | Original Cost $ | Amt. Existing Liens $ | Purpose of Refinance | Describe Improvements [ ] made [ ] to be made | Cost: $

Title Will Be Held In What Name(s) | Manner In Which Title Will Be Held

Source of Down Payment and Settlement Charges

This application is designed to be completed by the borrower(s) with the lender's assistance. The Co-Borrower Section and all other Co-Borrower questions must be completed and the appropriate box(es) checked if ☐ another person will be jointly obligated with the Borrower on the loan, ☐ the Borrower is relying on income from alimony, child support, or separate maintenance or on the income or assets of another person as a basis for repayment of the loan, or ☐ the Borrower is married and resides, or the property is located, in a community property state.

2. BORROWER

Name | Age | School Yrs.

Present Address | No. Years | ☐ Own ☐ Rent

Street

City/State/Zip

Former address if less than 2 years at present address

Street

City/State/Zip

Years at former address ☐ Own ☐ Rent

Marital Status: ☐ Married ☐ Separated ☐ Unmarried (incl. single, divorced, widowed)

Dependents other than listed by Co-borrower: No. | Ages

Name and Address of Employer | Years employed in this line of work or profession? years | Years on this job | ☐ Self Employed

Position/Title | Type of Business

Social Security Number | Home Phone | Business Phone

3. CO-BORROWER

Name | Age | School Yrs.

Present Address | No. Years | ☐ Own ☐ Rent

Street

City/State/Zip

Former address if less than 2 years at present address

Street

City/State/Zip

Years at former address ☐ Own ☐ Rent

Marital Status: ☐ Married ☐ Separated ☐ Unmarried (incl. single, divorced, widowed)

Dependents other than listed by Borrower: No. | Ages

Name and Address of Employer | Years employed in this line of work or profession? years | Years on this job | ☐ Self Employed

Position/Title | Type of Business

Social Security Number | Home Phone | Business Phone

4. GROSS MONTHLY INCOME

Item	Borrower	Co-Borrower	Total
Base Empl. Income	$	$	$
Overtime			
Bonuses			
Commissions			
Dividends/Interest			
Net Rental Income			
Other† (Before completing, see notice under Describe Other Income below.)			
Total	$	$	$

5. MONTHLY HOUSING EXPENSE

	Present*	Proposed
Rent	$	
First Mortgage (P&I)		$
Other Financing (P&I)		
Hazard Insurance		
Real Estate Taxes		
Mortgage Insurance		
Homeowner Assn. Dues		
Other		
Total Monthly Pmt.	$	$
Utilities		
Total	$	$

6. DETAILS OF PURCHASE

a. Purchase Price	$
b. Total Closing Costs (Est.)	
c. Pre Paid Escrows (Est.)	
d. Total (a+b+c)	$
e. Amount of Mortgage	( )
f. Other Financing	( )
g. Present Equity in Lot	( )
h. Amount of Cash Deposit	( )
i. Closing Costs Paid by Seller	( )
j. Cash Reqd. For Closing (Est.)	$

7. DESCRIBE OTHER INCOME

B–Borrower C–Co-Borrower | NOTICE: † Alimony, child support, or separate maintenance income need not be revealed if the Borrower or Co-Borrower does not choose to have it considered as a basis for repaying this loan. | Monthly Amount $

8. IF EMPLOYED IN CURRENT POSITION FOR LESS THAN TWO YEARS COMPLETE THE FOLLOWING

B/C	Previous Employer/School	City/State	Type of Business	Position/Title	Dates From/To	Monthly Income
						$

9. THESE QUESTIONS APPLY TO BOTH BORROWERS

If a "yes" answer is given to a question in this column, explain on an attached sheet.

	Borrower Yes/No	Co-Borrower Yes/No
Have you any outstanding judgments?		
In the last 14 years, have you been bankrupt?		
Have you had property foreclosed upon or given title or a deed in lieu thereof?		
Are you a co-maker or endorser on a note?		
Are you a party in a law suit?		
Are you obligated to pay alimony, child support, or separate maintenance?		
Is any part of the down payment borrowed?		

	Borrower Yes/No	Co-Borrower Yes/No
Do you have health and accident insurance?		
Do you have major medical coverage?		
Do you intend to occupy the property?		
Will this property be your primary residence?		
Have you previously owned a home?		
Sale price of previously owned home	$	$

* All Present Monthly Housing Expenses of the Borrower and Co-Borrower should be listed on a combined basis.

This statement and any applicable supporting schedules may be completed jointly by both married and unmarried co-borrowers if their assets and liabilities are sufficiently joined so that the statement can be meaningfully and fairly presented on a combined basis; otherwise separate statements and schedules are required. If the Co-Borrower section was completed about a spouse, this statement and supporting schedules must be completed about that spouse also.

☐ Completed Jointly ☐ Not Completed Jointly

STATEMENT OF ASSETS AND LIABILITIES

10. ASSETS

Description	Cash or Market Value
Cash Deposit Toward Purchase Held By	$
Checking and Savings Accounts (Names of Institutions/ Acct. Nos.)	
Stocks and Bonds (No./description)	
Life Insurance Net Cash Value	
Face Amount ($)	
SUBTOTAL LIQUID ASSETS	$
Real Estate Owned (*Enter Market Value from Schedule of Real Estate Owned*)	
Vested Interest in Retirement Fund	
Net Worth of Business Owned (*Attach Financial Stat.*)	
Automobiles (Make and Year)	
Furniture and Personal Property	
Other Assets (Itemize)	
TOTAL ASSETS	A $

11. LIABILITIES

Indicate by (*) those liabilities that will be satisfied upon sale of real estate owned or upon refinancing of property.

Creditor's Name, Address, Account Number	Acct. Name if Not Borrower(s)	Mo. Pmt and Mos. left to pay	Unpaid Balance
Installment Debts (include "revolving" charge accounts)		$ Pmt /Mos. /	$
		/	
		/	
		/	
Automobile Loans		/	
		/	
Real Estate Loans			
Other Debt, Including Stock Pledges			
		/	
Alimony, Child Support, and Maintenance Payments (Owed To)			
TOTAL MONTHLY PAYMENTS		$	
NET WORTH (A minus B) $		TOTAL LIABILITIES	B $

SCHEDULE OF REAL ESTATE OWNED (If Additional Properties Owned Attach Separate Schedule)

Address of Property (Indicate S if Sold, PN if Pending Sale or R if Rental being held for income)	Type of Property	Present Market Value	Amount of Mortgages & Liens	Gross Rental Income	Mortgage Payments	Taxes, Ins. Maintenance and Misc.	Net Rental Income
		$	$	$	$	$	$
TOTALS		$	$	$	$	$	$

12. LIST PREVIOUS CREDIT REFERENCES

B-Borrower C-Co-Borrower	Creditor's Name and Address	Account Number	Purpose	Highest Balance	Date Paid

List any additional names under which credit has previously been received

AGREEMENT. The Undersigned applies for the loan indicated in this application, to be secured by a first mortgage or deed of trust on the property described herein, and represents that the property will not be used for any illegal or restricted purpose and that all statements made in this application are true and are made for the purpose of obtaining the loan. Verification may be obtained from any source named in this application. The original or a copy of this application will be retained by the lender, even if the loan is not granted.

Borrower's Signature _____ Date / / Co-Borrower's Signature _____ Date / /

INFORMATION FOR GOVERNMENT MONITORING PURPOSES

The following information is requested by the federal government for certain types of loans related to a dwelling in order to monitor the lender's compliance with equal credit opportunity and fair housing laws. You are not required to furnish this information, but are encouraged to do so. The law provides that a lender may neither discriminate on the basis of this information, nor on whether you choose to furnish it. However, if you choose not to furnish the information, under federal regulations the lender is required to note race or national origin and sex on the basis of visual observation or surname. If you do not wish to furnish the information, please check below.

BORROWER: I do not wish to furnish this information ☐
RACE OR NATIONAL ORIGIN: ☐ American Indian, Alaskan Native ☐ Asian, Pacific Islander ☐ Black ☐ Hispanic ☐ White ☐ Other (specify) _____
SEX: ☐ Female ☐ Male

CO-BORROWER: I do not wish to furnish this information ☐
RACE OR NATIONAL ORIGIN: ☐ American Indian, Alaskan Native ☐ Asian, Pacific Islander ☐ Black ☐ Hispanic ☐ White ☐ Other (specify) _____
SEX: ☐ Female ☐ Male

FOR LENDER'S USE ONLY

Reverse

APPENDIX C TO PART 202—SAMPLE NOTIFICATION FORMS

This appendix contains nine sample notification forms. Forms C–1 through C–4 are intended for use in notifying an applicant that adverse action has been taken on an application or account under § 202.9(a)(1) and (2)(i) of this regulation. Form C–5 is a notice of disclosure of the right to request specific reasons for adverse action under § 202.9(a)(1) and (2)(ii). For C–6 is designed for use in notifying an applicant, under § 202.9(c)(2), that an application is incomplete. Forms C–7 and C–8 are intended for use in connection with applications for business credit under § 202.9(a)(3). Form C-9 is designed for use in notifying an applicant of the right to receive a copy of an appraisal under § 202.5a.

Form C–1 contains the Fair Credit Reporting Act disclosure as required by sections 615(a) and (b) of that act. Forms C–2 through C–5 contain only the section 615(a) disclosure (that a creditor obtained information from a consumer reporting agency that played a part in the credit decision). A creditor must provide the 615(a) disclosure when adverse action is taken against a consumer based on information from a consumer reporting agency. A creditor must provide the section 615(b) disclosure when adverse action is taken based on information from an outside source other than a consumer reporting agency. In addition, a creditor must provide the 615(b) disclosure if the creditor obtained information from an affiliate other than information in a consumer report or other than information concerning the affiliate's own transactions or experiences with the consumer. Creditors may comply with the disclosure requirements for adverse action based on information in a consumer report obtained from an affiliate by providing *either* the 615(a) or 615(b) disclosure.

The sample forms are illustrative and may not be appropriate for all creditors. They were designed to include some of the factors that creditors most commonly consider. If a creditor chooses to use the checklist of reasons provided in one of the sample forms in this appendix and if reasons commonly used by the creditor are not provided on the form, the creditor should modify the checklist by substituting or adding other reasons. For example, if ''inadequate down payment'' or ''no deposit relationship with us'' are common reasons for taking adverse action on an application, the creditor ought to add or substitute such reasons for those presently contained on the sample forms.

If the reasons listed on the forms are not the factors actually used, a creditor will not satisfy the notice requirement by simply checking the closest identifiable factor listed. For example, some creditors consider only references from banks or other depository institutions and disregard finance company references altogether; their statement of reasons should disclose ''insufficient bank references,'' not ''insufficient credit references.'' Similarly, a creditor that considers bank references and other credit references as distinct factors should treat the two factors separately and disclose them as appropriate. The creditor should either add such other factors to the form or check ''other'' and include the appropriate explanation. The creditor need not, however, describe how or why a factor adversely affected the application. For example, the notice may say ''length of residence'' rather than ''too short a period of residence.''

A creditor may design its own notification forms or use all or a portion of the forms contained in this appendix. Proper use of Forms C–1 through C–4 will satisfy the requirements of § 202.9(a)(2)(i). Proper use of Forms C–5 and C–6 constitutes full compliance with §§ 202.9(a)(2)(ii) and 202.9(c)(2), respectively. Proper use of Forms C–7 and C–8 will satisfy the requirements of § 202.9(a)(2)(i) and (ii), respectively, for applications for business credit. Proper use of Form C-9 will satisfy the requirements of § 202.5a of this part.

FORM C-1 -- SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS

Statement of Credit Denial, Termination, or Change

Date: _____

Applicant's Name: _____

Applicant's Address: _____

Description of Account, Transaction, or Requested Credit:

_____

Description of Action Taken:

_____

_____

PART I - PRINCIPAL REASON(S) FOR CREDIT DENIAL, TERMINATION, OR OTHER ACTION TAKEN CONCERNING CREDIT.
This section must be completed in all instances.

___Credit application incomplete

___Insufficient number of credit references provided

___Unacceptable type of credit references provided

___Unable to verify credit references

___Temporary or irregular employment

___Unable to verify employment

___Length of employment

___Income insufficient for amount of credit requested

___Excessive obligations in relation to income

___Unable to verify income

___Length of residence

___Temporary residence

___Unable to verify residence

___No credit file

___Limited credit experience

___Poor credit performance with us

___Delinquent past or present credit obligations with others

___Garnishment, attachment, foreclosure, repossession, collection action, or judgment

___Bankruptcy

___Value or type of collateral not sufficient

___Other, specify: _____

FORM C-1, page 2

PART II -DISCLOSURE OF USE OF INFORMATION OBTAINED FROM AN OUTSIDE SOURCE.
This section should be completed if the credit decision was based in whole or in part on information that has been obtained from an outside source.

___ Our credit decision was based in whole or in part on information obtained in a report from the consumer reporting agency listed below. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

Name: _____

_____

Address: _____

_____

[Toll-free] Telephone number: _____

___ Our credit decision was based in whole or in part on information obtained from an affiliate or from an outside source other than a consumer reporting agency. Under the Fair Credit Reporting Act, you have the right to make a written request, no later than 60 days after you receive this notice, for disclosure of the nature of this information.

If you have any questions regarding this notice, you should contact:

Creditor's name: _____

Creditor's address: _____

Creditor's telephone number: _____

NOTICE

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

FORM C-2-SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS

Date

Dear Applicant:

Thank you for your recent application. Your request for [a loan/a credit card/an increase in your credit limit] was carefully considered, and we regret that we are unable to approve your application at this time, for the following reason(s):

Your Income:
___ is below our minimum requirement.
___ is insufficient to sustain payments on the amount of credit requested.
___ could not be verified.

Your Employment:
___ is not of sufficient length to qualify.
___ could not be verified.

Your Credit History:
___ of making payments on time was not satisfactory.
___ could not be verified.

Your Application:
___ lacks a sufficient number of credit references.
___ lacks acceptable types of credit references.
___ reveals that current obligations are excessive in relation to income.

Other: _____

The consumer reporting agency contacted that provided information that influenced our decision in whole or in part was [name, address and [toll-free] telephone number of the reporting agency]. The reporting agency is unable to supply specific reasons why we have denied credit to you. You do, however, have a right under the Fair Credit Reporting Act to know the information contained in your credit file. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency. Any questions regarding such information should be directed to [consumer reporting agency].

If you have any questions regarding this letter, you should contact us at [creditor's name, address and telephone number].

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A).

FORM C-3 -- SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS (CREDIT SCORING)

Date

Dear Applicant:

Thank you for your recent application for _____. We regret that we are unable to approve your request.

Your application was processed by a credit scoring system that assigns a numerical value to the various items of information we consider in evaluating an application. These numerical values are based upon the results of analyses of repayment histories of large numbers of customers.

The information you provided in your application did not score a sufficient number of points for approval of the application. The reasons why you did not score well compared with other applicants were:

- Insufficient bank references
- Type of occupation
- Insufficient credit experience

In evaluating your application the consumer reporting agency listed below provided us with information that in whole or in part influenced our decision. The reporting agency played no part in our decision other than providing us with credit information about you. Under the Fair Credit Reporting Act, you have a right to know the information provided to us. It can be obtained by contacting: [name, address, and [toll-free] telephone number of the consumer reporting agency]. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

If you have any questions regarding this letter, you should contact us at

Creditor's Name: _____
Address: _____
_____
Telephone: _____

Sincerely,

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (with certain limited exceptions); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A).

FORM C-4 -- SAMPLE NOTICE OF ACTION TAKEN, STATEMENT OF REASONS AND COUNTEROFFER

Date

Dear Applicant:

Thank you for your application for _____. We are unable to offer you credit on the terms that you requested for the following reason(s): _____.

We can, however, offer you credit on the following terms: _____ _____.

If this offer is acceptable to you, please notify us within [amount of time] at the following address: _____.

Our credit decision on your application was based in whole or in part on information obtained in a report from [name, address and [toll-free] telephone number of the consumer reporting agency]. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

You should know that the federal Equal Credit Opportunity Act prohibits creditors, such as ourselves, from discriminating against credit applicants on the basis of their race, color, religion, national origin, sex, marital status, age because they receive income from a public assistance program, or because they may have exercised their rights under the Consumer Credit Protection Act. If you believe there has been discrimination in handling your application you should contact the [name and address of the appropriate federal enforcement agency listed in Appendix A.]

Sincerely,

FORM C-5 -- SAMPLE DISCLOSURE OF RIGHT TO REQUEST SPECIFIC REASONS FOR CREDIT DENIAL

Date

Dear Applicant:

Thank you for applying to us for_____ .

After carefully reviewing your application, we are sorry to advise you that we cannot [open an account for you/grant a loan to you/increase your credit limit] at this time.

If you would like a statement of specific reasons why your application was denied, please contact [our credit service manager] shown below within 60 days of the date of this letter. We will provide you with the statement of reasons within 30 days after receiving your request.

Creditor's Name
Address
Telephone number

If we obtained information from a consumer reporting agency as part of our consideration of your application, its name, address, and [toll-free] telephone number is shown below. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. [You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency.] You have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency. You can find out about the information contained in your file (if one was used) by contacting:

Consumer reporting agency's name
Address
[Toll-free] Telephone number

Sincerely,

NOTICE

The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A).

FORM C-6 -- SAMPLE NOTICE OF INCOMPLETE APPLICATION AND REQUEST FOR ADDITIONAL INFORMATION

Creditor's name
Address
Telephone number

Date

Dear Applicant:

Thank you for your application for credit. The following information is needed to make a decision on your application: _____

_____

We need to receive this information by (date). If we do not receive it by that date, we will regrettably be unable to give further consideration to your credit request.

Sincerely,

FORM C–7—SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS (BUSINESS CREDIT)

Creditor's name

Creditor's address

Date

Dear Applicant: Thank you for applying to us for credit. We have given your request careful consideration, and regret that we are unable to extend credit to you at this time for the following reasons:

(Insert appropriate reason, such as Value or type of collateral not sufficient Lack of established earnings record Slow or past due in trade or loan payments)

Sincerely,

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency listed in appendix A].

FORM C–8—SAMPLE DISCLOSURE OF RIGHT TO REQUEST SPECIFIC REASONS FOR CREDIT DENIAL GIVEN AT TIME OF APPLICATION (BUSINESS CREDIT)

Creditor's name

Creditor's address

If your application for business credit is denied, you have the right to a written statement of the specific reasons for the denial. To obtain the statement, please contact [name, address and telephone number of the person or office from which the statement of reasons can be obtained] within 60 days from the date you are notified of our decision. We will send you a written statement of reasons for the denial within 30 days of receiving your request for the statement.

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's

income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency listed in appendix A].

FORM C–9—SAMPLE DISCLOSURE OF RIGHT TO RECEIVE A COPY OF AN APPRAISAL

You have the right to a copy of the appraisal report used in connection with your application for credit. If you wish a copy, please write to us at the mailing address we have provided. We must hear from you no later than 90 days after we notify you about the action taken on your credit application or you withdraw your application.

[In your letter, give us the following information:]

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 54 FR 50486, Dec. 7, 1989; 58 FR 65662, Dec. 16, 1993; 63 FR 16394, Apr. 3, 1998]

APPENDIX D TO PART 202—ISSUANCE OF STAFF INTERPRETATIONS

Official Staff Interpretations

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this regulation. These interpretations provide the protection afforded under section 706(e) of the Act. Except in unusual circumstances, such interpretations will not be issued separately but will be incorporated in an official commentary to the regulation, which will be amended periodically.

Requests for Issuance of Official Staff Interpretations

A request for an official staff interpretation should be in writing and addressed to the Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551. The request should contain a complete statement of all relevant facts concerning the issue, including copies of all pertinent documents.

Scope of Interpretations

No staff interpretations will be issued approving creditor's forms or statements. This restriction does not apply to forms or statements whose use is required or sanctioned by a government agency.

SUPPLEMENT I TO PART 202—OFFICIAL STAFF INTERPRETATIONS

[Reg. B; ECO–1]

Following is an official staff interpretation of Regulation B issued under authority delegated by the Federal Reserve Board to officials in the Division of Consumer and Community Affairs. References are to sections of the regulation or the Equal Credit Opportunity Act (15 U.S.C. 1601 et seq.).

INTRODUCTION

1. *Official status.* Section 706(e) of the Equal Credit Opportunity Act protects a creditor from civil liability for any act done or omitted in good faith in conformity with an interpretation issued by a duly authorized official of the Federal Reserve Board. This commentary is the means by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation B. Good-faith compliance with this commentary affords a creditor protection under section 706(e) of the Act.

2. *Issuance of interpretations.* Under appendix D to the regulation, any person may request an official staff interpretation. Interpretations will be issued at the discretion of designated officials and incorporated in this commentary following publication for comment in the FEDERAL REGISTER. Except in unusual circumstances, official staff interpretations will be issued only by means of this commentary.

3. *Status of previous interpretations.* Interpretations of Regulation B previously issued by the Federal Reserve Board and its staff have been incorporated into this commentary as appropriate. All other previous Board and staff interpretations, official and unofficial, are superseded by this commentary.

4. *Footnotes.* Footnotes in the regulation have the same legal effect as the text of the regulation, whether they are explanatory or illustrative in nature.

5. *Comment designations.* The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. Each comment in the commentary is identified by a number and the regulatory section or paragraph that it interprets. For example, comments to § 202.2(c) are further divided by subparagraph, such as comment 2(c)(1)(ii)–1 and comment 2(c)(2)(ii)–1.

Section 202.1—Authority, Scope, and Purpose

1(a) *Authority and scope.*

1. *Scope.* The Equal Credit Opportunity Act and Regulation B apply to all credit—commercial as well as personal—without regard to the nature or type of the credit or the creditor. If a transaction provides for the deferral of the payment of a debt, it is credit covered by Regulation B even though it may not be a credit transaction covered by Regulation Z (Truth in Lending). Further, the definition of creditor is not restricted to the party or person to whom the obligation is

initially payable, as is the case under Regulation Z. Moreover, the Act and regulation apply to all methods of credit evaluation, whether performed judgmentally or by use of a credit scoring system.

2. *Foreign applicability*. Regulation B generally does not apply to lending activities that occur outside the United States. The regulation does apply to lending activities that take place within the United States (as well as the Commonwealth of Puerto Rico and any territory or possession of the United States), whether or not the applicant is a citizen.

3. *Board*. The term *Board*, as used in this regulation, means the Board of Governors of the Federal Reserve System.

Section 202.2 Definitions

2(c) *Adverse action*.

Paragraph 2(c)(1)(i)

1. *Application for credit*. A refusal to refinance or extend the term of a business or other loan is adverse action if the applicant applied in accordance with the creditor's procedures.

Paragraph 2(c)(1)(ii)

1. *Move from service area*. If a credit card issuer terminates the open-end account of a customer because the customer has moved out of the card issuer's service area, the termination is *adverse action* for purposes of the regulation unless termination on this ground was explicitly provided for in the credit agreement between the parties. In cases were termination is adverse action, notification is required under § 202.9.

2. *Termination based on credit limit*. If a creditor terminates credit accounts that have low credit limits (for example, under $400) but keeps open accounts with higher credit limits, the termination is adverse action and notification is required under § 202.9.

Paragraph 2(c)(2)(ii)

1. *Default—exercise of due-on-sale clause*. If a mortgagor sells or transfers mortgaged property without the consent of the mortgagee, and the mortgagee exercises its contractual right to accelerate the mortgage loan, the mortgagee may treat the mortgagor as being in default. An adverse action notice need not be given to the mortgagor or the transferee. (See comment 2(e)-1 for treatment of a purchaser who requests to assume the loan.)

2. *Current delinquency or default*. The term adverse action does not include a creditor's termination of an account when the accountholder is currently in default or delinquent on that account. Notification in accordance with § 202.9 of the regulation generally is required, however, if the creditor's action is based on a past delinquency or default on the account.

Paragraph (2)(c)(2)(iii)

1. *Point-of-sale transactions*. Denial of credit at point of sale is not adverse action except under those circumstances specified in the regulation. For example, denial, at point of sale is not adverse action in the following situations:

- A credit cardholder presents an expired card or a card that has been reported to the card issuer as lost or stolen.
- The amount of a transaction exceeds a cash advance or credit limit.
- The circumstances (such as excessive use of a credit card in a short period of time) suggests that fraud is involved.
- The authorization facilities are not functioning.
- Billing statements have been returned to the creditor for lack of a forwarding address.

2. *Application for increase in available credit*. A refusal or failure to authorize an account transaction at the point of sale or loan is not adverse action, except when the refusal is a denial of an application, submitted in accordance with the creditor's procedures, for an increase in the amount of credit.

Paragraph 2(c)(2)(v)

1. *Terms of credit versus type of credit offered*. When an applicant applies for credit and the creditor does not offer the credit terms requested by the applicant (for example, the interest rate, length of maturity, collateral, or amount of downpayment), a denial of the application for that reason is adverse action (unless the creditor makes a counteroffer that is accepted by the applicant) and the applicant is entitled to notification under § 202.9.

2(e) *Applicant*.

1. *Request to assume loan*. If a mortgagor sells or transfers the mortgaged property and the buyer makes an application to the creditor to assume the mortgage loan, the mortgagee must treat the buyer as an applicant unless its policy is not to permit assumptions.

2(f) *Application*.

1. *General*. A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants.

2. *Procedures established*. The term refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor's stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decision based on oral requests, the creditor's establish procedures are to accept both oral and written applications.

3. *When an inquiry becomes an application*. A creditor is encouraged to provide consumers with information about loan terms. However,

if in giving information to the consumer the creditor also evaluates information about the appliant, decides to decline the request, and communicates this to the applicant, the creditor has treated the inquiry as an application and must then comply with the notification requirements under §202.9. Whether the inquiry becomes an application depends on how the creditor responds to the applicant, not on what the appliant says or asks.

4. *Examples of inquiries that are not applications*. The following examples illustrate situations in which only an inquiry has taken place:

• When a consumer calls to asks about loan terms and an employee explains the creditor's basic loan terms, such as interest rates, loan to value ration, and debt to income ratio.

• When a consumer calls to ask about interest rates for car loans, and, in order to quote the appropriate rate, the loan officer asks for the make and sale price of the car and amount of the down-payment, then given the consumer the rate.

• When a consumer asks about terms for a loan to purchase home and tells the loan officer her income and intended down-payment, but the loan officer only explains the creditor's loan to value ratio policy and other basic lending policies, without telling the consumer whether she qualifies for the loan.

• When a consumer calls to ask about terms for a loan to purchase vacant land and states his income, the sale price of the property to be financed, and asks whether he qualifies for a loan, and the employee responds by describing the general lending policies, explaining that he would need to look at all of the applicant's qualifications before making a decision, and offering to send an application form to the consumer.

5. *Completed Application—diligence requirement*. The regulation defines a completed application in terms that give a creditor the latitude to establish its own information requirements. Nevertheless, the creditor must act with reasonable diligence to collect information needed to complete the application. For example, the creditor should request information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or telephone number needed to verify employment, the creditor should contact the applicant promptly. (But see comment 9(a)(1)–3, which discusses the creditors's option to deny an application on the basis of incompleteness.)

2(g) *Business credit*.

1. *Definition*. The test for deciding whether a transaction qualifies as business credit is one of primary purpose. For example, an open-end credit account used for both personal and business purposes is not business credit unless the primary purpose of the account is business-related. A creditor may rely on an applicant's statement of the purpose for the credit requested.

2(j) *Credit*.

1. *General*. Regulation B covers a wider range of credit transactions than Regulation Z (Truth in Lending). For purposes of Regulation B a transaction is credit if there is a right to defer payment of a debt—regardless of whether the credit is for personal or commercial purposes, the number of installments required for repayment, or whether the transaction is subject to a finance charge.

2(1) *Creditor*.

1. *Assignees*. The term *creditor* includes all persons participating in the credit decision. This may include an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated.

2. *Referrals to creditors*. For certain purposes, the term *creditor* includes persons such as real estate brokers who do not participate in credit decisions but who regularly refer applicants to creditors or who select or offer to select creditors to whom credit requests can be made. These persons must comply with §202.4, the general rule prohibiting discrimination, and with §202.5(a), on discouraging applications.

2(p) *Empirically derived and other credit scoring systems*.

1. *Purpose of definition*. The definition under §202.2(p)(1) through (iv) sets the criteria that a credit system must meet in order for the system to use age as a predictive factor. Credit systems that do not meet these criteria are judgmental systems and may consider age only for the purpose of determining a ''pertinent element of creditworthiness.'' (Both types of systems may favor an elderly applicant. See §202.6(b)(2).)

2. *Periodic revalidation*. The regulation does not specify how often credit scoring systems must be revalidated. To meet the requirements for statistical soundness, the credit scoring system must be revalidated frequently enough to assure that it continues to meet recognized professional statistical standards. To ensure that predictive ability is being maintained, creditors must periodically review the performance of the system. This could be done, for example, by analyzing the loan portfolio to determine the delinquency rate for each score interval, or by analyzing population stability over time to detect deviations of recent applications from the applicant population used to validate the system. If this analysis indicates that the system no longer predicts risk with statistical soundness, the system must be adjusted as necessary to reestablish its predictive ability. A creditor is responsible for ensuring its system is validated and revalidated based

on the creditor's own data when it becomes available.

3. *Pooled data scoring systems.* A scoring system or the data from which to develop such a system may be obtained from either a single credit grantor or multiple credit grantors. The resulting system will qualify as an empirically derived, demonstrably and statistically sound, credit scoring system provided the criteria set forth in paragraph (p)(1) (i) through (iv) of this section are met.

4. *Effects test and disparate treatment.* An empirically derived, demonstrably and statistically sound, credit scoring system may include age as a predictive factor (provided that the age of an elderly applicant is not assigned a negative factor or value). Besides age, no other prohibited basis may be used as a variable. Generally, credit scoring systems treat all applicants objectively and thus avoid problems of disparate treatment. In cases where a credit scoring system is used in conjunction with individual discretion, disparate treatment could conceivably occur in the evaluation process. In addition, neutral factors used in credit scoring systems could nonetheless be subject to challenge under the effects test. (See comment 6(a)–2 for a discussion of the effects test).

2(w) *Open-end credit.*

1. *Open-end real estate mortgages.* The term *open-end credit* does not include negotiated advances under an open-end real estate mortgage or a letter of credit.

2(z) *Prohibited basis.*

1. *Persons associated with applicant. Prohibited basis* as used in this regulation refers not only to certain characteristics—the race, color, religion, national origin, sex, marital status, or age—of an applicant (or officers of an applicant in the case of a corporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. This means, for example, that under the general rule stated in §202.4, a creditor may not discriminate against an applicant because of that person's personal or business dealings with members of a certain religion, because of the national origin of any persons associated with the extension of credit (such as the tenants in the apartment complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.

2. *National origin.* A creditor may not refuse to grant credit because an applicant comes from a particular country but may take the applicant's immigration status into account. A creditor may also take into account any applicable law, regulation, or executive order restricting dealings with citizens (or the government) of a particular country or imposing limitations regarding credit extended for their use.

3. *Public assistance program.* Any Federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is *public assistance* for purposes of the regulation. The term includes (but is not limited to) Aid to Families with Dependent Children, food stamps, rent and mortgage supplement or assistance programs, Social Security and Supplemental Security Income, and unemployment compensation. Only physicians, hospitals, and others to whom the benefits are payable need consider Medicare and Medicaid as public assistance.

Section 202.3—Limited Exceptions for Certain Classes of Transactions

1. *Scope.* This section relieves burdens with regard to certain types of credit for which full application of the procedural requirements of the regulation is not needed. All classes of transactions remain subject to the general rule given in §202.4, barring discrimination on a prohibited basis, and to any other provision not specifically excepted.

3(a) *Public utilities credit.*

1. *Definition.* This definition applies only to credit for the purchase of a utility service, such as electricity, gas, or telephone service. Credit provided or offered by a public utility for some other purpose—such as for financing the purchase of a gas dryer, telephone equipment, or other durable goods, or for insulation or other home improvements—is not excepted.

2. *Security deposits.* A utility company is a creditor when it supplies utility service and bills the user after the service has been provided. Thus, any credit term (such as a requirement for a security deposit) is subject to the regulation.

3. *Telephone companies.* A telephone company's credit transactions qualify for the exceptions provided in §202.3(a)(2) only if the company is regulated by a government unit or files the charges for service, delayed payment, or any discount for prompt payment with a government unit.

3(c) *Incidental credit.*

1. *Examples.* If a service provider (such as a hospital, doctor, lawyer or retailer) allows the client or customer to defer the payment of a bill, this deferral of debt is credit for purposes of the regulation, even though there is no finance charge and no agreement for payment in installments. Because of the exceptions provided by this section, however, these particular credit extensions are excepted from compliance with certain procedural requirements as specified in the regulation.

3(d) *Government credit.*

1. *Credit to governments.* The exception relates to credit extended to (not by) governmental entities. For example, credit extended to a local government by a creditor in the private sector is covered by this exception, but credit extended to consumers by a

federal or state housing agency does not qualify for special treatment under this category.

Section 202.4—General Rule Prohibiting Discrimination

1. *Scope of section.* The general rule stated in § 202.4 covers all dealings, without exception, between an applicant and a creditor, whether or not addressed by other provisions of the regulation. Other sections of the regulation identify specific practices that the Board has decided are impermissible because they could result in credit discrimination on a basis prohibited by the act. The general rule covers, for example, application procedures, criteria used to evaluate creditworthiness, administration of accounts, and treatment of delinquent or slow accounts. Thus, whether or not specifically prohibited elsewhere in the regulation, a credit practice that treats applicants differently on a prohibited basis violates the law because it violates the general rule. Disparate treatment on a prohibited basis is illegal whether or not it results from a conscious intent to discriminate. Disparate treatment would be found, for example, where a creditor requires a minority applicant to provide greater documentation to obtain a loan than a similarly situated nonminority applicant. Disparate treatment also would be found where a creditor waives or relaxes credit standards for a nonminority applicant but not for a similarly situated minority applicant. Treating applicants differently on a prohibited basis is unlawful if the creditor lacks a legitimate nondiscriminatory reason for its action, or if the asserted reason is found to be a pretext for discrimination.

Section 202.5—Rules Concerning Taking of Applications

5(a) *Discouraging applications.*

1. *Potential applicants.* Generally, the regulation's protections apply only to persons who have requested or received an extension of credit. In keeping with the purpose of the act—to promote the availability of credit on a nondiscriminatory basis § 202.5(a) covers acts or practices directed at potential applicants. Practices prohibited by this section include:

• A statement that the applicant should not bother to apply, after the applicant states that he is retired.

• Use of words, symbols, models or other forms of communication in advertising that express, imply or suggest a discriminatory preference or a policy of exclusion in violation of the act.

• Use of interview scripts that discourage applications on a prohibited basis.

2. *Affirmative advertising.* A creditor may affirmatively solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor.

5(b) *General rules concerning requests for information.*

1. *Requests for information.* This section governs the types of information that a creditor may gather. Section 202.6 governs how information may be used.

Paragraph 5(b)(2)

1. *Local laws.* Information that a creditor is allowed to collect pursuant to a ''state'' statute or regulation includes information required by a local statute, regulation, or ordinance.

2. *Information required by Regulation C.* Regulation C generally requires creditors covered by the Home Mortgage Disclosure Act (HMDA) to collect and report information about the race or national origin and sex of applicants for home improvement loans and home purchase loans, including some types of loans not covered by § 202.13. Certain creditors with assets under $30 million, though covered by HMDA, are not required to collect and report these data; but they may do so at their option under HMDA, without violating the ECOA or Regulation B.

3. *Collecting information on behalf of creditors.* Loan brokers, correspondents, or other persons do not violate the ECOA or Regulation B if they collect information that they are otherwise prohibited from collecting, where the purpose of collecting the information is to provide it to a creditor that is subject to the Home Mortgage Disclosure Act or another federal or state statute or regulation requiring data collection.

5(d) *Other limitations on information requests.*

Paragraph 5(d)(1)

1. *Indirect disclosure of prohibited information.* The fact that certain credit-related information may indirectly disclose marital status does not bar a creditor from seeking such information. For example, the creditor may ask about:

• The applicant's obligation to pay alimony, child support, or separate maintenance.

• The source of income to be used as the basis for repaying the credit requested, which could disclose that it is the income of a spouse.

• Whether any obligation disclosed by the applicant has a co-obligor, which could disclose that the co-obligor is a spouse or former spouse.

• The ownership of assets, which could disclose the interest of a spouse.

Paragraph 5(d)(2)

1. *Disclosure about income.* The sample application forms in appendix B to the regulation illustrate how a creditor may inform an

applicant of the right not to disclose alimony, child support, or separate maintenance income.

2. *General inquiry about source of income.* Since a general inquiry about the source of income may lead an applicant to disclose alimony, child support, or separate maintenance, a creditor may not make such an inquiry on an application form without prefacing the request with the disclosure required by this paragraph.

3. *Specific inquiry about sources of income.* A creditor need not give the disclosure if the inquiry about income is specific and worded in a way that is unlikely to lead the applicant to disclose the fact that income is derived from alimony, child support or separate maintenance payments. For example, an application form that asks about specific types of income such as salary, wages, or investment income need not include the disclosure.

5(e) *Written applications.*

1. *Requirement for written applications.* The requirement of written applications for certain types of dwelling-related loans is intended to assist the federal supervisory agencies in monitoring compliance with the ECOA and the Fair Housing Act. Model application forms are provided in appendix B to the regulation, although use of a printed form of any kind is not required. A creditor will satisfy the requirement by writing down the information that it normally considers in making a credit decision. The creditor may complete the application on behalf of an applicant and need not require the applicant to sign the application.

2. *Telephone applications.* A creditor that accepts applications by telephone for dwelling-related credit covered by §202.13 can meet the requirements for written applications by writing down pertinent information that is provided by the applicant(s).

3. *Computerized entry.* Information entered directly into and retained by a computerized system qualifies as a written application under this paragraph. (See the commentary to section 202.13(b), *Applications through electronic media* and *Applications through video.*)

Section 202.5a—Rules on Providing Appraisal Reports

5a(a) Providing appraisals.

1. *Coverage.* This section covers applications for credit to be secured by a lien on a dwelling, as that term is defined in §202.5a(c), whether the credit is for a business purpose (for example, a loan to start a business) or a consumer purpose (for example, a loan to finance a child's education).

2. *Renewals.* If an applicant requests that a creditor renew an existing extension of credit, and the creditor obtains a new appraisal report to evaluate the request, this section applies. This section does not apply to a renewal request if the creditor uses the appraisal report previously obtained in connection with the decision to grant credit.

5a(a)(2)(i) Notice.

1. *Multiple applicants.* When an application that is subject to this section involves more than one applicant, the notice about the appraisal report need only be given to one applicant, but it must be given to the primary applicant where one is readily apparent.

5a(a)(2)(ii) Delivery.

1. *Reimbursement.* Creditors may charge for photocopy and postage costs incurred in providing a copy of the appraisal report, unless prohibited by state or other law. If the consumer has already paid for the report—for example, as part of an application fee—the creditor may not require additional fees for the appraisal (other than photocopy and postage costs).

5a(c) Definitions.

1. *Appraisal reports.* Examples of appraisal reports are:

i. A report prepared by an appraiser (whether or not licensed or certified), including written comments and other documents submitted to the creditor in support of the appraiser's estimate or opinion of value.

ii. A document prepared by the creditor's staff which assigns value to the property, if a third-party appraisal report has not been used.

iii. An internal review document reflecting that the creditor's valuation is different from a valuation in a third party's appraisal report (or different from valuations that are publicly available or valuations such as manufacturers' invoices for mobile homes).

2. *Other reports.* The term ''appraisal report'' does not cover all documents relating to the value of the applicant's property. Examples of reports not covered are:

i. Internal documents, if a third-party appraisal report was used to establish the value of the property.

ii. Governmental agency statements of appraised value.

iii. Valuations lists that are publicly available (such as published sales prices or mortgage amounts, tax assessments, and retail price ranges) and valuations such as manufacturers' invoices for mobile homes.

Section 202.6—Rules Concerning Evaluation of Applications

6(a) *General rule concerning use of information.*

1. *General.* When evaluating an application for credit, a creditor generally may consider any information obtained. However, a creditor may not consider in its evaluation of creditworthiness any information that it is barred by §202.5 from obtaining.

2. *Effects test.* The effects test is a judicial doctrine that was developed in a series of employment cases decided by the Supreme Court under Title VII of the Civil Rights Act

of 1964 (42 U.S.C. 2000e et seq.), and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (42 U.S.C. 2000e-2). Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94–589, pp. 4–5; and in the House Report that accompanied H.R. 6516, No. 94–210, p. 5. The act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on is face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact. For example, requiring that applicants have incomes in excess of a certain amount to qualify for an overdraft line of credit could mean that women and minority applicants will be rejected at a higher rate than men and non-minority applicants. If there is a demonstrable relationship between the income requirement and creditworthiness for the level of credit involved, however, use of the income standard would likely be permissible.

6(b) *Specific rules concerning use of information.*

Paragraph 6(b)(1)

1. *Prohibited basis—marital status.* A creditor may not use marital status as a basis for determining the applicant's creditworthiness. However, a creditor may consider an applicant's marital status for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit. For example, in a secured transaction involving real property, a creditor could take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral. Except to the extent necessary to determine rights and remedies for a specific credit transaction, a creditor that offers joint credit may not take the applicants' marital status into account in credit evaluations. Because it is unlawful for creditors to take marital status into account, creditors are barred from applying different standards in evaluating married and unmarried applicants. In making credit decisions, creditors may not treat joint applicants differently based on the existence, the absence, or the likelihood of a marital relationship between the parties.

2. *Prohibited basis—special purpose credit.* In a special purpose credit program, a creditor may consider a prohibited basis to determine whether the applicant possesses a characteristic needed for eligibility. (See § 202.8.)

Paragraph 6(b)(2)

1. *Favoring the elderly.* Any system of evaluating creditworthiness may favor a credit applicant who is age 62 or older. A credit program that offers more favorable credit terms to applicants age 62 or older is also permissible; a program that offers more favorable credit terms to applicants at an age lower than 62 is permissible only if it meets the special-purpose credit requirements of § 202.8.

2. *Consideration of age in a credit scoring system.* Age may be taken directly into account in a credit scoring system that is ''demonstrably and statistically sound,'' as defined in section 202.2(p), with one limitation: applicants 62 years or older must be treated at least as favorably as applicants who are under 62. If age is scored by assigning points to an applicant's age category, elderly applicants must receive the same or a greater number of points as the most favored class of nonelderly applicants.

i. *Age-split scorecards.* A creditor may segment the population into scorecards based on the age of an applicant. In such a system, one card covers a narrow age range (for example, applicants in their twenties or younger) who are evaluated under attributes predictive for that age group. A second card covers all other applicants who are evaluated under the attributes predictive for that broad class. When a system uses a card covering a wide age range that encompasses elderly applicants, the credit scoring system does not score age. Thus, the system does not raise the issue of assigning a negative factor or value to the age of elderly applicants. But if a system segments the population by age into multiple scorecards, and includes elderly applicants in a narrower age range, the credit scoring system does score age. To comply with the act and regulation in such a case, the creditor must ensure that the system does not assign a negative factor or value to the age of elderly applicants as a class.

3. *Consideration of age in a judgmental system.* In a judgmental system, defined in § 202.2(t), a creditor may not take age directly into account in any aspect of the credit transaction. For example, the creditor may not reject an application or terminate an account because the applicant is 60 years old. But a creditor that uses a judgmental system may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness. For example:

• A creditor may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the extension of credit to its maturity.

• A creditor may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy

of the applicant and the cost of realizing on the collateral could exceed the applicant's equity. (An elderly applicant might not qualify for a 5 percent down, 30-year mortgage loan but might qualify with a larger downpayment or a shorter loan maturity.)

• A creditor may consider the applicant's age to assess the significance of the length of the applicant's employment (a young applicant may have just entered the job market) or length of time at an address (an elderly applicant may recently have retired and moved from a long-term residence).

As the examples above illustrate, the evaluation must be made in an individualized, case-by-case manner; and it is impermissible for a creditor, in deciding whether to extend credit or in setting the terms and conditions, to base its decision on age or information related exclusively to age. Age or age-related information may be considered only in evaluating other ''pertinent elements of creditworthiness'' that are drawn from the particular facts and circumstances concerning the applicant.

4. *Consideration of age in a reverse mortgage.* A reverse mortgage is a home-secured loan in which the borrower receives payments from the creditor, and does not become obligated to repay these amounts (other than in the case of default) until the borrower dies, moves permanently from the home or transfers title to the home, or upon a specified maturity date. Disbursements to the borrower under a reverse mortgage typically are determined by considering the value of the borrower's home, the current interest rate, and the borrower's life expectancy. A reverse mortgage program that requires borrowers to be age 62 or older is permissible under section 202.6(b)(2)(iv). In addition, under section 202.6(b)(2)(iii), a creditor may consider a borrower's age to evaluate a pertinent element of creditworthiness, such as the amount of the credit or monthly payments that the borrower will receive, or the estimated repayment date.

5. *Consideration of age in a combined system.* A creditor using a credit scoring system that qualifies as ''empirically derived'' under §202.2(p) may consider other factors (such as credit report or the applicant's cash flow) on a judgmental basis. Doing so will not negate the classification of the credit scoring component of the combined system as ''demonstrably and statistically sound.'' While age could be used in the credit scoring portion, however, in the judgmental portion age may not be considered directly. It may be used only for the purpose of determining a ''pertinent element of creditworthiness.'' (See comment 6(b)(2)–3.)

6. *Consideration of public assistance.* When considering income derived from a public assistance program, a creditor may take into account, for example:

• The length of time an applicant will likely remain eligible to receive such income.

• Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (such as Aid to Families with Dependent Children or Social Security payments to a minor).

• Whether the creditor can attach or garnish the income to assure payment of the debt in the event of default.

Paragraph 6(b)(5)

1. *Consideration of an individual applicant.* A creditor must evaluate income derived from part-time employment, alimony, child support, separate maintenance, retirement benefits, or public assistance (all referred to as ''protected income'') on an individual basis, not on the basis of aggregate statistics, and must assess its reliability or unreliability by analyzing the applicant's actual circumstances, not by analyzing statistical measures derived from a group.

2. *Payments consistently made.* In determining the likelihood of consistent payments of alimony, child support, or separate maintenance, a creditor may consider factors such as whether payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; whether the payments are regularly received by the applicant; the availability of court or other procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when it is available to the creditor.

3. *Consideration of income.* A creditor need not consider income at all in evaluating creditworthiness. If a creditor does consider income, there are several acceptable methods, whether in a credit scoring or a judgmental system:

• A creditor may score or take into account the total sum of all income stated by the applicant without taking steps to evaluate the income.

• A creditor may evaluate each component of the applicant's income, and then score or take into account reliable income separately from income that is not reliable, or the creditor may disregard that portion of income that is not reliable before aggregating it with reliable income.

• A creditor that does not evaluate all income components for reliability must treat as reliable any component of protected income that is not evaluated.

In considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any protected income. Any discounting or exclusion must be based on the applicant's actual circumstances.

4. *Part-time employment, sources of income.* A creditor may score or take into account the fact that an individual applicant has more than one source of earned income—a full-

time and a part-time job or two part-time jobs. A creditor may also score or treat earned income from a secondary source differently than earned income from a primary source. However, the creditor may not score or otherwise take into account the number of sources for protected income—for example, retirement income, social security, alimony. Nor may the creditor treat negatively the fact that an applicant's only earned income is derived from a part-time job.

Paragraph 6(b)(6)

1. *Types of credit references.* A creditor may restrict the types of credit history and credit references that it will consider, provided that the restrictions are applied to all credit applicants without regard to sex, marital status, or any other prohibited basis. However, on the applicant's request, a creditor must consider credit information not reported through a credit bureau when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit bureau.

Paragraph 6(b)(7)

1. *National origin—immigration status.* The applicant's immigration status and ties to the community (such as employment and continued residence in the area) could have a bearing on a creditor's ability to obtain repayment. Accordingly, the creditor may consider and differentiate, for example, between a noncitizen who is a long-time resident with permanent resident status and a noncitizen who is temporarily in this country on a student visa.

2. *National origin—citizenship.* Under the regulation a denial of credit on the ground that an applicant is not a United States citizen is nor per se discrimination based on national origin.

Section 202.7—Rules Concerning Extensions of Credit

7(a) *Individual accounts.*

1. *Open-end credit—authorized user.* A creditor may not require a creditworthy applicant seeking an individual credit account to provide additional signatures. However, the creditor may condition the designation of an authorized user by the account holder on the authorized user's becoming contractually liable for the account, as long as the creditor does not differentiate on any prohibited basis in imposing this requirement.

2. *Open-end credit—choice of authorized user.* A creditor that permits an account holder to designate an authorized user may not restrict this designation on a prohibited basis. For example, if the creditor allows the designation of spouses as authorized users, the creditor may not refuse to accept a nonspouse as an authorized user.

3. *Overdraft authority on transaction accounts.* If a transaction account (such as a checking account or NOW account) includes an overdraft line of credit, the creditor may require that all persons authorized to draw on the transaction account assume liability for any overdraft.

7(b) *Designation of name.*

1. *Single name on account.* A creditor may require that joint applicants on an account designate a single name for purposes of administering the account and that a single name be embossed on any credit card(s) issued on the account. But the creditor may not require that the name be the husband's name. (See §202.10 for rule governing the furnishing of credit history on accounts held by spouses.)

7(c) *Action concerning existing open-end accounts.*

Paragraph 7(c)(1)

1. *Termination coincidental with marital status change.* When an account holder's marital status changes, a creditor generally may not terminate the account unless it has evidence that the account holder is unable or unwilling to repay. But the creditor may terminate an account on which both spouses are jointly liable, even if the action coincides with a change in marital status, when one or both spouses:

- Repudiate responsibility for future charges on the joint account.
- Request separate accounts in their own names.
- Request that the joint account be closed.

2. *Updating information.* A creditor may periodically request updated information from applicants but may not use events related to a prohibited basis—such as an applicant's retirement, reaching a particular age, or change in name or marital status—to trigger such a request.

Paragraph 7(c)(2)

1. *Procedure pending reapplication.* A creditor may require a reapplication from a contractually liable party, even when there is no evidence of unwillingness or inability to repay, if (1) the credit was based on the qualifications of a person who is no longer available to support the credit and (2) the creditor has information indicating that the account holder's income by itself may be insufficient to support the credit. While a reapplication is pending, the creditor must allow the account holder full access to the account under the existing contract terms. The creditor may specify a reasonable time period within which the account holder must submit the required information.

7(d) *Signature of spouse or other person.*

1. *Qualified applicant.* The signature rules assure that qualified applicants are able to obtain credit in their own names. Thus,

when an applicant requests individual credit, a creditor generally may not require the signature of another person unless the creditor has first determined that the applicant alone does not qualify for the credit requested.

2. *Unqualified applicant*. When an applicant applies for individual credit but does not alone meet a creditor's standards, the creditor may require a cosigner, guarantor or the like—but cannot require that it be the spouse. (See commentary to §202.7(d) (5) and (6).)

Paragraph 7(d)(1)

1. *Joint applicant*. The term *joint applicant* refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested.

Paragraph 7(d)(2)

1. *Jointly owned property*. If an applicant requests unsecured credit, does not own sufficient separate property, and relies on joint property to establish creditworthiness, the creditor must value the applicant's interest in the jointly owned property. A creditor may not request that a nonapplicant joint owner sign any instrument as a condition of the credit extension unless the applicant's interest does not support the amount and terms of the credit sought.

i. *Valuation of applicant's interest*. In determining the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the form of ownership prior to or at consummation, and not on the possibility of a subsequent change. For example, in determining whether a married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property may be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the nonapplicant spouse in these or similar circumstances.

ii. *Other options to support credit*. If the applicant's interest in jointly owned property does not support the amount and terms of credit sought, the creditor may offer the applicant other options to provide additional support for the extension of credit. For example—

A. Requesting an additional party (see §202.7(d)(5));

B. Offering to grant the applicant's request on a secured basis (see §202.7(d)(4)); or

C. Asking for the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (e.g., a limited guarantee). A creditor may not routinely require, however, that a joint owner sign an instrument (such as a quitclaim deed) that would result in the forfeiture of the joint owner's interest in the property.

2. *Need for signature—reasonable belief*. A creditor's reasonable belief as to what instruments need to be signed by a person other than the applicant should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

Paragraph 7(d)(3)

1. *Residency*. In assessing the creditworthiness of a person who applies for credit in a community property state, a creditor may assume that the applicant is a resident of the state unless the applicant indicates otherwise.

Paragraph 7(d)(4)

1. *Creation of enforceable lien*. Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require them to do so.

2. *Need for signature—reasonable belief*. Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to assure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

3. *Integrated instruments*. When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be required to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated

instrument that makes clear—for example, by a legend placed next to the spouse's signature—that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.

Paragraph 7(d)(5)

Qualifications of additional parties. In establishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties but may not discriminate on the basis of sex, marital status or any other prohibited basis. For example, the creditor could require that the additional party live in the creditor's market area.

2. *Reliance on income of another person—individual credit.* An applicant who requests individual credit relying on the income of another person (including a spouse in a noncommunity property state) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature of a spouse may be required if the applicant relies on the spouse's separate income. If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so—even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See §202.6(c) on consideration of state property laws.)

3. *Renewals.* If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not, release the additional party.

Paragraph 7(d)(6)

1. *Guarantees.* A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only from the married officers of a business or married shareholders of a closely held corporation.

2. *Spousal guarantees.* The rules in §202.7(d) bar a creditor from requiring a signature of a *guarantor's spouse* just as they bar the creditor from requiring the signature of an *applicant's spouse.* For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of a spouse in appropriate circumstances in accordance with §202.7(d)(2).

7(e) *Insurance.*

1. *Differences in terms.* Differences in the availability, rates, and other terms on which credit-related casualty insurance or credit life, health, accident, or disability insurance is offered or provided to an applicant does not violate Regulation B.

2. *Insurance information.* A creditor may obtain information about an applicant's age, sex, or marital status for insurance purposes. The information may only be used, however, for determining eligibility and premium rates for insurance, and not in making the credit decision.

Section 202.8—Special Purpose Credit Programs

8(a) *Standards for programs.*

1. *Determining qualified programs.* The Board does not determine whether individual programs qualify for special purpose credit status, or whether a particular program benefits an ''economically disadvantaged class of persons.'' The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program.

2. *Compliance with a program authorized by Federal or State law.* A creditor does not violate Regulation B when it complies in good faith with a regulation promulgated by a government agency implementing a special purpose credit program under §202.8(a)(1). It is the agency's responsibility to promulgate a regulation that is consistent with Federal and State law.

3. *Expressly authorized.* Credit programs authorized by Federal or State law include programs offered pursuant to Federal, State or local statute, regulation or ordinance, or by judicial or administrative order.

4. *Creditor liability.* A refusal to grant credit to an applicant is not a violation of the act or regulation if the applicant does not meet the eligibility requirements under a special purpose credit program.

5. *Determining need.* In designing a special-purpose program under §202.8(a), a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's own research or data from outside sources including governmental reports and studies. For example, a bank could

review Home Mortgage Disclosure Act data along with demographic data for its assessment area and conclude that there is a need for a special-purpose credit program for low-income minority borrowers.

6. *Elements of the program.* The written plan must contain information that supports the need for the particular program. The plan also must either state a specific period of time for which the program will last, or contain a statement regarding when the program will be reevaluated to determine if there is a continuing need for it.

8(b) *Rules is other sections.*

1. *Applicability of rules.* A creditor that rejects an application because the applicant does not meet the eligibility requirements (common characteristic or financial need, for example) must nevertheless notify the applicant of action taker as required by § 202.9.

8(c) *Special rule concerning requests and use of information.*

1. *Request of prohibited information.* This section permits a creditor to request and consider certain information that would otherwise be prohibited by §§ 202.5 and 202.6 to determine an applicant's eligibility for a particular program.

2. *Examples.* Examples of programs under which the creditor can ask for and consider information related to prohibited basis are:

• Energy conservation programs to assist the elderly, for which the creditor must consider the applicant's age.

• Programs under a Minority Enterprise Small Business Investment Corporation, for which a creditor must consider the applicant's minority status.

8(d) *Special rule in the case of financial need.*

1. *Request of prohibited information.* This section permits a creditor to request and consider certain information that would otherwise be prohibited by §§ 202.5 and 202.6, and to require signatures that would otherwise be prohibited by § 202.7(d).

2. *Examples.* Examples of programs in which financial need is a criterion are:

• Subsidized housing programs for low- to moderate-income households, for which a creditor may have to consider the applicant's receipt of alimony or child support, the spouse's or parents' income, etc.

• Student loan programs based on the family's financial need, for which a creditor may have to consider to spouse's or parents' financial resources.

3. *Student loans.* In a guaranteed student loan program, a creditor may obtain the signature of a parent as a guarantor when required by federal or state law or agency regulation, or when the student does not meet the creditor's standards of creditworthiness. (See § 202.7(d)(1) and (5).) The creditor may not require an additional signature when a student has a work or credit history that satisfies the creditor's standards.

Section 202.9—Notifications

1. *Use of the term adverse action.* The regulation does not require that a creditor use the term *adverse* in communicating to an applicant that a request for an extension of credit has not been approved. In notifying an applicant of adverse action as defined by § 202.2(c)(1), a creditor may use any words or phrases that describe the action taken on the application.

2. *Expressly withdrawn applications.* When an applicant expressly withdraws a credit application, the creditor is not required to comply with the notification requirements under § 202.9. (The creditor must, however, comply with the record retention requirements of the regulation. See § 202.12(b)(3).)

3. *When notification occurs.* Notification occurs when a creditor delivers or mails a notice to the applicant's last known address or, in the case of an oral notification, when the creditor communicates the credit decision to the applicant.

4. *Location of notice.* The notifications required under § 202.9 may appear on either or both sides of a form or letter.

5. *Prequalification and preapproval programs.* Whether a creditor must provide a notice of action taken for a prequalification or preapproval request depends on the creditor's response to the request, as discussed in the commentary to section 202.2(f). For instance, a creditor may treat the request as an inquiry if the creditor provides general information such as loan terms and the maximum amount a consumer could borrow under various loan programs, explaining the process the consumer must follow to submit a mortgage application and the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a request as an application, and is subject to the adverse action notice requirements of § 202.9 if, after evaluating information, the creditor decides that it will not approve the request and communicates that decision to the consumer. For example, if in reviewing a request for prequalification, a creditor tells the consumer that it would not approve an application for a mortgage because of a bankruptcy in the consumer's record, the creditor has denied an application for credit.

9(a) *Notification of action taken, ECOA notice, and statement of specific reasons.*

Paragraph 9(a)(1)

1. *Timing of notice—when an application is complete.* Once a creditor has obtained all the information it normally considers in making a credit decision, the application is complete and the creditor has 30 days in which to notify the applicant of the credit decision. (See also comment 2(f)–5.)

2. *Notification of approval.* Notification of approval may be express or by implication.

For example, the creditor will satisfy the notification requirement when it gives the applicant the credit card, money, property, or services requested.

3. *Incomplete application—denial for incompleteness.* When an application is incomplete regarding matters that the applicant can complete and the creditor lacks sufficient data for a credit decision, the creditor may deny the application giving as the reason for denial that the application is incomplete. The creditor has the option, alternatively, of providing a notice of incompleteness under § 202.9(c).

4. *Incomplete application—denial for reasons other than incompleteness.* When an application is missing information but provides sufficient data for a credit decision, the creditor may evaluate the application and notify the applicant under this section as appropriate. If credit is denied, the applicant must be given the specific reasons for the credit denial (or notice of the right to receive the reasons); in this instance the incompleteness of the application cannot be given as the reason for the denial.

5. *Length of counteroffer.* Section 202.9(a)(1)(iv) does not require a creditor to hold a counteroffer open for 90 days or any other particular length of time.

6. *Counteroffer combined with adverse action notice.* A creditor that gives the applicant a combined counteroffer and adverse action notice that complies with § 202.9(a)(2) need not send a second adverse action notice if the applicant does not accept the counteroffer. A sample of a combined notice is contained in form C–4 of Appendix C to the regulation.

7. *Denial of a telephone application.* When an application is conveyed by means of telephone and adverse action is taken, the creditor must request the applicant's name and address in order to provide written notification under this section. If the applicant declines to provide that information, then the creditor has no further notification responsibility.

Paragraph 9(a)(3)

1. *Coverage.* In determining the rules in this paragraph that apply to a given business credit application, a creditor may rely on the applicant's assertion about the revenue size of the business. (Applications to start a business are governed by the rules in § 202.9(a)(3)(i).) If an applicant applies for credit as a sole proprietor, the revenues of the sole proprietorship will determine which rules in the paragraph govern the application. However, if an applicant applies for business purpose credit as an individual, the rules in paragraph 9(a)(3)(i) apply unless the application is for trade or similar credit.

2. *Trade credit.* The term *trade credit* generally is limited to a financing arrangement that involves a buyer and a seller—such as a supplier who finances the sale of equipment, supplies, or inventory; it does not apply to an extension of credit by a bank or other financial institution for the financing of such items.

3. *Factoring.* Factoring refers to a purchase of accounts receivable, and thus is not subject to the act or regulation. If there is a credit extension incident to the factoring arrangement, the notification rules in § 202.9(a)(3)(ii) apply as do other relevant sections of the act and regulation.

4. *Manner of compliance.* In complying with the notice provisions of the act and regulation, creditors offering business credit may follow the rules governing consumer credit. Similarly, creditors may elect to treat all business credit the same (irrespective of revenue size) by providing notice in accordance with § 202.9(a)(3)(i).

5. *Timing of notification.* A creditor subject to § 202.9(a)(3)(ii)(A) is required to notify a business credit applicant, orally or in writing, of action taken on an application within a reasonable time of receiving a completed application. Notice provided in accordance with the timing requirements of § 202.9(a)(1) is deemed reasonable in all instances.

9(b) *Form of ECOA notice and statement specific reasons.*

Paragraph 9(b)(1)

1. *Substantially similar notice.* The ECOA notice sent with a notification of a credit denial or other adverse action will comply with the regulation if it is ''substantially similar'' to the notice contained in § 202.9(b)(1). For example, a creditor may add a reference to the fact that the ECOA permits age to be considered in certain scoring systems, or add a reference to a similar state statute or regulation and to a state enforcement agency.

Paragraph 9(b)(2)

1. *Number of specific reasons.* A creditor must disclose the principal reasons for denying an application or taking other adverse action. The regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant.

2. *Source of specific reasons.* The specific reasons disclosed under § 202.9 (a)(2) and (b)(2) must relate to and accurately describe the factors actually considered or scored by a creditor.

3. *Description of reasons.* A creditor need not describe how or why a factor adversely affected an applicant. For example, the notice may say ''length of residence'' rather than ''too short a period of residence.''

4. *Credit scoring system.* If a creditor bases the denial or other adverse action on a credit scoring system, the reasons disclosed must relate only to those factors actually scored

in the system. Moreover, no factor that was a principal reason for adverse action may be excluded from disclosure. The creditor must disclose the actual reasons for denial (for example, ''age of automobile'') even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.

5. *Credit scoring—method for selecting reasons.* The regulation does not require that any one method be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system. Various methods will meet the requirements of the regulation. One method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by applicants whose total score was at or slightly above the minimum passing score. Another method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by all applicants. These average scores could be calculated during the development or use of the system. Any other method that produces results substantially similar to either of these methods is also acceptable under the regulation.

6. *Judgmental system.* If a creditor uses a judgmental system, the reasons for the denial or other adverse action must relate to those factors in the applicant's record actually reviewed by the person making the decision.

7. *Combined credit scoring and judgmental system.* If a creditor denies an application based on a credit evaluation system that employs both credit scoring and judgmental components, the reasons for the denial must come from the component of the system that the applicant failed. For example, if a creditor initially credit scores an application and denies the credit request as a result of that scoring, the reasons disclosed to the applicant must relate to the factors scored in the system. If the application passes the credit scoring stage but the creditor then denies the credit request based on a judgmental assessment of the applicant's record, the reasons disclosed must relate to the factors reviewed judgmentally, even if the factors were also considered in the credit scoring component.

8. *Automatic denial.* Some credit decision methods contain features that call for automatic denial because of one or more negative factors in the applicant's record (such as the applicant's previous bad credit history with that creditor, the applicant's declaration of bankruptcy, or the fact that the applicant is a minor). When a creditor denies the credit request because of an automatic-denial factor, the creditor must disclose that specific factor.

9. *Combined ECOA–FCRA disclosures.* The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or from its own files. Disclosing that a credit report was obtained and used to deny the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons. For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy §202.9(b)(2) the creditor must disclose that the application was denied because of the applicant's delinguent credit obligations. To satisfy the FCRA requirement, the credit must also disclose that a credit report was obtained and used to deny credit. Sample forms C–1 through C–5 of appendix C of the regulation provide for the two disclosures.

9(c) *Incomplete applications.*

Paragraph 9(c)(2)

1. *Reapplication.* If information requested by a creditor is submitted by an applicant after the expiration of the time period designated by the creditor, the creditor may require the applicant to make a new application.

Paragraph 9(c)(3)

1. *Oral inquiries for additional information.* If the applicant fails to provide the information in response to an oral request, a creditor must send a written notice to the applicant within the 30-day period specified in §202.9 (c)(1) and (c)(2). If the applicant does provide the information, the creditor shall take action on the application and notify the applicant in accordance with §202.9(a).

9(g) *Applications submitted through a third party.*

1. *Third parties.* The notification of adverse action may be given by one of the creditors to whom an application was submitted. Alternatively, the third party may be a noncreditor.

2. *Third-party notice—enforcement agency.* If a single adverse action notice is being provided to an applicant on behalf of several creditors and they are under the jurisdiction of different federal enforcement agencies, the notice need not name each agency; disclosure of any one of them will suffice.

3. *Third-party notice—liability.* When a notice is to be provided through a third party, a creditor is not liable for an act or omission of the third party that constitutes a violation of the regulation if the creditor accurately and in a timely manner provided the third party with the information necessary for the notification and maintains reasonable procedures adapted to prevent such violations.

Section 202.10—Furnishing of Credit Information

1. *Scope.* The requirements of §202.10 for designating and reporting credit information apply only to consumer credit transactions. Moreover, they apply only to creditors that opt to furnish credit information to credit bureaus or to other creditors; there is no requirement that a creditor furnish credit information on its accounts.

2. *Reporting on all accounts.* The requirements of §202.10 apply only to accounts held or used by spouses. However, a creditor has the option to designate all joint accounts (or all accounts with an authorized user) to reflect the participation of both parties, whether or not the accounts are held by persons married to each other.

3. *Designating accounts.* In designating accounts and reporting credit information, a creditor need not distinguish between accounts on which the spouse is an authorized user and accounts on which the spouse is a contractually liable party.

4. *File and index systems.* The regulation does not require the creation or maintenance of separate files in the name of each participant on a joint or user account, or require any other particular system of record-keeping or indexing. It requires only that a creditor be able to report information in the name of each spouse on accounts covered by §202.10. Thus, if a creditor receives a credit inquiry about the wife, it should be able to locate her credit file without asking the husband's name.

10(a) *Designation of accounts.*

1. *New parties.* When new parties who are spouses undertake a legal obligation on an account, as in the case of a mortgage loan assumption, the creditor should change the designation on the account to reflect the new parties and should furnish subsequent credit information on the account in the new names.

2. *Request to change designation of account.* A request to change the manner in which information concerning an account is furnished does not alter the legal liability of either spouse upon the account and does not require a creditor to change the name in which the account is maintained.

Section 202.11 Relation to State Law

11(a) *Inconsistent state laws.*

1. *Preemption determination—New York.* Effective November 11, 1988, the Board has determined that the following provisions in the state law of New York are preempted by the federal law:

• Article 15, section 296a(1)(b)—Unlawful discriminatory practices in relation to credit on the basis of race, creed, color, national origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars taking a prohibited basis into account when establishing eligibility for certain special-purpose credit programs.

• Article 15, section 296a(1)(c)—Unlawful discriminatory practice to make any record or inquiry based on race, creed, color, national origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars a creditor from requesting and considering information regarding the particular characteristics (for example, race, national origin, or sex) required for eligibility for special-purpose credit programs.

2. *Preemption determination—Ohio.* Effective July 23, 1990, the Board has determined that the following provision in the state law of Ohio is preempted by the federal law:

• Section 4112.021(B)(1)—Unlawful discriminatory practices in credit transactions. This provision is preempted to the extent that it bars asking or favorably considering the age of an elderly applicant; prohibits the consideration of age in a credit scoring system; permits without limitation the consideration of age in real estate transactions; and limits the consideration of age in special-purpose credit programs to certain government-sponsored programs identified in the state law.

Section 202.12—Record Retention

12(a) *Retention of prohibited information.*

1. *Receipt of prohibited information.* Unless the creditor specifically requested such information, a creditor does not violate this section when it receives prohibited information from a consumer reporting agency.

2. *Use of retained information.* Although a creditor may keep in its files prohibited information as provided in §202.12(a), the creditor may use the information in evaluating credit applications only if permitted to do so by §202.6.

12(b) *Preservation of records.*

1. *Copies.* A copy of the original record includes carbon copies, photocopies, microfilm or microfiche copies, or copies produced by any other accurate retrieval system, such as documents stored and reproduced by computer. A creditor that uses a computerized or mechanized system need not keep a written copy of a document (for example, an adverse action notice) if it can regenerate all pertinent information in a timely manner for examination or other purposes.

2. *Computerized decisions.* A creditor that enters information items from a written application into a computerized or mechnaized system and makes the credit decision mechanically, based only on the items of information entered into the system, may comply with §202.12(b) by retaining the information actually entered. It is not required to store the complete written application, nor is it required to enter the remaining items of information into the system. If the transaction is subject to §202.13, however, the creditor is

required to enter and retain the data on personal characteristics in order to comply with the requirements of that section.

Paragraph 12(b)(3)

1. *Withdrawn and brokered applications.* In most cases, the 25-month retention period for applications runs from the date a notification is sent to the applicant granting or denying the credit requested. In certain transactions, a creditor is not obligated to provide a notice of the action taken. (See, for example, comment 9–2.) In such cases, the 25-month requirement runs from the date of application, as when:

• An application is withdrawn by the applicant.

• An application is submitted to more than one creditor on behalf of the applicant, and the application is approved by one of the other creditors.

12(b)(6) Self-tests

1. The rule requires all written or recorded information about a self-test to be retained for 25 months after a self-test has been completed. For this purpose, a self-test is completed after the creditor has obtained the results and made a determination about what corrective action, if any, is appropriate. Creditors are required to retain information about the scope of the self-test, the methodology used and time period covered by the self-test, the report or results of the self-test including any analysis or conclusions, and any corrective action taken in response to the self-test.

Section 202.13—Information for Monitoring purposes

13(a) *Information to be requested.*

1. *Natural person.* Section 202.13 applies only to applications from natural persons.

2. *Principal residence.* The requirements of § 202.13 apply only if an application relates to a dwelling that is or will be occupied by the applicant as the principal residence. A credit application related to a vacation home or a rental unit is not covered. In the case of a two- to four-unit dwelling, the application is covered if the applicant intends to occupy one of the units as a principal residence.

3. *Temporary financing.* An application for temporary financing to construct a dwelling is not subject to § 202.13. But an application for both a temporary loan to finance construction of a dwelling and a permanent mortgage loan to take effect upon the completion of construction is subject to § 202.13.

4. *New principal residence.* A person can have only one principal residence at a time. However, if a person buys or builds a new dwelling that will become that person's principal residence within a year or upon completion of construction, the new dwelling is considered the principal residence for purposes of § 202.13.

5. *Transactions not covered.* The information-collection requirements of this section apply to applications for credit primarily for the purchase or refinancing of a dwelling that is or will become the applicant's principal residence. Therefore, applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not subject to information-collection requirements. An application for an open-end home equity line of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the line is for the purchase or refinancing of a principal dwelling.

6. *Refinancings.* A refinancing occurs when an existing obligation is satisfied and replaced by a new obligation undertaken by the same borrower. A creditor that receives an application to refinance an existing extension of credit made by that creditor for the purchase of the applicant's dwelling may request the monitoring information again but is not required to do so if it was obtained in the earlier transaction.

7. *Data collection under Regulation C.* See comment 5(b)(2)–2.

13(b) *Obtaining of information.*

1. *Forms for collecting data.* A creditor may collect the information specified in § 202.13(a) either on an application form or on a separate form referring to the application.

2. *Written applications.* The regulation requires written applications for the types of credit covered by § 202.13. A creditor can satisfy this requirement by recording in writing or by means of computer the information that the applicant provides orally and that the creditor normally considers in a credit decision.

3. *Telephone, mail applications.* If an applicant does not apply in person for the credit requested, a creditor does not have to complete the monitoring information. For example:

• When a creditor accepts an application by telephone, it does not have to request the monitoring information.

• When a creditor accepts an application by mail, it does not have to make a special request to the applicant if the applicant fails to complete the monitoring information on the application form sent to the creditor.

If it is not evident on the face of the application that it was received by mail or telephone, the creditor should indicate on the form or other application record how the application was received.

4. *Applications through electronic media.* If an applicant applies through an electronic medium (for example, the Internet or a facsimile) without video capability that allows

the creditor to see the applicant, the creditor may treat the application as if it were received by mail or telephone.

5. *Applications through video.* If a creditor takes an application through a medium that allows the creditor to see the applicant, the creditor treats the application as taken in person and must note the monitoring information on the basis of visual observation or surname, if the applicant chooses not to provide the information.

6. *Applications through loan-shopping services.* When a creditor receives an application through an unaffiliated loan-shopping service, it does not have to request the monitoring information for purposes of the ECOA or Regulation B. Creditors subject to the Home Mortgage Disclosure Act should be aware, however, that data collection may be called for under Regulation C which generally requires creditors to report, among other things, the sex and race or national origin of an applicant on brokered applications or applications received through a correspondent.

7. *Inadvertent notation.* If a creditor inadvertently obtains the monitoring information in a dwelling related transaction not covered by §202.13, the creditor may process and retain the application without violating the regulation.

13(c) *Disclosure to applicant(s).*

1. *Procedures for providing disclosures.* The disclosures to an applicant regarding the monitoring information may be provided in writing. Appendix B contains a sample disclosure. A creditor may devise its own disclosure so long as it is substantially similar. The creditor need not orally request the applicant to provide the monitoring information if it is requested in writing.

13(d) *Substitute monitoring program.*

1. *Substitute program.* An enforcement agency may adopt, under its established rulemaking or enforcement procedures, a program requiring creditors under its jurisdiction to collect information in addition to that required by this section.

Section 202.14—Enforcement, penalties and liabilities

14(c) *Failure of compliance.*

1. *Inadvertent errors.* Inadvertent errors include, but are not limited to, clerical mistake, calculation error, computer malfunction, and printing error. An error of legal judgment is not an inadvertent error under the regulation.

2. *Correction of error.* For inadvertent errors that occur under §§202.12 and 202.13, this section requires that they be corrected prospectively only.

Section 202.15—Incentives for Self-testing and Self-correction

15(a) General Rules

15(a)(1) Voluntary Self-Testing and Correction

1. Activities required by any governmental authority are not voluntary self-tests. A governmental authority includes both administrative and judicial authorities for federal, state, and local governments.

15(a)(2) Corrective Action Required

1. To qualify for the privilege, appropriate corrective action is required when the results of a self-test show that it is more likely than not that there has been a violation of the ECOA or this regulation. A self-test is also privileged when it identifies no violations.

2. In some cases, the issue of whether certain information is privileged may arise before the self-test is complete or corrective actions are fully under way. This would not necessarily prevent a creditor from asserting the privilege. In situations where the self-test is not complete, for the privilege to apply the lender must satisfy the regulation's requirements within a reasonable period of time. To assert the privilege where the self-test shows a likely violation, the rule requires, at a minimum, that the creditor establish a plan for corrective action and a method to demonstrate progress in implementing the plan. Creditors must take appropriate corrective action on a timely basis after the results of the self-test are known.

3. A creditor's determination about the type of corrective action needed, or a finding that no corrective action is required, is not conclusive in determining whether the requirements of this paragraph have been satisfied. If a creditor's claim of privilege is challenged, an assessment of the need for corrective action or the type of corrective action that is appropriate must be based on a review of the self-testing results, which may require an in camera inspection of the privileged documents.

15(a)(3) Other privileges

1. A creditor may assert the privilege established under this section in addition to asserting any other privilege that may apply, such as the attorney-client privilege or the work product privilege. Self-testing data may still be privileged under this section, whether or not the creditor's assertion of another privilege is upheld.

15(b) Self-test Defined

15(b)(1) Definition

Paragraph 15(b)(1)(i)

1. To qualify for the privilege, a self-test must be sufficient to constitute a determination of the extent or effectiveness of the creditor's compliance with the act and Regulation B. Accordingly, a self-test is only privileged if it was designed and used for that purpose. A self-test that is designed or used to determine compliance with other laws or regulations or for other purposes is not privileged under this rule. For example, a self-test designed to evaluate employee efficiency or customers' satisfaction with the level of service provided by the creditor is not privileged even if evidence of discrimination is uncovered incidentally. If a self-test is designed for multiple purposes, only the portion designed to determine compliance with the ECOA is eligible for the privilege.

Paragraph 15(b)(1)(ii)

1. The principal attribute of self-testing is that it constitutes a voluntary undertaking by the creditor to produce new data or factual information that otherwise would not be available and could not be derived from loan or application files or other records related to credit transactions. Self-testing includes, but is not limited to, the practice of using fictitious applicants for credit (testers), either with or without the use of matched pairs. A creditor may elect to test a defined segment of its business, for example, loan applications processed by a specific branch or loan officer, or applications made for a particular type of credit or loan program. A creditor also may use other methods of generating information that is not available in loan and application files, such as surveying mortgage loan applicants. To the extent permitted by law, creditors might also develop new methods that go beyond traditional pre-application testing, such as hiring testers to submit fictitious loan applications for processing.

2. The privilege does not protect a creditor's analysis performed as part of processing or underwriting a credit application. A creditor's evaluation or analysis of its loan files, Home Mortgage Disclosure Act data, or similar types of records (such as broker or loan officer compensation records) does not produce new information about a creditor's compliance and is not a self-test for purposes of this section. Similarly, a statistical analysis of data derived from existing loan files is not privileged.

15(b)(3) Types of Information not Privileged

Paragraph 15(b)(3)(i)

1. The information listed in this paragraph is not privileged and may be used to determine whether the prerequisites for the privilege have been satisfied. Accordingly, a creditor might be asked to identify the self-testing method, for example, whether pre-application testers were used or data were compiled by surveying loan applicants. Information about the scope of the self test (such as the types of credit transactions examined, or the geographic area covered by the test) also is not privileged.

Paragraph 15(b)(3)(ii)

1. Property appraisal reports, minutes of loan committee meetings or other documents reflecting the basis for a decision to approve or deny an application, loan policies or procedures, underwriting standards, and broker compensation records are examples of the types of records that are not privileged. If a creditor arranges for testers to submit loan applications for processing, the records are not related to actual credit transactions for purposes of this paragraph and may be privileged self-testing records.

15(c) Appropriate Corrective Action

1. The rule only addresses what corrective actions are required for a creditor to take advantage of the privilege in this section. A creditor may still be required to take other actions or provide additional relief if a formal finding of discrimination is made.

15(c)(1) General Requirement

1. Appropriate corrective action is required even though no violation has been formally adjudicated or admitted by the creditor. In determining whether it is more likely than not that a violation occurred, a creditor must treat testers as if they are actual applicants for credit. A creditor may not refuse to take appropriate corrective action under this section because the self-test used fictitious loan applicants. The fact that a tester's agreement with the creditor waives the tester's legal right to assert a violation does not eliminate the requirement for the creditor to take corrective action, although no remedial relief for the tester is required under paragraph 15(c)(3).

15(c)(2) Determining the Scope of Appropriate Corrective Action

1. Whether a creditor has taken or is taking corrective action that is appropriate will be determined on a case-by-case basis. Generally, the scope of the corrective action that is needed to preserve the privilege is governed by the scope of the self-test. For example, a creditor that self-tests mortgage loans and discovers evidence of discrimination may focus its corrective actions on mortgage loans, and is not required to expand its testing to other types of loans.

2. In identifying the policies or practices that are the likely cause of the violation, a

creditor might identify inadequate or improper lending policies, failure to implement established policies, employee conduct, or other causes. The extent and scope of a likely violation may be assessed by determining which areas of operations are likely to be affected by those policies and practices, for example, by determining the types of loans and stages of the application process involved and the branches or offices where the violations may have occurred.

3. Depending on the method and scope of the self-test and the results of the test, appropriate corrective action may include one or more of the following:

i. If the self-test identifies individuals whose applications were inappropriately processed, offering to extend credit if the application was improperly denied and compensating such persons for out-of-pocket costs and other compensatory damages;

ii. Correcting institutional polices or procedures that may have contributed to the likely violation, and adopting new policies as appropriate;

iii. Identifying and then training and/or disciplining the employees involved;

iv. Developing outreach programs, marketing strategies, or loan products to serve more effectively segments of the lender's markets that may have been affected by the likely discrimination; and

v. Improving audit and oversight systems to avoid a recurrence of the likely violations.

15(c)(3) Types of Relief

Paragraph 15(c)(3)(ii)

1. The use of pre-application testers to identify policies and practices that illegally discriminate does not require creditors to review existing loan files for the purpose of identifying and compensating applicants who might have been adversely affected.

2. If a self-test identifies a specific applicant that was subject to discrimination on a prohibited basis, in order to qualify for the privilege in this section the creditor must provide appropriate remedial relief to that applicant; the creditor would not be required under this paragraph to identify other applicants who might also have been adversely affected.

Paragraph 15(c)(3)(iii)

1. A creditor is not required to provide remedial relief to an applicant that would not be available by law. An applicant might also be ineligible from obtaining certain types of relief due to changed circumstances. For example, a creditor is not required to offer credit to a denied applicant if the applicant no longer qualifies for the credit due to a change in financial circumstances, although some other type of relief might be appropriate.

15(d)(1) Scope of Privilege

1. The privilege applies with respect to any examination, investigation or proceeding by federal, state, or local government agencies relating to compliance with the Act or this regulation. Accordingly, in a case brought under the ECOA, the privilege established under this section preempts any inconsistent laws or court rules to the extent they might require disclosure of privileged self-testing data. The privilege does not apply in other cases, for example, litigation filed solely under a state's fair lending statute. In such cases, if a court orders a creditor to disclose self-test results, the disclosure is not a voluntary disclosure or waiver of the privilege for purposes of paragraph 15(d)(2); creditors may protect the information by seeking a protective order to limit availability and use of the self-testing data and prevent dissemination beyond what is necessary in that case. Paragraph 15(d)(1) precludes a party who has obtained privileged information from using it in a case brought under the ECOA, provided the creditor has not lost the privilege through voluntarily disclosure under paragraph 15(d)(2).

15(d)(2) Loss of Privilege

Paragraph 15(d)(2)(i)

1. Corrective action taken by a creditor, by itself, is not considered a voluntary disclosure of the self-test report or results. For example, a creditor does not disclose the results of a self-test merely by offering to extend credit to a denied applicant or by inviting the applicant to reapply for credit. Voluntary disclosure could occur under this paragraph, however, if the creditor disclosed the self-test results in connection with a new offer of credit.

2. Disclosure of self-testing results to an independent contractor acting as an auditor or consultant for the creditor on compliance matters does not result in loss of the privilege.

Paragraph 15(d)(2)(ii)

1. The privilege is lost if the creditor discloses privileged information, such as the results of the self-test. The privilege is not lost if the creditor merely reveals or refers to the existence of the self-test.

Paragraph 15(d)(2)(iii)

1. A creditor's claim of privilege may be challenged in a court or administrative law proceeding with appropriate jurisdiction. In resolving the issue, the presiding officer may require the creditor to produce privileged information about the self-test.

Paragraph 15(d)(3) Limited use of Privileged Information

1. A creditor may be required to produce privileged documents for the purpose of determining a penalty or remedy after a violation of the ECOA or Regulation B has been formally adjudicated or admitted. A creditor's compliance with this requirement does not evidence the creditor's intent to forfeit the privilege.

Section 202.16—[Reserved]

Section 202.17—Electronic Communication

(b) General Rule

1. *Relationship to the E-Sign Act.* The E-Sign Act authorizes the use of electronic disclosures. It does not affect any requirement imposed under this part other than a provision that requires disclosures to be in paper form, and it does not affect the content or timing of disclosures. Electronic disclosures are subject to the regulation's format, timing, and retainability rules and the clear and conspicuous standard. For example, to satisfy the clear and conspicuous standard for disclosures, electronic disclosures must use visual text. The clear and conspicuous and retainability requirements apply to all disclosures provided electronically—those expressly required by the act and regulation to be in writing, and those provided in writing where the creditor has the option to give the disclosure orally or in writing.

2. *Clear and conspicuous standard.* A creditor must provide electronic disclosures using a clear and conspicuous format. Also, in accordance with the E-Sign Act:

i. The creditor must disclose the requirements for accessing and retaining disclosures in that format;

ii. The applicant must demonstrate the ability to access the information electronically and affirmatively consent to electronic delivery; and

iii. The creditor must provide the disclosures in accordance with the specified requirements.

3. *Timing and effective delivery.*

i. *When an applicant applies for credit on-line.* When a creditor permits an applicant to apply for credit on-line, the applicant must be required to access the disclosures required at application before submitting the application. A link to the disclosures satisfies the timing rule if the applicant cannot bypass the disclosures before submitting the application. Or the disclosures must automatically appear on the screen, even if multiple screens are required to view all of the information. The creditor is not required to confirm that the applicant has read the disclosures.

ii. *Appraisals and adverse action.* Disclosures provided by e-mail are timely based on when the disclosures are sent. Disclosures posted at an Internet web site, such as adverse action notices or copies of appraisals, are timely when the creditor has both made the disclosures available and sent a notice alerting the applicant that the disclosures have been posted. For example, under §202.9, a creditor must provide a notice of action taken within 30 days of receiving a completed application. For an adverse action notice posted on the Internet, a creditor must post the notice and notify the applicant of its availability within 30 days of receiving the applicant's completed application.

4. *Retainability of disclosures.* Creditors satisfy the requirement that disclosures be in a form that the applicant may keep if electronic disclosures are delivered in a format that is capable of being retained (such as by printing or storing electronically). The format must also be consistent with the information required to be provided under section 101(c)(1)(C)(i) of the E-Sign Act (15 U.S.C. 7001(c)(1)(*C*)(i)) about the hardware and software requirements for accessing and retaining electronic disclosures.

5. *Disclosures provided on creditor's equipment.* A creditor that controls the equipment providing electronic disclosures to applicants (for example, a computer terminal in a creditor's lobby or an automated loan machine at a public kiosk) must ensure that the equipment satisfies the regulation's requirements to provide timely disclosures in a clear and conspicuous format and in a form that the applicant may keep. For example, if disclosures are required at the time of an on-line application, the disclosures must be sent to the applicant's e-mail address or must be made available at another location such as the creditor's Internet web site, unless the creditor provides a printer that automatically prints the disclosures.

17(d) Address or Location To Receive Electronic Communication

Paragraph 17(d)(1)

1. *Electronic address.* An applicant's electronic address is an e-mail address that is not limited to receiving communication transmitted solely by the creditor.

Paragraph 17(d)(2)

1. *Identifying account involved.* A creditor may identify a specific account in a variety of ways and is not required to identify an account by reference to the account number. For example, where the applicant has only one credit card account, and no confusion would result, the creditor may refer to ''your credit card account.'' If the applicant has two credit card accounts, the creditor may, for example, differentiate accounts based on the card program or by using a truncated account number.

2. *90-day rule.* The actual disclosures provided to an applicant must be available for

at least 90 days, but the creditor has discretion to determine whether they should be available at the same location for the entire period.

17(e) Redelivery

1. *E-mail returned as undeliverable.* If an e-mail to the applicant (containing an alert notice or other disclosure) is returned as undeliverable, the redelivery requirement is satisfied if, for example, the creditor sends the disclosure to a different e-mail address or postal address that the creditor has on file for the applicant. Sending the disclosures a second time to the same electronic address is not sufficient if the creditor has a different address for the applicant on file.

17(f) Electronic Signatures

1. *Relationship to the E-Sign Act.* The E-Sign Act provides that electronic signatures have the same validity as handwritten signatures. Section 106 of the E-Sign Act (15 U.S.C. 7006) defines an electronic signature. To comply with the E-Sign Act, an electronic signature must be executed or adopted by an applicant with the intent to sign the record. Accordingly, regardless of the technology used to meet this requirement, the process must evidence the applicant's identity.

APPENDIX B—MODEL APPLICATION FORMS

1. *FHLMC/FNMA form—residential loan application.* The uniform residential loan application form (FHLMC 65/FNMA 1003), including supplemental form (FHLMC 65A/FNMA 1003A), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated May 1991 may be used by creditors without violating this regulation even though the form's listing of race or national origin categories in the ''Information for Government Monitoring Purposes'' section differs from the classifications currently specified in § 202.13(a)(1). The classifications used on the FNMA–FHLMC form are those required by the U.S. Office of Management and Budget for notation of race and ethnicity by federal programs in their administrative reporting and statistical activities. Creditors that are governed by the monitoring requirements of Regulation B (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data-collection section on the form when using it for transactions not covered by § 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) or by the Home Mortgage Disclosure Act (HMDA) may use the form as issued, in compliance with the substitute program or HMDA.

2. *FHLMC/FNMA form—home-improvement loan application.* The home-improvement and energy loan application form (FHLMC 703/FNMA 1012), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated October 1986, complies with the requirements of the regulation for some creditors but not others because of the form's section on ''Information for Government Monitoring Purposes.'' Creditors that are governed by § 202.13(a) of the regulation (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data collection section on the form when using it for transactions not covered by § 202.13(a) to assure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) may use the form as issued, in compliance with that substitute program.

APPENDIX C—SAMPLE NOTIFICATION FORMS

Form C–9. Creditors may design their own form, add to, or modify the model form to reflect their individual policies and procedures. For example, a creditor may want to add:

i. A telephone number that applicants may call to leave their name and the address to which an appraisal report should be sent.

ii. A notice of the cost the applicant will be required to pay the creditor for the appraisal or a copy of the report.

[Reg. B, 50 FR 48026, Nov. 20, 1985, as amended at 52 FR 10733, Apr. 3, 1987; 53 FR 11045, Apr. 5, 1988; 54 FR 9416, Mar. 7, 1989; 55 FR 12472, Apr. 4, 1990; 55 FR 14830, Apr. 19, 1990; 56 FR 14462, Apr. 10, 1991; 56 FR 16265, Apr. 22, 1991; 57 FR 12203, Apr. 9, 1992; 60 FR 29967, 29968, 29969, June 7, 1995; 61 FR 50950, 50951, Sept. 30, 1996; 62 FR 66419, Dec. 18, 1997; 66 FR 17786, Apr. 4, 2001]

PART 203—HOME MORTGAGE DISCLOSURE (REGULATION C)

Sec.
203.1 Authority, purpose, and scope.
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203.3 Exempt institutions.
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APPENDIX A TO PART 203—FORM AND INSTRUCTIONS FOR COMPLETION OF HMDA LOAN/APPLICATION REGISTER

APPENDIX B TO PART 203—FORM AND INSTRUCTIONS FOR DATA COLLECTION ON RACE OR NATIONAL ORIGIN AND SEX

SUPPLEMENT I TO PART 203—STAFF COMMENTARY

AUTHORITY: 12 U.S.C. 2801–2810.

SOURCE: 54 FR 51362, Dec. 15, 1989, unless otherwise noted.

§ 203.1 Authority, purpose, and scope.

(a) *Authority*. This regulation is issued by the Board of Governors of the Federal Reserve System (''Board'') pursuant to the Home Mortgage Disclosure Act (12 U.S.C. 2801 *et seq.*), as amended. The information-collection requirements have been approved by the U.S. Office of Management and Budget under 44 U.S.C. 3501 *et seq.* and have been assigned OMB Numbers 1557–0159, 3064–0046, 1550–0021, and 7100–0247 for institutions reporting data to the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the Federal Reserve System, respectively; numbers for the National Credit Union Administration and the Department of Housing and Urban Development are pending.

(b) *Purpose*. (1) This regulation implements the Home Mortgage Disclosure Act, which is intended to provide the public with loan data that can be used:

(i) To help determine whether financial institutions are serving the housing needs of their communities;

(ii) To assist public officials in distributing public-sector investments so as to attract private investment to areas where it is needed; and

(iii) To assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

(2) Neither the act nor this regulation is intended to encourage unsound lending practices or the allocation of credit.

(c) *Scope*. This regulation applies to certain financial institutions, including banks, saving associations, credit unions, and other mortgage lending institutions, as defined in § 203.2(e). It requires an institution to report data to its supervisory agency about home purchase and home improvement loans it originates or purchases, or for which it receives applications; and to disclose certain data to the public.

(d) *Loan aggregation and central data depositories*. Using the loan data made available by financial institutions, the Federal Financial Institutions Examination Council will prepare disclosure statements and will produce various reports for individual institutions for each metropolitan statistical area (MSA), showing lending patterns by location, age of housing stock, income level, sex, and racial characteristics. The disclosure statements and reports will be available to the public at central data depositories located in each MSA. A listing of central data depositories can be obtained from the Federal Financial Institutions Examination Council, Washington, DC 20006.

[Reg. C, 54 FR 51362, Dec. 15, 1989, as amended at 63 FR 52142, Sept. 30, 1998]

§ 203.2 Definitions.

In this regulation:

(a) *Act* means the Home Mortgage Disclosure Act (12 U.S.C. 2801 *et seq.*), as amended.

(b) *Application* means an oral or written request for a home purchase or home improvement loan that is made in accordance with procedures established by a financial institution for the type of credit requested.

(c) *Branch office* means: (1) Any office of a bank, savings association, or credit union that is approved as a branch by a federal or state supervisory agency, but excludes free-standing electronic terminals such as automated teller machines;

(2) Any office of a mortgage lending institution (other than a bank, savings association, or credit union) that takes applications from the public for home purchase or home improvement loans. A mortgage lending institution is also deemed to have a branch office in an MSA if, in the preceding calendar year, it received applications for, originated, or purchased five or more home purchase or home improvement loans on property located in that MSA.

(d) *Dwelling* means a residential structure (whether or not it is attached to real property) located in a state of the United States of America, the District of Columbia, or the Commonwealth of Puerto Rico. The term includes an individual condominium unit, cooperative unit, or mobile or manufactured home.

(e) *Financial institution* means:

(1) A bank, savings association, or credit union that originated in the preceding calendar year a home purchase

loan (other than temporary financing such as a construction loan), including a refinancing of a home purchase loan, secured by a first lien on a one- to four-family dwelling if:

(i) The institution is federally insured or regulated; or

(ii) The loan is insured, guaranteed, or supplemented by any federal agency; or

(iii) The institution intended to sell the loan to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation;

(2) A for-profit mortgage lending institution (other than a bank, savings association, or credit union) whose home purchase loan originations (including refinancings of home purchase loans) equaled or exceeded ten percent of its loan origination volume, measured in dollars, in the preceding calendar year.

(f) *Home improvement loan* means any loan that:

(1) Is for the purpose, in whole or in part, of repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which it is located; and

(2) Is classified by the financial institution as a home improvement loan.

(g) *Home purchase loan* means any loan secured by and made for the purpose of purchasing a dwelling.

(h) *Metropolitan statistical area or MSA* means a metropolitan statistical area or a primary metropolitan statistical area, as defined by the U.S. Office of Management and Budget.

[Reg. C, 54 FR 51362, Dec. 15, 1989, as amended at 56 FR 59857, Nov. 26, 1991; 59 FR 63704, Dec. 9, 1994]

§ 203.3 Exempt institutions.

(a) *Exemption based on location, asset size, or number of home purchase loans.* (1) A bank, savings association, or credit union is exempt from the requirements of this part for a given calendar year if on the preceding December 31:

(i) The institution had neither a home office nor a branch office in an MSA; or

(ii) The institution's total assets were at or below the asset threshold established by the Board. The asset threshold was adjusted from $10 million to $28 million as of December 31, 1996. For subsequent years, the Board will adjust the threshold based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each twelve-month period ending in November, with rounding to the nearest million. The Board will publish any adjustment to the asset figure in December in the staff commentary.

(2) A for-profit mortgage lending institution (other than a bank, savings association, or credit union) is exempt from the requirements of this part for a given calendar year if:

(i) The institution had neither a home office nor a branch office in an MSA on the preceding December 31; or

(ii) The institution's total assets combined with those of any parent corporation were $10 million or less on the preceding December 31, and the institution originated fewer than 100 home purchase loans (including refinancings of home purchase loans) in the preceding calendar year.

(b) *Exemption based on state law.* (1) A state-chartered or state-licensed financial institution is exempt from the requirements of this regulation if the Board determines that the institution is subject to a state disclosure law that contains requirements substantially similar to those imposed by this regulation and contains adequate provisions for enforcement.

(2) Any state, state-chartered or state-licensed financial institution, or association of such institutions may apply to the Board for an exemption under this paragraph.

(3) An institution that is exempt under this paragraph shall submit the data required by the state disclosure law to its state supervisory agency for purposes of aggregation.

(c) *Loss of exemption.* (1) An institution losing an exemption that was based on the criteria set forth in paragraph (a) of this section shall comply with this part beginning with the calendar year following the year in which it lost its exemption.

(2) An institution losing an exemption that was based on state law under paragraph (b) of this section shall comply with this regulation beginning with

the calendar year following the year for which it last reported loan data under the state disclosure law.

[Reg. C, 54 FR 51362, Dec. 15, 1989, as amended at 57 FR 56965, Dec. 2, 1992; 62 FR 28623, May 27, 1997; 63 FR 52142, Sept. 30, 1998]

§ 203.4 Compilation of loan data.

(a) *Data format and itemization.* A financial institution shall collect data regarding applications for, and originations and purchases of, home purchase and home improvement loans (including refinancings of both) for each calendar year. These transactions shall be recorded, within thirty calendar days after the end of each calendar quarter in which final action is taken (such as origination or purchase of a loan, or denial or withdrawal of an application), on a register in the format prescribed in Appendix A of this part and shall include the following items:

(1) A number for the loan or loan application, and the date the application was received.

(2) The type and purpose of the loan.

(3) The owner-occupancy status of the property to which the loan relates.

(4) The amount of the loan or application.

(5) The type of action taken, and the date.

(6) The location of the property to which the loan relates, by MSA, state, county, and census tract, if the institution has a home or a branch office in that MSA.

(7) The race or national origin and sex of the applicant or borrower, and the gross annual income relied upon in processing the application.

(8) The type of entity purchasing a loan that the institution originates or purchases and then sells within the same calendar year.

(b) *Collection of data on race or national origin, sex, and income.* (1) A financial institution shall collect data about the race or national origin and sex of the applicant or borrower as prescribed in appendix B. If the applicant or borrower chooses not to provide the information, the lender shall note the data on the basis of visual observation or surname, to the extent possible.

(2) Race or national origin, sex, and income data may but need not be collected for:

(i) Loans purchased by the financial institution; or

(ii) Applications received or loans originated by a bank, savings association, or credit union with assets on the preceding December 31 of $30 million or less.

(c) *Optional data.* A financial institution may report the reasons it denied a loan application.

(d) *Excluded data.* A financial institution shall not report:

(1) Loans originated or purchased by the financial institution acting in a fiduciary capacity (such as trustee);

(2) Loans on unimproved land;

(3) Temporary financing (such as bridge or construction loans);

(4) The purchase of an interest in a pool of loans (such as mortgage-participation certificates); or

(5) The purchase solely of the right to service loans.

(e) *Data reporting under CRA for banks and savings associations with total assets of $250 million or more and banks and savings associations that are subsidiaries of a holding company whose total banking and thrift assets are $1 billion or more.* As required by agency regulations that implement the Community Reinvestment Act, banks and savings associations that had total assets of $250 million or more (or are subsidiaries of a holding company with total banking and thrift assets of $1 billion or more) as of December 31 for each of the immediately preceding two years, shall also collect the location of property located outside the MSAs in which the institution has a home or branch office, or outside any MSAs.

[54 FR 51362, Dec. 15, 1989; 55 FR 695, Jan. 8, 1990, as amended at 56 FR 59857, Nov. 26, 1991; 56 FR 66343, Dec. 23, 1991; Reg. C, 59 FR 63704, Dec. 9, 1994; 60 FR 22225, May 4, 1995]

§ 203.5 Disclosure and reporting.

(a) *Reporting to agency.* By March 1 following the calendar year for which the loan data are compiled, a financial institution shall send its complete loan application register to the agency office specified in Appendix A of this part, and shall retain a copy for its

records for a period of not less than three years.

(b) *Public disclosure of statement.* (1) A financial institution shall make its mortgage loan disclosure statement (to be prepared by the Federal Financial Institutions Examination Council) available to the public at its home office no later than three business days after receiving it from the Examination Council.

(2) In addition, a financial institution shall either:

(i) Make its disclosure statement available to the public (within ten business days of receiving it) in at least one branch office in each additional MSA where the institution has offices (the disclosure statement need only contain data relating to the MSA where the branch is located); or

(ii) Post the address for sending written requests for the disclosure statement in the lobby of each branch office in an MSA where the institution has offices, and mail or deliver a copy of the disclosure statement, within fifteen calendar days of receiving a written request (the disclosure statement need only contain data relating to the MSA for which the request is made). Including the address in the general notice required under paragraph (e) of this section satisfies this requirement.

(c) *Public disclosure of loan application register.* A financial institution shall make its loan application register available to the public after modifying it in accordance with appendix A. An institution shall make its modified register available following the calendar year for which the data are compiled, by March 31 for a request received on or before March 1, and within 30 days for a request received after March 1. The modified register need only contain data relating to the MSA for which the request is made.

(d) *Availability of data.* A financial institution shall make its modified register available to the public for a period of three years and its disclosure statement available for a period of five years. An institution shall make the data available for inspection and copying during the hours the office is normally open to the public for business. It may impose a reasonable fee for any cost incurred in providing or reproducing the data.

(e) *Notice of availability.* A financial institution shall post a general notice about the availability of its HMDA data in the lobby of its home office and of each branch office located in an MSA. It shall promptly upon request provide the location of the institution's offices where the statement is available for inspection and copying, or it may include the location in the notice.

[58 FR 13405, Mar. 11, 1993, as amended at Reg. C, 59 FR 63704, Dec. 9, 1994; 62 FR 28623, May 27, 1997]

§ 203.6 Enforcement.

(a) *Administrative enforcement.* A violation of the act or this regulation is subject to administrative sanctions as provided in section 305 of the act, including the imposition of civil money penalties, where applicable. Compliance is enforced by the agencies listed in appendix A of this regulation.

(b) *Bona fide errors.* An error in compiling or recording loan data is not a violation of the act or this regulation if it was unintentional and occurred despite the maintenance of procedures reasonably adapted to avoid such errors.

[54 FR 51362, Dec. 15, 1989, as amended at 56 FR 59857, Nov. 26, 1991]

APPENDIX A TO PART 203—FORM AND INSTRUCTIONS FOR COMPLETION OF HMDA LOAN/APPLICATION REGISTER

PAPERWORK REDUCTION ACT NOTICE

This report is required by law (12 U.S.C. 2801–2810 and 12 CFR part 203). An agency may not conduct or sponsor, and an organization is not required to respond to, a collection of information unless it displays a currently valid OMB Control Number. The OMB Control Numbers for this information collection are 1557–0159, 3064–0046, 1550–0021, and 7100–0247 for institutions reporting data to the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the Federal Reserve System, respectively; numbers for the National Credit Union Administration and the Department of Housing and Urban Development are pending. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to the respective

agencies and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, D.C. 20503.

I. Who Must File a Report

A. Depository Institutions

1. Subject to the exception discussed below, banks, savings associations, and credit unions must complete a register listing data about loan applications received, loans originated, and loans purchased if on the preceding December 31 an institution:

a. Had assets of more than the asset threshold for coverage as published by the Board each year in December, and

b. Had a home or a branch office in a ''metropolitan statistical area'' or a ''primary metropolitan statistical area'' (both are referred to in these instructions by the term ''MSA'').

2. The asset threshold was adjusted from $10 million to $28 million as of December 31, 1996. Any adjustment to the asset threshold for depository institutions will be published by the Board in December in the staff commentary.

3. *Example*. If on December 31 you had a home or branch office in an MSA and your assets exceeded the asset threshold, you must complete a register that lists the home-purchase and home-improvement loans that you originate or purchase (and also lists applications that did not result in an origination) beginning January 1.

B. Depository Institutions—Exception

You need not complete a register—even if you meet the tests for asset size and location—if your institution is a bank, savings association, or credit union that made *no* first-lien home purchase loans (including refinancings) on one-to-four-family dwellings in the preceding calendar year. This exception does not apply in the case of nondepository institutions.

C. Other Lending Institutions

Subject to the exception discussed below, for-profit mortgage lending institutions (other than banks, savings associations, and credit unions) must complete a register listing data about loan applications received, loans originated, and loans purchased if the institution had a home or branch office in an MSA on the preceding December 31, and

1. Had assets of more than $10 million (based on the combined assets of the institution and any parent corporation) on the preceding December 31, or

2. Originated 100 or more home purchase loans (including refinancings of such loans) during the preceding calendar year, regardless of asset size.

D. Other Lending Institutions—Exception

You need not complete a register—even if you meet the tests for location and asset size or number of home purchase loans—if your institution is a for-profit mortgage lender (other than a bank, savings association, or credit union) and home purchase loans that you originated in the preceding calendar year (including refinancings) came to less than 10 percent of your total loan origination volume, measured in dollars.

E. If you are the subsidiary of a bank or savings association you must complete a separate register for your institution. You will submit the register, directly or through your parent, to the agency that supervises your parent. (See paragraph VI.)

F. Institutions that are specifically exempted by the Federal Reserve Board from complying with the federal Home Mortgage Disclosure Act because they are covered by a similar state law on mortgage loan disclosures must use the disclosure form required by their state law and submit the data to their state supervisory agency.

II. Required Format and Reporting Procedures

A. Institutions must submit data to their supervisory agencies in an automated, machine-readable form. The format must conform exactly to that of form FR HMDA-LAR, including the order of columns, column headings, etc. Contact your federal supervisory agency for information regarding procedures and technical specifications for automated data submission; in some cases, agencies also make software for automated data submission available to institutions. The data must be edited before submission, using the edits included in the agency-supplied software or equivalent edits in software available from vendors or developed in-house. (Institutions that report 25 or fewer entries on their HMDA-LAR may collect and report the data in paper form. An institution that submits its register in nonautomated form must send two copies that are typed or computer printed, and must use the format of form FR HMDA-LAR (but need not use the form itself). Each page must be numbered, and the total number of pages must be given (for example, ''Page 1 of 3'').)

B. The required data are to be entered in the register for each loan origination, each application acted on, and each loan purchased during the calendar year. Your institution should decide on the procedure it wants to follow—for example, whether to begin entering the required data when an application is received, or to wait until final action is taken (such as when a loan goes to closing or an application is denied). Keep in mind that an application is to be reported in the calendar year when final action is taken. Report loan originations in the year they go

to closing; if an application has been approved but has not yet gone to closing at year-end, report it the following year.

C. Your institution may collect the data on separate registers at different branches, or on separate registers for different loan types (such as for home purchase or home improvement loans, or for loans on multifamily dwellings). But make sure the application or loan numbers (discussed under paragraph V.A.1., below) are unique.

D. Entries need not be grouped on your register by MSA, or chronologically, or by census tract numbers, or in any other particular order.

E. Applications and loans must be recorded on your register within thirty calendar days after the end of the calendar quarter in which final action (such as origination or purchase of a loan, or denial or withdrawal of an application) is taken. The type of purchaser for loans sold need not be included in these quarterly updates.

III. Submission of HMDA–LAR and Public Release of Data

A. You must submit the data for your institution to the office specified by your supervisory agency no later than March 1 following the calendar year for which the data are compiled. A list of the agencies appears at the end of these instructions.

B. You must submit all required data to your supervisory agency *in one complete package,* with the prescribed transmittal sheet. An officer of your institution must certify to the accuracy of the data. Any additional data submissions that become necessary (for example, because you discover that data were omitted from the initial submission, or because revisions are called for) also must be accompanied by a transmittal sheet.

C. The transmittal sheet must state the total number of line entries contained in the accompanying data submission. If the data submission involves revisions or deletions of previously submitted data, state the total of *all* line entries contained in *that submission,* including both those representing revisions or deletions of previously submitted entries, and those that are being resubmitted unchanged or are being submitted for the first time. If you are a depository institution, you also are asked to provide a list of the MSAs where you have a home or branch office.

D. *Availability of disclosure statement.* 1. The Federal Financial Institutions Examination Council (FFIEC) will prepare a disclosure statement from the data you submit. Your disclosure statement will be returned to the name and address indicated on the transmittal sheet. Within three business days of receiving the disclosure statement, you must make a copy available at your home office for inspection by the public. For these purposes a business day is any calendar day other than a Saturday, Sunday, or legal public holiday. You also must either:

a. Make your disclosure statement available to the public, within ten business days of receiving it from the FFIEC, in at least one branch office in each additional MSA where you have offices (the disclosure statement need only contain data relating to properties in the MSA where the branch office is located); or

b. Post in the lobby of each branch office in an MSA the address where a written request for the disclosure statement may be sent, and mail or deliver a copy of the statement to any person requesting it, within fifteen calendar days of receiving a written request. The disclosure statement need only contain data relating to the MSA for which the request is made.

2. You may make the disclosure statement available in paper form or, if the person requesting the data agrees, in automated form (such as by PC diskette or computer tape).

E. *Availability of modified loan application register.*

1. To protect the privacy of applicants and borrowers, an institution must modify its loan application register by removing the following information before releasing it to the public: the application or loan number, date application received, and date of action taken.

2. You may make the modified register available in paper or automated form (such as by PC diskette or computer tape). Although you are not required to make the modified loan application register available in census-tract order, you are strongly encouraged to do so in order to enhance its utility to users.

3. You must make your modified register available following the calendar year for which the data are complied, by March 31 for a request received on or before March 1, and within 30 days for a request received after March 1. You are not required to prepare a modified loan application register in advance of receiving a request from the public for this information, but must be able to respond to a request within 30 days. A modified register need only reflect data relating to the MSA for which the request is made.

F. *Posters.*

1.*Suggested language.* Some of the agencies provide HMDA posters that you can use to inform the public of the availability of your HMDA data, or you may create your own posters. If you print your own, the following language is suggested but is not required:

Home Mortgage Disclosure Act Notice

The HMDA data about our residential mortgage lending are available for review. The data show geographic distribution of

loans and applications; race, gender, and income of applicants and borrowers; and information about loan approvals and denials. Inquire at this office regarding the locations where HMDA data may be inspected.

2. *Additional language for institutions making the disclosure statement available upon request.* For an institution that makes its disclosure statement available upon request instead of at branch offices must post a notice informing the public of the address to which a request should be sent. For example, the institution could include the following sentence in its general notice: ''To receive a copy of these data send a written request to [address].''

IV. Types of Loans and Applications Covered and Excluded by HMDA

A. Types of Loans and Applications to be Reported

1. Report the data on home purchase and home improvement loans that you originated (that is, loans that were closed in your name) and loans that you purchased during the calendar year covered by the report. Report these data even if the loans were subsequently sold by your institution. Include refinancings of home purchase and home improvement loans.

2. Report the data for applications for home purchase and home improvement loans that did not result in originations—for example, applications that your institution denied or that the applicant withdrew during the calendar year covered by the report.

3. In the case of brokered loan applications or applications forwarded to you through a correspondent, report as originations loans that you approved and subsequently acquired according to a pre-closing arrangement (whether or not they closed in your institution's name). Additionally, report the data for all applications that did not result in originations—for example, applications that your institution denied or that the applicant withdrew during the calendar year covered by the report (whether or not they would have closed in your institution's name). For all of these loans and applications, report the race or national origin, sex, and income information, unless your institution is a bank, savings association, or credit union with assets of $30 million or less on the preceding December 31.

4. Originations are to be reported only once. If you are the loan broker or correspondent, do not report as originations loans that you forwarded to another lender for approval prior to closing, and that were approved and subsequently acquired by that lender (whether or not they closed in your name).

5. Report applications that were received in the previous calendar year but were acted upon during the calendar year covered by the current register.

B. Data To Be Excluded

Do not report loans or applications for loans of the following types:

1. Loans that, although secured by real estate, are made for purposes other than home purchase, home improvement, or refinancing (for example, do not report a loan secured by residential real property for purposes of financing college tuition, a vacation, or goods for business inventory).

2. Loans made in a fiduciary capacity (for example, by your trust department).

3. Loans on unimproved land.

4. Construction or bridge loans and other temporary financing.

5. The purchase of an interest in a pool of loans (such as mortgage-participation certificates).

6. The purchase solely of the right to service loans.

V. Instructions for Completion of Loan/Application Register

A. Application or Loan Information

1. *Application or Loan Number*

Enter an identifying number that can be used later to retrieve the loan or application file. It can be any number of your choosing (not exceeding 25 characters). You may use letters, numerals, or a combination of both.

Make sure that all numbers are unique within your institution. If your register contains data for branch offices, for example, you could use a letter or a numerical code to identify the loans or applications of different branches, or could assign a certain series of numbers to particular branches to avoid duplicate numbers. You are strongly encouraged not to use the applicant's or borrower's name or social security number, for privacy reasons.

2. *Date application received.* For paper submissions only, enter the date the loan application was received by your institution by month, day, and year, using numerals in the form MM/DD/CCYY (for example, 01/15/1999). For institutions submitting data in electronic form, the proper format is CCYYMMDD. If your institution normally records the date shown on the application form, you may use that date instead. Enter ''NA'' for loans purchased by your institution.

3. *Type.* Indicate the type of loan or application by entering the applicable code from the following:

1—Conventional (any loan other than FHA, VA, FSA, or RHS loans)
2—FHA-insured (Federal Housing Administration)
3—VA-guaranteed (Veterans Administration)

4—FSA/RHS-guaranteed (Farm Service Agency or Rural Housing Service)

4. *Purpose*

Indicate the purpose of the loan or application by entering the applicable code from the following:

1—Home purchase (one-to-four family)
2—Home improvement (one-to-four family)
3—Refinancing (home purchase or home improvement, one-to-four family)
4—Multifamily dwelling (home purchase, home improvement, and refinancings)

5. *Explanation of Purpose Codes*

Code 1: Home purchase.

a. This code applies to loans and applications made for the purpose of purchasing a residential dwelling for one to four families, if the loan is to be secured by the dwelling being purchased or by another dwelling.

b. At your option, you may use code 1 for loans that are made for home improvement purposes but are secured by a first lien, if you normally classify such first-lien loans as home purchase loans.

Code 2: Home improvement.

a. Code 2 applies to loans and applications for loans if (i) a portion of the proceeds is to be used for repairing, rehabilitating, remodeling, or improving a one- to four-family residential dwelling, or the real property upon which it is located, and (ii) the loan is classified as a home improvement loan.

b. Report both secured and unsecured loans.

c. At your option, you may report data about home-equity lines of credit—even if the credit line is not classified as a home improvement loan. If you choose to do so, you may report a home-equity line of credit as a home improvement loan if some portion of the proceeds will be used for home improvement. (See Paragraph 8. ''Loan amount.'') If you report originations of home-equity lines of credit, you must also report applications for such loans that did not result in originations.

Code 3: Refinancings.

a. Use this code for refinancings (and applications for refinancings) of loans secured by one- to four-family residential dwellings. A refinancing involves the satisfaction of an existing obligation that is replaced by a new obligation undertaken by the same borrower. But do not report a refinancing if, under the loan agreement, you are unconditionally obligated to refinance the obligation, or you are obligated to refinance the obligation subject to conditions within the borrower's control.

b. Use this code whether or not you were the original creditor on the loan being refinanced, and whether or not the refinancing involves an increase in the outstanding principal.

c. You may report all refinancings of loans secured by one- to four-family residential dwellings, regardless of the purpose of or amount outstanding on the original loan, and regardless of the amount of new money (if any) that is for home purchase or home improvement purposes.

Code 4: Multifamily dwelling.

a. Use this code for loans and loan applications on dwellings for five or more families, including home purchase loans, refinancings, and loans for repairing, rehabilitation, and remodeling purposes.

b. Do not use this code for loans on individual condominium or cooperative units; use codes 1, 2, or 3 for such loans, as applicable.

6. *Owner Occupancy*

Indicate whether the property to which the loan or loan application relates is to be owner-occupied as a principal dwelling by entering the applicable code from the following:

1—Owner-occupied as a principal dwelling
2—Not owner-occupied
3—Not applicable

7. *Explanation of Codes*

a. Use code 2 for second homes or vacation homes, as well as rental properties.

b. Use code 2 only for nonoccupant loans, or applications for nonoccupant loans, related to one-to-four family dwellings (including individual condominium or cooperative units).

c. Use code 3 if the property to which the loan relates is a multifamily dwelling; is not located in an MSA; or is located in an MSA in which your institution has neither a home nor a branch office.

d. For purchased loans, you may assume that the property will be owner-occupied as a principal dwelling (code 1) unless the loan documents or application contain information to the contrary.

8. *Loan Amount*

Enter the amount of the loan or application. Do not report loans below $500. Show the amount in thousands rounding to the nearest thousand ($500 should be rounded up to the next $1,000). For example, a loan for $167,300 should be entered as 167 and one for $15,500 as 16.

a. For home purchase loans that you originate, enter the principal amount of the loan as the loan amount. For home purchase loans that you purchase, enter the unpaid principal balance of the loan at the time of purchase as the loan amount.

b. For home improvement loans (both originations and purchases), you may include unpaid finance charges in the loan amount if that is how you record such loans on your books. For a multiple purpose loan

classified by you as a home improvement loan because it involves a home improvement purpose, enter the full amount of the loan, not just the amount specified for home improvement.

c. For home-equity lines of credit (if you have chosen to report them), enter as the loan amount only that portion of the line that is for home improvement purposes. Report the loan amount for applications that did not result in originations in the same manner. Report only in the year the line is established.

d. For refinancings of dwelling-secured loans, indicate the total amount of the refinancing, including the amount outstanding on the original loan and the amount of new money (if any).

e. For a loan application that was denied or withdrawn, enter the amount applied for.

f. If you make a counteroffer for an amount different from the amount initially applied for, and the counteroffer is accepted by the applicant, report it as an origination for the amount of the loan actually granted. If the applicant turns down the counteroffer or fails to respond, report it as a denial for the amount initially requested.

B. Action Taken

1. *Type of action*. Indicate the type of action taken on the application or loan by using one of the following codes. Do not report any loan application still pending at the end of the calendar year; you will report that application on your register for the year in which final action is taken.

1—Loan originated
2—Application approved but not accepted
3—Application denied
4—Application withdrawn
5—File closed for incompleteness
6—Loan purchased by your institution

2. *Explanation of Codes*

a. Use code 1 for a loan that is originated, including one resulting from a counteroffer (your offer to the applicant to make the loan on different terms or in a different amount than initially applied for) that the applicant accepts.

b. Use code 2 when an application is approved but the applicant (or a loan broker or correspondent) fails to respond to your notification of approval or your commitment letter within the specified time.

c. Use code 3 when an application is denied. This includes the situation when an applicant turns down or fails to respond to your counteroffer. Do *not* report as a withdrawn application or as an application that was approved but not accepted.

d. Use code 4 only when an application is expressly withdrawn by the applicant before a credit decision was made.

e. Use code 5 if you sent a written notice of incompleteness under §202.9(c)(2) of Regulation B (Equal Credit Opportunity) and the applicant failed to respond to your request for additional information within the period of time specified in your notice.

3. *Date of Action*

For paper submissions only, enter the date by month, day, and year, using numerals in the form MM/DD/CCYY (for example, 02/22/1999). For institutions submitting data in electronic form, the proper format is CCYYMMDD.

a. For loans originated, enter the settlement or closing date. For loans purchased, enter the date of purchase by your institution.

b. For applications denied, applications approved but not accepted by the applicant, and files closed for incompleteness, enter the date that the action was taken by your institution or the date the notice was sent to the applicant.

c. For applications withdrawn, enter the date you received the applicant's express withdrawal; or you may enter the date shown on the notification from the applicant, in the case of a written withdrawal.

C. Property Location

In these columns enter the applicable codes for the MSA, state, county, and census tract for the property to which a loan relates. For home purchase loans secured by one dwelling, but made for the purpose of purchasing another dwelling, report the property location for the property in which the security interest is to be taken. If the home purchase loan is secured by more than one property, report the location data for the property being purchased. (See paragraphs 5., 6., and 7. of paragraph V.C. of this appendix for treatment of loans on property outside the MSAs in which you have offices.)

1. *MSA*

For each loan or loan application, indicate the location of the property by the MSA number. Enter only the MSA number, not the MSA name. MSA boundaries are defined by the U.S. Office of Management and Budget; use the boundaries that were in effect on January 1 of the calendar year for which you are reporting. A listing of MSAs is available from your regional supervisory agency or the FFIEC. (In these instructions, the term MSA refers to both metropolitan statistical area and primary metropolitan statistical area.)

2. *State and County*

You must use the Federal Information Processing Standard (FIPS) two-digit numerical code for the state and the three-digit numerical code for the county. These codes are available from your regional supervisory

agency or the FFIEC. Do not use the letter abbreviations used by the U.S. Postal Service.

3. *Census Tract*

Indicate the census tract where the property is located.

a. Enter the code ''NA'' if the property is located in an area not divided into census tracts on the U.S. Census Bureau's census-tract outline maps (see paragraph 4. below).

b. If the property is located in a county with a population of 30,000 or less in the 1990 census (as determined by the Census Bureau's 1990 CPH–2 population series), enter ''NA'' (even if the population has increased above 30,000 since 1990), or you may enter the census tract number.

4. *Census Tract Number*

For the census tract number, consult the U.S. Census Bureau's Census Tract/Street Index for 1990, and for addresses not listed in the index, consult the Census Bureau's census tract outline maps. You must use the maps from the Census Bureau's 1990 CPH–3 series, or equivalent 1990 census data from the Census Bureau (such as the Census TIGER/Line File) or from a private publisher.

5. *Outside-MSA*

For loans on property located outside the MSAs in which you have a home or branch office (or outside any MSA), you have two options. Under option 1, you may enter the MSA, state, and county codes and the census tract number. You may enter ''NA'' in the MSA or census tract column if no code or number exists for the property. (Codes exist for all states and counties.) If you choose option 1, the codes and tract number must accurately identify the location for the property in question. Under option 2, you may enter ''NA'' in all four columns, whether or not the codes or number exist for the property.

6. *Nondepository Lenders*

If you are a for-profit mortgage lending institution (other than a bank, savings association, or credit union), and in the preceding calendar year you received applications for, or originated or purchased, loans for home purchase or home improvement adding up to a total of five or more for a given MSA, you are deemed to have a branch office in that MSA, whether or not you have a physical office there. As a result, you will have to enter the MSA, state, county, and census tract numbers for any transactions in that MSA. Because you must keep accurate records about lending within MSAs in the current calendar year in order to report data accurately the following year, to comply with this rule you may find it easier to enter the geographic information routinely for any property located within any MSA.

7. *Data Reporting Under CRA for Banks and Savings Associations With Total Assets of $250 Million or More and Banks and Savings Associations That Are Subsidiaries of a Holding Company Whose Total Banking and Thrift Assets Are $1 Billion or More*

If you are a bank or savings association with total assets of $250 million or more as of December 31 for each of the immediately preceding two years, you must also enter the location of property located outside the MSAs in which you have a home or branch office, or outside any MSA. You must also enter this information if you are a bank or savings association that is a subsidiary of a holding company with total banking and thrift assets of $1 billion or more as of December 31 for each of the immediately preceding two years.

D. Applicant Information—Race or National Origin, Sex, and Income

Appendix B of Regulation C contains instructions for the collection of data on race or national origin and sex, and also contains a sample form for data collection. The form is substantially similar to the form prescribed by §202.13 of Regulation B (Equal Credit Opportunity) and contained in appendix B to that regulation. You may use either form.

1. *Applicability*

You must report this applicant information for loans that you originate as well as for applications that do not result in an origination.

a. You need not collect or report this information for loans purchased. If you choose not to, enter the codes specified in paragraphs 3., 4., and 5. below for ''not applicable.''

b. If your institution is a bank, savings association, or credit union that had assets of $30 million or less on the preceding December 31, you may—but need not—collect and report these data. If you choose not to, enter the codes specified in paragraphs 3., 4., and 5. below for ''not applicable.''

c. If the borrower or applicant is not a natural person (a corporation or partnership, for example), use the codes specified in paragraphs 3., 4., and 5. below for ''not applicable.''

2. *Mail and Telephone Applications*

Any loan applications mailed to applicants must contain a collection form similar to that shown in appendix B, and you must record on your register the data on race or

national origin and sex if the applicant provides it. If the applicant chooses not to provide the data, enter the code for ''information not provided by applicant in mail or telephone application'' specified in paragraphs 3. and 4. below. If an application is taken entirely by telephone, you need not request this information. (See appendix B for complete information on the collection of this data in mail or telephone applications.)

3. *Race or National Origin of Borrower or Applicant*

Use the following codes to indicate the race or national origin of the applicant or borrower under column ''A'' and of any co-applicant or co-borrower under column ''CA.'' If there is more than one co-applicant, provide this information only for the first co-applicant listed on the application form. If there are no co-applicants or co-borrowers, enter code 8 for ''not applicable'' in the co-applicant column.

1—American Indian or Alaskan Native
2—Asian or Pacific Islander
3—Black
4—Hispanic
5—White
6—Other
7—Information not provided by applicant in mail or telephone application
8—Not applicable

4. *Sex of Borrower or Applicant*

Use the following codes to indicate the sex of the applicant or borrower under column ''A'' and of any co-applicant or co-borrower under column ''CA.'' If there is more than one co-applicant, provide this information only for the first co-applicant listed on the application form. If there are no co-applicants or co-borrowers, enter code 4 for ''not applicable.''

1—Male
2—Female
3—Information not provided by applicant in mail or telephone application
4—Not applicable

5. *Income*

Enter the gross annual income that your institution relied upon in making the credit decision.

a. Round all dollar amounts to the nearest thousand (round $500 up to the next $1,000), and show in terms of thousands. For example, $35,500 should be reported as 36.

b. For loans on multifamily dwellings, enter ''NA.''

c. If no income information is asked for or relied on in the credit decision, enter ''NA.''

E. Type of Purchaser

1. Enter the applicable code to indicate whether a loan that your institution originated or purchased was then sold to a secondary market entity within the same calendar year:

0—Loan was not originated or was not sold in calendar year covered by register
1—FNMA (Federal National Mortgage Association)
2—GNMA (Government National Mortgage Association)
3—FHLMC (Federal Home Loan Mortgage Corporation)
4—FAMC (Federal Agricultural Mortgage Corporation)
5—Commercial bank
6—Savings bank or savings association
7—Life insurance company
8—Affiliate institution
9—Other type of purchaser

2. *Explanation of codes.* a. Enter the code 0 for applications that were denied, withdrawn, or approved but not accepted by the applicant; and for files closed for incompleteness.

b. If you originated or purchased a loan and did not sell it during that same calendar year, enter the code 0. If you sell the loan in a succeeding year, you need not report the sale.

c. If you conditionally assign a loan to GNMA in connection with a mortgage-backed security transaction, use code 2.

d. Loans ''swapped'' for mortgage-backed securities are to be treated as sales; enter the type of entity receiving the loans that are swapped as the purchaser.

e. Use code 8 for loans sold to an institution affiliated with you, such as your subsidiary or a subsidiary of your parent corporation.

F. Reasons for Denial

1. You are not required to enter the reasons for the denial of an application. But if you choose to do so, you may indicate up to three reasons by using the following codes:

1—Debt-to-income ratio
2—Employment history
3—Credit history
4—Collateral
5—Insufficient cash (downpayment, closing costs)
6—Unverifiable information
7—Credit application incomplete
8—Mortgage insurance denied
9—Other

2. Leave this column blank if the ''action taken'' on the application is not a denial. For example, do not complete this column if the application was withdrawn or the file was closed for incompleteness.

3. If your institution uses the model form for adverse action contained in the appendix to Regulation B (Form C–1 in appendix C, Sample Notification Form, which offers some 20 reasons for denial), the following list shows which codes to enter.

a. *Code 1 corresponds to:* Income insufficient for amount of credit requested, and Excessive obligations in relation to income.

b. *Code 2 corresponds to:* Temporary or irregular employment, and Length of employment.

c. *Code 3 corresponds to:* Insufficient number of credit references provided; Unacceptable type of credit references provided; No credit file; Limited credit experience; Poor credit performance with us; Delinquent past or present credit obligations with others; Garnishment, attachment, foreclosure, repossession, collection action, or judgment; and Bankruptcy.

d. *Code 4 corresponds to:* Value or type of collateral not sufficient.

e. *Code 6 corresponds to:* Unable to verify credit references, Unable to verify employment, Unable to verify income, and Unable to verify residence.

f. *Code 7 corresponds to:* Credit application incomplete.

g. *Code 9 corresponds to:* Length of residence, Temporary residence, and Other reasons specified on notice.

VI. Federal Supervisory Agencies

Send your loan/application register and direct any questions to the office of your federal supervisory agency as specified below. If you are the nondepository subsidiary of a bank, savings association, or credit union, send the register to the supervisory agency for your parent institution. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

A. National Banks and Their Subsidiaries and Federal Branches and Federal Agencies of Foreign Banks.

District office of the Office of the Comptroller of the Currency for the district in which the institution is located.

B. State Member Banks of the Federal Reserve System, Their Subsidiaries, Subsidiaries of Bank Holding Companies, Branches and Agencies of Foreign Banks (other than federal branches, federal agencies, and insured state branches of foreign banks), Commercial Lending Companies Owned or Controlled by Foreign Banks, and Organizations Operating Under Section 25 or 25A of the Federal Reserve Act.

Federal Reserve Bank serving the district in which the state member bank is located; for institutions other than state member banks, the Federal Reserve Bank specified by the Board of Governors.

C. Nonmember Insured Banks (except for federal savings banks) and Their Subsidiaries and Insured State Branches of Foreign Banks.

Regional Director of the Federal Deposit Insurance Corporation for the region in which the institution is located.

D. Savings Institutions Insured Under the Savings Association Insurance Fund of the FDIC, Federally-Chartered Savings Banks Insured Under the Bank Insurance Fund of the FDIC (But Not Including State-Chartered Savings Banks Insured Under the Bank Insurance Fund), Their Subsidiaries, and Subsidiaries of Savings Institution Holding Companies

Regional or other office specified by the Office of Thrift Supervision.

E. Credit Unions

National Credit Union Administration, Office of Examination and Insurance, 1776 G Street, NW., Washington, DC 20456.

F. Other Depository Institutions

Regional Director of the Federal Deposit Insurance Corporation for the region in which the institution is located.

G. Other Mortgage Lending Institutions

Assistant Secretary for Housing, HMDA Reporting—Room 9233, U.S. Department of Housing and Urban Development, 451 7th Street, SW., Washington, DC 20410.

LOAN/APPLICATION REGISTER

Form FR HMDA-LAR.
OMB Nos. 1557-0159 (OCC), 3064-0046 (FDIC), 1550-0021 (OTS), and 7100-0247 (FRB); NCUA and HUD numbers pending.

TRANSMITTAL SHEET

You must complete this transmittal sheet (please type or print) and attach it to the Loan/Application Register, required by the Home Mortgage Disclosure Act, that you submit to your supervisory agency.

Reporter's Identification Number	Agency Code	Reporter's Tax Identification Number	Total line entries contained in attached Loan/Application Register
|_|_|_|_|_|_|_|_|_|_|_| - |_|		|_|_| - |_|_|_|_|_|_|_|	_____

The Loan/Application Register that is attached covers activity during the year _____ and contains a total of ___ pages.

Enter the name and address of your institution. The disclosure statement that is produced by the Federal Financial Institutions Examination Council will be mailed to the address you supply below:

_____
Name of Institution

_____
Address

_____
City, State, ZIP

Enter the name, telephone number, and facsimile number of a person who may be contacted about questions regarding your register:

_____ (___) _____ (___)_____
Name Telephone Number Facsimile Number

An officer of your institution must complete the following section:

I certify to the accuracy of the data contained in this register.

_____ _____ _____
Name of Officer Signature Date

LOAN/APPLICATION REGISTER Page___of___

Form FR HMDA–LAR

Name of Reporting Institution

City, State, ZIP

Reporter's Identification Number

Agency Code

All columns (except Reasons for Denial) must be completed for each entry. See the instructions for details.

Application or Loan Information						Action Taken		Property Location				Applicant Information A = Applicant CA = Co-Applicant						
												Race or National Origin		Sex				
Application or Loan Number	Date Application Received (mm/dd/ccyy)	Type	Purpose	Owner Occupancy	Loan amount in thousands	Type	Date (mm/dd/ccyy)	Four-Digit MSA Number	Two-Digit State Code	Three-Digit County Code	Six-Digit Census Tract	A	CA	A	CA	Gross Annual Income in thousands	Type of Purchaser of Loan	Reasons for Denial (Optional)
Example of Loan Originated																		
LB-687439	01/15/1999	2	1	1	65	1	02/22/1999	8840	51	059	4219.85	3	8	1	4	24	7	
Example of Application Denied																		
0123456789-98765432 10	03/20/1999	1	1	1	125	3	04/30/1999	0450	01	015	0021.00	5	4	2	1	55	0	415

LOAN/APPLICATION REGISTER CODE SHEET

Use the following codes to complete the Loan/Application Register. The instructions to the HMDA–LAR explain the proper use of each code.

APPLICATION OR LOAN INFORMATION

Type:
1—Conventional (any loan other than FHA, VA, FSA, or RHS loans)
2—FHA-insured (Federal Housing Administration)
3—VA-guaranteed (Veterans Administration)
4—FSA/RHS-guaranteed (Farm Service Agency or Rural Housing Service)

Purpose:
1—Home purchase (one-to-four family)
2—Home improvement (one-to-four family)
3—Refinancing (home purchase or home improvement, one-to-four family)
4—Multifamily dwelling (home purchase, home improvement, and refinancings)

Owner-Occupancy:
1—Owner-occupied as a principal dwelling
2—Not owner-occupied
3—Not applicable

Action Taken:
1—Loan originated
2—Application approved but not accepted
3—Application denied by financial institution
4—Application withdrawn by applicant
5—File closed for incompleteness
6—Loan purchased by your institution

APPLICANT INFORMATION

Race or National Origin:
1—American Indian or Alaskan Native
2—Asian or Pacific Islander
3—Black
4—Hispanic
5—White
6—Other
7—Information not provided by applicant in mail or telephone application
8—Not applicable

Sex:
1—Male
2—Female
3—Information not provided by applicant in mail or telephone application
4—Not applicable

TYPE OF PURCHASER

0—Loan was not originated or was not sold in calendar year covered by register
1—FNMA (Federal National Mortgage Association)
2—GNMA (Government National Mortgage Association)
3—FHLMC (Federal Home Loan Mortgage Corporation)
4—FAMC (Federal Agricultural Mortgage Corporation)
5—Commercial bank
6—Savings bank or savings association
7—Life insurance company
8—Affiliate institution
9—Other type of purchaser

REASONS FOR DENIAL (OPTIONAL)

1—Debt-to-income ratio
2—Employment history
3—Credit history
4—Collateral
5—Insufficient cash (downpayment, closing costs)
6—Unverifiable information
7—Credit application incomplete
8—Mortgage insurance denied
9—Other

[Reg. C, 56 FR 59857, Nov. 26, 1991, as amended at 57 FR 20400, May 13, 1992; 57 FR 56965, 56967, Dec. 2, 1992; 58 FR 13405, Mar. 11, 1993; 59 FR 63704, Dec. 9, 1994; 60 FR 22225, May 4, 1995; 62 FR 28623, 28624, May 27, 1997; 62 FR 33340, June 19, 1997; 63 FR 52143-52146, Sept. 30, 1998]

APPENDIX B TO PART 203—FORM AND INSTRUCTIONS FOR DATA COLLECTION ON RACE OR NATIONAL ORIGIN AND SEX

I. Instructions on collection of data on race or national origin and sex.

A. Format.

You may list questions regarding the race or national origin and sex of the applicant on your loan application form, or on a separate form that refers to the application. (See the sample form below for recommended language.)

B. Procedures.

1. You must ask for this information, but cannot require the applicant to provide it.

2. If the applicant chooses not to provide the information for an application taken in person, note this fact on the form and note the data, to the extent possible, on the basis of visual observation or surname.

3. Inform the applicant that the Federal government is requesting this information in order to monitor compliance with Federal statutes that prohibit lenders from discriminating against applicants on these bases. Inform the applicant that if the information is not provided where the application is taken in person, you are required to note the data on the basis of visual observation or surname.

4. If an application is made entirely by telephone, you need not request this information. And you need not provide the data when you take an application by mail, if the applicant fails to answer these questions on

the application form. You should indicate whether an application was received by mail or telephone, if it is not otherwise evident on the face of the application.

5. The ''other'' block is available only to the applicant who chooses to indicate some other appropriate category for race or national origin. If completing the form based on visual observation, do not use this category; use one of the other five categories.

II. Sample race or national origin and sex data collection form

INFORMATION FOR GOVERNMENT MONITORING PURPOSES

The following information is requested by the federal government for certain types of loans related to a dwelling in order to monitor the lender's compliance with equal credit opportunity, fair housing, and home mortgage disclosure laws. You are not required to furnish this information, but are encouraged to do so. The law provides that a lender may not discriminate on the basis of this information, or on whether you choose to furnish it. However, if you choose not to furnish the information and you have made this application in person, under federal regulations the lender is required to note race or national origin and sex on the basis of visual observation or surname. If you do not wish to furnish the information, please check below.

APPLICANT:	CO-APPLICANT:
☐ I do not wish to furnish this information	☐ I do not wish to furnish this information
Race or National Origin:	Race or National Origin:
☐ American Indian, Alaskan Native	☐ American Indian, Alaskan Native
☐ Asian, Pacific Islander	☐ Asian, Pacific Islander
☐ Black	☐ Black
☐ Hispanic	☐ Hispanic
☐ White	☐ White
☐ Other (specify)_____	☐ Other (specify)_____
Sex:	Sex:
☐ Female	☐ Female
☐ Male	☐ Male

SUPPLEMENT I TO PART 203—STAFF COMMENTARY

Introduction

1. *Status and citations.* The commentary in this supplement is the vehicle by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues formal staff interpretations of Regulation C (12 CFR part 203). The parenthetical citations given are references to Appendix A to Regulation C, Form and Instructions for Completion of the HMDA Loan/Application Register.

Section 203.1—Authority, Purpose, and Scope

1(c) *Scope.*

1. *General.* The comments in this section address issues affecting coverage of institutions, exemptions from coverage, and data collection requirements. (Appendix A of this part, I., IV., and V.)

2. *Meaning of refinancing.* A refinancing of a loan is the satisfaction and replacement of an existing obligation by a new obligation by the same borrower. The term ''refinancing'' refers to the new obligation. If the existing obligation is not satisfied and replaced, but is only renewed, modified, extended, or consolidated (as in certain modification, extension, and consolidation agreements), the transaction is not a refinancing for purposes of HMDA. (Appendix A of this part, Paragraph V.A.5. Code 3.)

3. *Refinancing—coverage.* The regulation bases coverage, in part, on whether an institution originates home purchase loans. For determining whether an institution is subject to Regulation C or is exempt from coverage, an origination of a home-purchase

loan includes the refinancing of a home-purchase loan. An institution may always determine the actual purpose of the existing obligation (for example, by reference to available documents). (Appendix A of this part, Paragraphs I.B., I.C., and I.D.) Alternatively, an institution may:

i. Rely on the statement of the applicant that the existing obligation was (or was not) a home-purchase loan; or

ii. Assume that the new obligation is not a refinancing of a home-purchase loan if either the existing obligation or the new obligation is not secured by a first lien on the dwelling.

4. *Refinancing—data collection*. The regulation requires collection and reporting of data on refinancings of home-purchase and home-improvement loans. An institution may always determine the actual purpose of the existing obligation (for example, by reference to available documents). (Appendix A of this part, Paragraph V.A.5. Code 3.) Alternatively, an institution may:

i. Rely on the statement of the applicant that the existing obligation was (or was not) a home-purchase or home-improvement loan; or

ii. Assume that the new obligation is a refinancing of a home-purchase or home-improvement loan only if the existing obligation was secured by a lien on a dwelling; or

iii. Assume that the new obligation is a refinancing of a home-purchase or home-improvement loan only if the new obligation will be secured by a lien on a dwelling.

5. *The broker rule and the meaning of ''broker'' and ''investor.''* For the purposes of the guidance given in this commentary, an institution that takes and processes a loan application and arranges for another institution to acquire the loan at or after closing is acting as a ''broker,'' and an institution that acquires a loan from a broker at or after closing is acting as an ''investor.'' (The terms used in this commentary may have different meanings in certain parts of the mortgage lending industry and other terms may be used in place of these terms, for example in the Federal Housing Administration mortgage insurance programs.) Depending on the facts, a broker may or may not make a credit decision on an application (and thus it may or may not have reporting responsibilities). If the broker makes a credit decision, it reports that decision; if it does not make a credit decision, it does not report. If an investor reviews an application and makes a credit decision prior to closing, the investor reports that decision. If the investor does not review the application prior to closing, it reports only the loans that it purchases; it does not report the loans it does not purchase. Thus, an institution that makes a credit decision on an application prior to closing reports that decision regardless of whose name the loan closes in. (Appendix A of this part, Paragraphs IV.A. and V.B.)

6. *Illustrations of the broker rule*. Assume that, prior to closing, four investors receive the same application from a broker; two deny it, one approves it, and one approves it and acquires the loan. In these circumstances, the first two report denials, the third reports the transaction as approved but not accepted, and the fourth reports an origination (whether the loan closes in the name of the broker or the investor). Alternatively, assume that the broker denies a loan before sending it to an investor; in this situation, the broker reports a denial. (Appendix A of this part, Paragraphs IV.A. and V.B.)

7. *Broker's use of investor's underwriting criteria*. If a broker makes a credit decision based on underwriting criteria set by an investor, but without the investor's review prior to closing, the broker has made the credit decision. The broker reports as an origination a loan that it approves and closes, and reports as a denial an application that it turns down (either because the application does not meet the investor's underwriting guidelines or for some other reason). The investor reports as purchases only those loans it purchases. (Appendix A of this part, Paragraphs IV.A. and V.B.)

8. *Insurance and other criteria*. If an institution evaluates an application based on the criteria or actions of a third party other than an investor (such as a government or private insurer or guarantor), the institution must report the action taken on the application (loan originated, approved but not accepted, or denied, for example). (Appendix A of this part, Paragraphs IV.A. and V.B.)

9. *Credit decision of agent is decision of principal*. If an institution approves loans through the actions of an agent, the institution must report the action taken on the application (loan originated, approved but not accepted, or denied, for example). State law determines whether one party is the agent of another. (Appendix A of this part, Paragraphs IV.A. and V.B.)

10. *Affiliate bank underwriting (250.250 review)*. If an institution makes an independent evaluation of the creditworthiness of an applicant (for example, as part of a pre-closing review by an affiliate bank under 12 CFR 250.250, which interprets section 23A of the Federal Reserve Act), the institution is making a credit decision. If the institution then acquires the loan, it reports the loan as an origination whether the loan closes in the name of the institution or its affiliate. An institution that does not acquire the loan but takes another action reports that action. (Appendix A of this part, Paragraphs IV.A. and V.B.)

11. *Participation loan*. An institution that originates a loan and then sells partial interests to other institutions reports the loan as an origination. An institution that acquires

only a partial interest in such a loan does not report the transaction even if it has participated in the underwriting and origination of the loan. (Appendix A of this part, Paragraphs I., II., IV., and V.)

12. *Assumptions.* An assumption occurs when an institution enters into a written agreement accepting a new borrower as the obligor on an existing obligation. An institution reports as a home-purchase loan an assumption (or an application for an assumption) in the amount of the outstanding principal. If a transaction does not involve a written agreement between a new borrower and the institution, it is not an assumption for HMDA purposes and is not reported. (Appendix A of this part, Paragraphs IV.A. and V.B.)

Section 203.2—Definitions

2(b) *Application.*

1. *Consistency with Regulation B.* Board interpretations that appear in the official staff commentary to Regulation B (Equal Credit Opportunity, 12 CFR Part 202, Supplement I) are generally applicable to the definition of an application under Regulation C. However, under Regulation C the definition of an application does not include prequalification requests. (Appendix A of this part, Paragraph IV.A.)

2. *Prequalification.* A prequalification request is a request by a prospective loan applicant for a preliminary determination on whether the prospective applicant would likely qualify for credit under an institution's standards, or on the amount of credit for which the prospective applicant would likely qualify. Some institutions evaluate prequalification requests through a procedure that is separate from the institution's normal loan application process; others use the same process. In either case, Regulation C does not require an institution to report prequalification requests on the HMDA–LAR, even though these requests may constitute applications under Regulation B. (Appendix A of this part, Paragraphs I. and IV.A.)

2(c) *Branch office.*

1. *Credit union.* For purposes of Regulation C, a ''branch'' of a credit union is any office where member accounts are established or loans are made, whether or not the office has been approved as a branch by a federal or state agency. (See 12 U.S.C. 1752.) (Appendix A of this part, Paragraphs I., V.A.7., and V.C.)

2. *Depository institution.* A branch of a depository institution does not include a loan production office, the office of an affiliate, or the office of a third party such as a loan broker. (Appendix A of this part, Paragraphs I., V.A.7., and V.C.) (But see Appendix A of this part, Paragraph V.C.7., which requires certain depository institutions to report property location even for properties located outside those MSAs in which the institution has a home or branch office.)

3. *Nondepository institution.* A branch of a nondepository institution does not include the office of an affiliate or other third party such as a loan broker. (Appendix A of this part, Paragraphs I., V.A.7., and V.C.) (But see Appendix A of this part, Paragraph V.C.6., which requires certain nondepository institutions to report property location even in MSAs where they do not have a physical location.)

2(d) *Dwelling.*

1. *Scope.* The definition of ''dwelling'' is not limited to the principal or other residence of the applicant or borrower, and thus includes vacation or second homes and rental properties. A dwelling also includes a mobile or manufactured home, a multifamily structure (such as an apartment building), and a condominium or a cooperative unit. Recreational vehicles such as boats or campers are not dwellings for purposes of HMDA. (Appendix A of this part, Paragraphs I.B., IV., and V.A.5.)

2(e) *Financial institution.*

1. *Branches of foreign banks—treated as a bank.* A federal branch or a state-licensed insured branch of a foreign bank is a ''bank'' under section 3(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(a)), and is covered by HMDA if it meets the tests for a depository institution found in §§203.2(e)(1) and 203.3(a)(1) of Regulation C. (Appendix A of this part, Paragraphs I.A. and I.B.)

2. *Branches and offices of foreign banks—treated as a for-profit mortgage lending institution.* Federal agencies, state-licensed agencies, state-licensed uninsured branches of foreign banks, commercial lending companies owned or controlled by foreign banks, and entities operating under section 25 or 25(a) of the Federal Reserve Act, 12 U.S.C. 601 and 611 (Edge Act and Agreement corporations) are not ''banks'' under the Federal Deposit Insurance Act. These entities are nonetheless covered by HMDA if they meet the tests for a nondepository mortgage lending institution found in §§203.2(e)(2) and 203.3(a)(2) of Regulation C. (Appendix A of this part, Paragraphs I.C. and I.D.)

2(f) *Home-improvement loan.*

1. *Definition.* A home-improvement loan is a loan that is made for the purpose of home improvement and that is classified by the institution as a home-improvement loan. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.)

2. *Statement of the applicant.* An institution may rely on the oral or written statement of an applicant regarding the proposed use of loan proceeds. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.c.)

3. *Home-equity lines.* An institution that has chosen to report home-equity lines of credit reports as a home-improvement loan only

the part of a home-equity line that is intended for home improvement. An institution that reports home-equity lines reports the disposition of all applications, not just originations. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.c.)

4. *Classification requirement.* An institution has ''classified'' a loan as a home-improvement loan if it has entered the loan on its books as a home-improvement loan, or has otherwise coded or identified the loan as a home-improvement loan. For example, an institution that has booked a loan or reported it on a ''call report'' as a home-improvement loan has classified it as a home-improvement loan. An institution may also classify loans as home-improvement loans in other ways (for example, by color-coding loan files). (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.)

5. *Improvements to real property.* Home improvements include improvements both to a dwelling and to the real property on which the dwelling is located (for example, installation of a swimming pool, construction of a garage, or landscaping). (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.)

6. *Commercial and other loans.* A loan for improvement purposes originated outside an institution's consumer lending division (such as a loan to improve an apartment building made through the commercial loan department) is reported if the institution classifies it as a home-improvement loan. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 1.)

7. *Multiple-purpose loan.* A loan for home improvement and for other purposes is treated as a home-improvement loan even if less than 50 percent of the total loan proceeds are to be used for improvement, provided the institution classifies the loan as a home-improvement loan. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.) (But see comment (2)(f)–3 of this supplement on home-equity lines of credit.)

8. *Mixed-use property.* A loan to improve property used for residential and commercial purposes (for example, a building containing apartment units and retail space) satisfies the purpose requirement if the loan proceeds are primarily to improve the residential portion of the property. If the loan proceeds are to improve the entire property (for example, to replace the heating system), the loan satisfies the purpose requirement if the property itself is primarily residential. An institution may use any reasonable standard to determine the primary use of the property, such as by square footage or by the income generated. An institution may select the standard to apply on a case-by-case basis. To report the loan as a home-improvement loan, the institution must also classify it as such. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 2.)

2(g) *Home-purchase loan.*

1. *Multiple properties.* A home-purchase loan includes a loan secured by one dwelling and used to purchase another dwelling. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 1.)

2. *Mixed-use property.* A loan to purchase property used primarily for residential purposes (for example, an apartment building containing a convenience store) is a home-purchase loan. An institution may use any reasonable standard to determine the primary use of the property, such as by square footage or by the income generated. An institution may select the standard to apply on a case-by-case basis. (Appendix A of this part, Paragraphs IV.A., IV.B.1., and V.A.5. Code 1.)

3. *Farm loan.* A loan to purchase property used primarily for agricultural purposes is not a home-purchase loan even if the property includes a dwelling. An institution may use any reasonable standard to determine the primary use of the property, such as by reference to the exemption from Regulation X (Real Estate Settlement Procedures, 24 CFR 3500.5(b)(1)) for a loan on property of 25 acres or more. An institution may select the standard to apply on a case-by-case basis. (Appendix A of this part, Paragraphs IV.B.1. and V.A.5. Code 1.)

4. *Commercial and other loans.* A home-purchase loan includes a loan originated outside an institution's residential mortgage lending division (such as a loan for the purchase of an apartment building made through the commercial loan department). For home-purchase loans, there is no classification test. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 1.)

5. *Construction and permanent financing.* A home-purchase loan includes both a combined construction/permanent loan and the permanent financing that replaces a construction-only loan. It does not include a construction-only loan, which is considered ''temporary financing'' under Regulation C and is not reported. (Appendix A of this part, Paragraphs IV.A. and B.2, and V.A.5. Code 1.)

6. *Home-equity line.* An institution that has chosen to report home-equity lines of credit reports as a home-purchase loan only the part that is intended for home purchase. An institution may rely on the applicant's oral or written statement about the proposed use of the funds. An institution that reports home-equity lines reports the disposition of all applications, not just the originations. (Appendix A of this part, Paragraphs IV. and V.A.5. Code 1.)

Section 203.3—Exempt Institutions

3(a) *Exemption based on location, asset size, or number of home-purchase loans.*

1. *General.* An institution that ceases to meet the tests for HMDA coverage (such as

the 10 percent test for nondepository institutions) or becomes exempt may stop collecting HMDA data beginning with the next calendar year. For example, a bank whose assets are at or below the threshold on December 31 of a given year reports data for that full calendar year, in which it was covered, but does not report data for the succeeding calendar year. (Appendix A of this part, Paragraph I.)

2. *Adjustment of exemption threshold for depository institutions.* For data collection in 2002, the asset–size exemption threshold is $32 million. Depository institutions with assets at or below $32 million are exempt from collecting data for 2002.

3. *Coverage after a merger.* Several scenarios of data collection responsibilities for the calendar year of a merger are described below. Under all the scenarios, if the merger results in a covered institution, that institution must begin data collection January 1 of the following calendar year. (Appendix A of this part, Paragraph I.)

i. Two institutions are exempt from Regulation C because of asset size. The institutions merge. No data collection is required for the year of the merger (even if the merger results in a covered institution).

ii. A covered institution and an exempt institution merge. The covered institution is the surviving institution. For the year of the merger, data collection is required for the covered institution's transactions. Data collection is optional for transactions handled in offices of the previously exempt institution.

iii. A covered institution and an exempt institution merge. The exempt institution is the surviving institution, or a new institution is formed. Data collection is required for transactions of the covered institution that take place prior to the merger. Data collection is optional for transactions taking place after the merger date.

iv. Two covered institutions merge. Data collection is required for the entire year. The surviving or resulting institution files either a consolidated submission or separate submissions for that year.

4. *Mergers versus purchases in bulk.* If a covered institution acquires loans in bulk from another institution (for example, from the receiver for a failed institution) but no merger or acquisition of an institution is involved, the institution reports the loans as purchased loans. (Appendix A of this part, Paragraph V.B.)

Section 203.4—Compilation of Loan Data

4(a) *Data format and itemization.*

1. *Quarterly updating.* An institution must make a good-faith effort to record all data concerning covered transactions—loan originations (including refinancings), loan purchases, and the disposition of applications that did not result in originations—fully and accurately within 30 days after the end of each calendar quarter. If some data are inaccurate or incomplete despite this good-faith effort, the error or omission is not a violation of Regulation C provided that the institution corrects and completes the information prior to reporting the HMDA–LAR to its regulatory agency. (Appendix A of this part, Paragraph II.E.)

2. *Updating—agency requirements.* Certain state or federal regulations, such as the Federal Deposit Insurance Corporation's regulations, may require an institution to update its data more frequently than is required under Regulation C. (Appendix A of this part, Paragraph II.E.)

3. *Form of updating.* An institution may maintain the quarterly updates of the HMDA–LAR in electronic or any other format, provided the institution can make the information available to its regulatory agency in a timely manner upon request. (Appendix A of this part, Paragraph II.E.)

Paragraph 4(a)(1) Application date.

1. *Application date—consistency.* In reporting the date of application, an institution reports the date the application was received or the date shown on the application. Although an institution need not choose the same approach for its entire HMDA submission, it should be generally consistent (such as by routinely using one approach within a particular division of the institution or for a category of loans). (Appendix A of this part, Paragraph V.A.2.)

2. *Application date—application forwarded by a broker.* For an application forwarded by a broker, an institution reports the date the application was received by the broker, the date the application was received by the institution, or the date shown on the application. Although an institution need not choose the same approach for its entire HMDA submission, it should be generally consistent (such as by routinely using one approach within a particular division of the institution or for a category of loans). (Appendix A of this part, Paragraph V.A.2.)

3. *Application date—reinstated application.* If, within the same calendar year, an applicant asks an institution to reinstate a counteroffer that the applicant previously did not accept (or asks the institution to reconsider an application that was denied, withdrawn, or closed for incompleteness), the institution may treat that request as the continuation of the earlier transaction or as a new transaction. If the institution treats the request for reinstatement or reconsideration as a new transaction, it report the date of the request as the application date. (Appendix A of this part, Paragraph V.A.2.)

Paragraph 4(a)(2) Type and purpose.

1. *Purpose—multiple-purpose loan.* If a loan is for home improvement and another covered purpose, an institution reports the loan

as a home-improvement loan if the institution classifies it as a home-improvement loan. Otherwise the institution reports the loan as a home-purchase loan or a refinancing, as appropriate. An institution may determine how to report such loans on a case-by-case basis. (Appendix A of this part, Paragraphs V.A.4. and 5.)

Paragraph 4(a)(3) Occupancy.

1. *Occupancy—actual occupancy status.* If a loan relates to multifamily property, property located outside an MSA, or property in an MSA where the institution has no home or branch office, the institution may either report the actual occupancy status or report using the code for ''not applicable.'' (A nondepository institution may be deemed to have a home or branch office in an MSA under §203.2(c)(2) of Regulation C.) (Appendix A of this part, Paragraph V.A.7.)

2. *Occupancy—multiple properties.* If a loan relates to multiple properties, the institution reports the owner-occupancy status of the property for which property location is being reported. (See the comments to paragraphs 4(a)(6) Property location.) (Appendix A of this part, Paragraphs V.A.6. and 7.)

Paragraph 4(a)(4) Loan amount.

1. *Loan amount—counteroffer.* If an applicant accepts a counteroffer for an amount different from the amount initially requested, the institution reports the loan amount granted. If an applicant does not accept a counteroffer or fails to respond, the institution reports the loan amount initially requested. (Appendix A of this part, Paragraph V.A.8.f.)

2. *Loan amount—multiple-purpose loan.* Except in the case of a home-equity line of credit, an institution reports the entire amount of the loan, even if only a part of the proceeds is intended for home purchase or home improvement. (Appendix A of this part, Paragraph V.A.8.)

3. *Loan amount—home-equity line.* An institution that reports home-equity lines of credit reports only the part that is intended for home-improvement or home-purchase purposes. An institution may rely on the applicant's oral or written statement about the proposed use of the loan proceeds. (Appendix A of this part, Paragraph V.A.8.c.)

4. *Loan amount—assumption.* An institution that enters into a written agreement accepting a new party as the obligor on a loan reports the amount of the outstanding principal on the assumption as the loan amount. (Appendix A of this part, Paragraphs V.A.8.)

Paragraph 4(a)(5) Type of action taken and date.

1. *Action taken—counteroffers.* If an institution makes a counteroffer to lend on terms different from the applicant's initial request (for example, for a shorter loan maturity) and the applicant does not accept the counteroffer or fails to respond, the institution reports the action taken as a denial. (Appendix A of this part, Paragraph V.B.)

2. *Action taken—rescinded transactions.* If a borrower rescinds a transaction after closing, the institution, on a case-by-case basis, may report the transaction either as an origination or as an application that was approved but not accepted. (Appendix A of this part, Paragraph V.B.)

3. *Action taken—purchased loans.* An institution reports the loans that it purchased during the calendar year, and does not report the loans that it declined to purchase. (Appendix A of this part, Paragraph V.B.)

4. *Action taken—conditional approvals.* If an institution issues a loan approval subject to the applicant's meeting underwriting conditions (other than customary loan commitment or loan closing conditions, such as a ''clear title'' requirement or an acceptable property survey) and the applicant does not meet them, the institution reports the action taken as a denial. (Appendix A of this part, Paragraph V.B.)

5. *Action taken date—approved but not accepted.* For a loan approved by an institution but not accepted by the applicant, the institution reports using any reasonable date, such as the approval date, the deadline for accepting the offer, or the date the file was closed. Although an institution need not choose the same approach for its entire HMDA submission, it should be generally consistent (such as by routinely using one approach within a particular division of the institution or for a category of loans). (Appendix A of this part, Paragraph V.B.3.b.)

6. *Action taken date—originations.* For loan originations, an institution generally reports the settlement or closing date. For loan originations that an institution acquires through a broker, the institution reports either the settlement or closing date, or the date the institution acquired the loan from the broker. If the disbursement of funds takes place on a date later than the settlement or closing date, the institution may use the date of disbursement. For a construction/permanent loan, the institution reports either the settlement or closing date, or the date the loan converts to the permanent financing. Although an institution need not choose the same approach for its entire HMDA submission, it should be generally consistent (such as by routinely using one approach within a particular division of the institution or for a category of loans). (Appendix A of this part, Paragraph V.B.3.)

Paragraph 4(a)(6) Property location.

1. *Property location—multiple properties (home improvement/refinance of home improvement).* For a home-improvement loan, an institution reports the property being improved. If more than one property is being improved, the institution reports the location of one of the properties or reports the loan using multiple entries on its HMDA–

LAR (with unique identifiers) and allocating the loan amount among the properties. (Appendix A of this part, Paragraph V.C.)

2. *Property location—multiple properties (home purchase/refinance of home purchase).* For a home-purchase loan, an institution reports the property taken as security. If an institution takes more than one property as security, the institution reports the location of the property being purchased if there is just one. If the loan is to purchase multiple properties and is secured by multiple properties, the institution reports the location of one of the properties or reports the loan using multiple entries on its HMDA–LAR (with unique identifiers) and allocating the loan amount among the properties. (Appendix A of this part, Paragraph V.C.)

3. *Property location—loans purchased from another institution.* The requirement to report the property location by census tract in an MSA where the institution has a home or branch office applies not only to loan applications and originations but also to loans purchased from another institution. This includes loans purchased from an institution that did not have a home or branch office in that MSA and did not collect the property location information. (Appendix A of this part, Paragraph V.C.)

4. *Property location—mobile or manufactured home.* If information about the potential site of a mobile or manufactured home is not available, an institution reports using the code for ''not applicable.'' (Appendix A of this part, Paragraph V.C.)

5. *Property location—use of BNA.* At its option, an institution may report property location by using a block numbering area (BNA). The U.S. Census Bureau, in conjunction with state agencies, has established BNAs as statistical subdivisions of counties in which census tracts have not been established. BNAs are generally identified in census data by numbers in the range 9501 to 9999.99. (Appendix A of this part, Paragraph V.C.4.)

Paragraph 4(a)(7) Applicant and income data.

1. *Applicant data—completion by applicant.* An institution reports the monitoring information as provided by the applicant. For example, if an applicant checks the ''other'' box the institution reports using the ''other'' code. (Appendix A of this part, Paragraph V.D.)

2. *Applicant data—completion by lender.* If an applicant fails to provide the requested information for an application taken in person, the institution reports the data on the basis of visual observation or surname. As stated in paragraph I.B.5 to Appendix B of this part, the institution does not use the ''other'' code, but selects from the categories listed on the form. (Appendix A of this part, Paragraph V.D.)

3. *Applicant data—application completed in person.* When an applicant meets in person with a lender to complete an application that was begun by mail or telephone, the institution must request the monitoring information. If the meeting occurs after the application process is complete, for example, at closing, the institution is not required to obtain monitoring information. (Appendix A of this part, Paragraph V.D.)

4. *Applicant data—joint applicant.* A joint applicant may enter the government monitoring information on behalf of an absent joint applicant. If the information is not provided, the institution reports using the code for ''information not provided by applicant in mail or telephone application.'' (Appendix A of this part, Paragraph V.D.)

5. *Applicant data—video and other electronic application processes.* An institution that accepts applications through electronic media with a video component treats the applications as taken in person and collects the information about the race or national origin and sex of applicants. An institution that accepts applications through electronic media without a video component (for example, the Internet or facsimile) treats the applications as accepted by mail. (Appendix A of this part, Paragraph V.D.) (See Appendix B of this part for procedures to be used for data collection.)

6. *Income data—income relied upon.* An institution reports the gross annual income relied on in evaluating the creditworthiness of applicants. For example, if an institution relies on an applicant's salary to compute a debt-to-income ratio, but also relies on the applicant's annual bonus to evaluate creditworthiness, the institution reports the salary and the bonus to the extent relied upon. Similarly, if an institution relies on the income of a cosigner to evaluate creditworthiness, the institution includes this income to the extent relied upon. But an institution does not include the income of a guarantor who is only secondarily liable. (Appendix A of this part, Paragraph V.D.5.)

7. *Income data—co-applicant.* If two persons jointly apply for a loan and both list income on the application, but the institution relies only on the income of one applicant in computing ratios and in evaluating creditworthiness, the institution reports only the income relied on. (Appendix A of this part, Paragraph V.D.5.)

8. *Income data—loan to employee.* An institution may report ''NA'' in the income field for loans to employees to protect their privacy, even though the institution relied on their income in making its credit decisions. (Appendix A of this part, Paragraph V.D.5.)

Paragraph 4(a)(8) Purchaser.

1. *Type of purchaser—loan participation interests sold to more than one entity.* An institution that originates a loan, and then sells it to more than one entity, reports the ''type of purchaser'' based on the entity purchasing the greatest interest, if any. If an institution

retains a majority interest it does not report the sale. (Appendix A of this part, Paragraph V.E.)

4(c) Optional data.

1. *Agency requirements.* Certain state or federal entities, such as the Office of Thrift Supervision, require institutions to report the reasons for denial even though this is optional reporting under HMDA and Regulation C. (Appendix A of this part, Paragraph V.F.)

4(d) Excluded data.

1. *Loan pool.* The purchase of an interest in a loan pool (such as a mortgage-participation certificate, a mortgage-backed security, or a real estate mortgage investment conduit or ''REMIC'') is a purchase of an interest in a security under HMDA and is not reported on the HMDA–LAR. (Appendix A of this part, Paragraph IV.B.5.)

Section 203.5—Disclosure and Reporting

5(a) Reporting to agency.

1. *Change in supervisory agency.* If the supervisory agency for a covered institution changes (as a consequence of a merger or a change in the institution's charter, for example), the institution reports data to its new supervisory agency for the year of the change and subsequent years. (Appendix A of this part, Paragraphs I., III. and VI.)

2. *Subsidiaries.* An institution is a subsidiary of a bank or savings association (for purposes of reporting HMDA data to the parent's supervisory agency) if the bank or savings association holds or controls an ownership interest that is greater than 50 percent of the institution. (Appendix A of this part, Paragraph I.E. and VI.)

5(e) Notice of availability.

1. *Poster—suggested text.* The suggested wording of the poster text provided in Appendix A of this part is optional. An institution may use other text that meets the requirements of the regulation. (Appendix A of this part, Paragraph III.F.)

Section 203.6—Enforcement

6(b) Bona fide errors.

1. *Bona fide error—information from third parties.* An institution that obtains the property location information for applications and loans from third parties (such as appraisers or vendors of ''geocoding'' services) is responsible for ensuring that the information reported on its HMDA–LAR is correct. An incorrect entry for a census tract number is a bona fide error, and is not a violation of the act or regulation, provided that the institution maintains reasonable procedures to avoid such errors (for example, by conducting periodic checks of the information obtained from these third parties). (Appendix A of this part, Paragraph V.C.)

[Reg. C, 60 FR 63396, Dec. 11, 1995, as amended at 62 FR 28626, May 27, 1997; 62 FR 66260, Dec. 18, 1997; 63 FR 70997, Dec. 23, 1998; 64 FR 70992, Dec. 20, 1999; 65 FR 80735, Dec. 22, 2000; 66 FR 66295, Dec. 26, 2001]

PART 204—RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS (REGULATION D)

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AUTHORITY: 12 U.S.C. 248(a), 248(c), 371a, 461, 601, 611, and 3105.

§ 204.1 Authority, purpose and scope.

(a) *Authority*. This part is issued under the authority of section 19 (12 U.S.C. 461 *et seq.*) and other provisions of the Federal Reserve Act and of section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).

(b) *Purpose*. This part relates to reserves that depository institutions are required to maintain for the purpose of facilitating the implementation of monetary policy by the Federal Reserve System.

(c) *Scope*. (1) The following depository institutions are required to maintain reserves in accordance with this part:

(i) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)) or any bank that is eligible to apply to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(ii) Any savings bank or mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(f), (g));

(iii) Any insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752(7)) or any credit union that is eligible to apply to become an insured credit union under section 201 of such Act (12 U.S.C. 1781);

(iv) Any member as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422(4)); and

(v) Any insured institution as defined in section 401 of the National Housing Act (12 U.S.C. 1724(a)) or any institution which is eligible to apply to become an insured institution under section 403 of such Act (12 U.S.C. 1726).

(2) Except as may be otherwise provided by the Board, a foreign bank's branch or agency located in the United States is required to comply with the provisions of this part in the same manner and to the same extent as if the branch or agency were a member bank, if its parent foreign bank (i) has total worldwide consolidated bank assets in excess of $1 billion; or (ii) is controlled by a foreign company or by a group of foreign companies that own or control foreign banks that in the aggregate have total worldwide consolidated bank assets in excess of $1 billion. In addition, any other foreign bank's branch located in the United States that is eligible to apply to become an insured bank under section 5 of the Federal Deposit Insurance Act (12 U.S.C. 1815) is required to maintain reserves in accordance with this part as a nonmember depository institution.

(3) Except as may be otherwise provided by the Board, an Edge Corporation (12 U.S.C. 611 *et seq.*) or an Agreement Corporation (12 U.S.C. 601 *et seq.*) is required to comply with the provisions of this part in the same manner and to the same extent as a member bank.

(4) This part does not apply to any financial institution that (i) is organized solely to do business with other financial institutions; (ii) is owned primarily by the financial institutions with which it does business; and (iii) does not do business with the general public.

(5) The provisions of this part do not apply to any deposit that is payable only at an office located outside the United States.

[45 FR 56018, Aug. 22, 1980]

§ 204.2 Definitions.

For purposes of this part, the following definitions apply unless otherwise specified:

(a)(1) *Deposit* means:

(i) The unpaid balance of money or its equivalent received or held by a depository institution in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to an account, including interest credited, or which is evidenced by an instrument on which the depository institution is primarily liable;

(ii) Money received or held by a depository institution, or the credit given for money or its equivalent received or held by the depository institution in the usual course of business for a special or specific purpose, regardless of the legal relationships established thereby, including escrow funds, funds held as security for securities loaned by the depository institution, funds deposited as advance payment on subscriptions to United States government securities, and funds held to meet its acceptances;

(iii) An outstanding teller's check, or an outstanding draft, certified check,

cashier's check, money order, or officer's check drawn on the depository institution, issued in the usual course of business for any purpose, including payment for services, dividends or purchases;

(iv) Any due bill or other liability or undertaking on the part of a depository institution to sell or deliver securities to, or purchase securities for the account of, any customer (including another depository institution), involving either the receipt of funds by the depository institution, regardless of the use of the proceeds, or a debit to an account of the customer before the securities are delivered. A deposit arises thereafter, if after three business days from the date of issuance of the obligation, the depository institution does not deliver the securities purchased or does not fully collateralize its obligation with securities similar to the securities purchased. A security is similar if it is of the same type and if it is of comparable maturity to that purchased by the customer;

(v) Any liability of a depository institution's affiliate that is not a depository institution, on any promissory note, acknowledgment of advance, due bill, or similar obligation (written or oral), with a maturity of less than one and one-half years, to the extent that the proceeds are used to supply or to maintain the availability of funds (other than capital) to the depository institution, except any such obligation that, had it been issued directly by the depository institution, would not constitute a deposit. If an obligation of an affiliate of a depository institution is regarded as a deposit and is used to purchase assets from the depository institution, the maturity of the deposit is determined by the shorter of the maturity of the obligation issued or the remaining maturity of the assets purchased. If the proceeds from an affiliate's obligation are placed in the depository institution in the form of a reservable deposit, no reserves need be maintained against the obligation of the affiliate since reserves are required to be maintained against the deposit issued by the depository institution. However, the maturity of the deposit issued to the affiliate shall be the shorter of the maturity of the affiliate's obligation or the maturity of the deposit;

(vi) Credit balances;

(vii) Any liability of a depository institution on any promissory note, acknowledgment of advance, bankers' acceptance, or similar obligation (written or oral), including mortgage-backed bonds, that is issued or undertaken by a depository institution as a means of obtaining funds, except any such obligation that:

(A) Is issued or undertaken and held for the account of:

(*1*) An office located in the United States of another depository institution, foreign bank, Edge or Agreement Corporation, or New York Investment (Article XII) Company;

(*2*) The United States government or an agency thereof; or

(*3*) The Export-Import Bank of the United States, Minbanc Capital Corporation, the Government Development Bank for Puerto Rico, a Federal Reserve Bank, a Federal Home Loan Bank, or the National Credit Union Administration Central Liquidity Facility;

(B) Arises from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States Government or any agency thereof that the depository institution is obligated to repurchase;

(C) Is not insured by a Federal agency, is subordinated to the claims of depositors, has a weighted average maturity of five years or more, and is issued by a depository institution with the approval of, or under the rules and regulations of, its primary Federal supervisor;

(D) Arises from a borrowing by a depository institution from a dealer in securities, for one business day, of proceeds of a transfer of deposit credit in a Federal Reserve Bank or other immediately available funds (commonly referred to as *Federal funds*), received by such dealer on the date of the loan in connection with clearance of securities transactions; or

(E) Arises from the creation, discount and subsequent sale by a depository institution of its bankers' acceptance of the type described in paragraph

7 of section 13 of the Federal Reserve Act (12 U.S.C. 372).

(viii) Any liability of a depository institution that arises from the creation after June 20, 1983, of a bankers' acceptance that is not of the type described in paragraph 7 of section 13 of the Federal Reserve Act (12 U.S.C. 372) except any such liability held for the account of an entity specified in § 204.2(a)(1)(vii)(A); or

(2) *Deposit* does not include:

(i) Trust funds received or held by the depository institution that it keeps properly segregated as trust funds and apart from its general assets or which it deposits in another institution to the credit of itself as trustee or other fiduciary. If trust funds are deposited with the commecial department of the depository institution or otherwise mingled with its general assets, a deposit liability of the institution is created;

(ii) An obligation that represents a conditional, contingent or endorser's liability;

(iii) Obligations, the proceeds of which are not used by the depository institution for purposes of making loans, investments, or maintaining liquid assets such as cash or ''due from'' depository institutions or other similar purposes. An obligation issued for the purpose of raising funds to purchase business premises, equipment, supplies, or similar assets is not a deposit;

(iv) Accounts payable;

(v) Hypothecated *deposits* created by payments on an installment loan where (A) the amounts received are not used immediately to reduce the unpaid balance due on the loan until the sum of the payments equals the entire amount of loan principal and interest; (B) and where such amounts are irrevocably assigned to the depository institution and cannot be reached by the borrower or creditors of the borrower;

(vi) Dealer reserve and differential accounts that arise from the financing of dealer installment accounts receivable, and which provide that the dealer may not have access to the funds in the account until the installment loans are repaid, as long as the depository institution is not actually (as distinguished from contingently) obligated to make credit or funds available to the dealer;

(vii) A dividend declared by a depository institution for the period intervening between the date of the declaration of the dividend and the date on which it is paid;

(viii) An obligation representing a *pass through account,* as defined in this section;

(ix) An obligation arising from the retention by the depository institution of no more than a 10 per cent interest in a pool of conventional 1–4 family mortgages that are sold to third parties;

(x) An obligation issued to a State or municipal housing authority under a loan-to-lender program involving the issuance of tax exempt bonds and the subsequent lending of the proceeds to the depository institution for housing finance purposes;

(xi) Shares of a credit union held by the National Credit Union Administration or the National Credit Union Administration Central Liquidity Facility under a statutorily authorized assistance program; and

(xii) Any liability of a United States branch or agency of a foreign bank to another United States branch or agency of the same foreign bank, or the liability of the United States office of an Edge Corporation to another United States office of the same Edge Corporation.

(b)(1) *Demand deposit* means a deposit that is payable on demand, or a deposit issued with an original maturity or required notice period of less than seven days, or a deposit representing funds for which the depository institution does not reserve the right to require at least seven days' written notice of an intended withdrawal. Demand deposits may be in the form of:

(i) Checking accounts;

(ii) Certified, cashier's, teller's, and officer's checks (including such checks issued in payment of dividends);

(iii) Traveler's checks and money orders that are primary obligations of the issuing institution;

(iv) Checks or drafts drawn by, or on behalf of, a non-United States office of a depository institution on an account maintained at any of the institution's United States offices;

(v) Letters of credit sold for cash or its equivalent;

(vi) Withheld taxes, withheld insurance and other withheld funds;

(vii) Time deposits that have matured or time deposits upon which the contractually required notice of withdrawal as given and the notice period has expired and which have not been renewed (either by action of the depositor or automatically under the terms of the deposit agreement); and

(viii) An obligation to pay, on demand or within six days, a check (or other instrument, device, or arrangement for the transfer of funds) drawn on the depository institution, where the account of the institution's customer already has been debited.

(2) The term *demand deposit* also means deposits or accounts on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and from which the depositor is authorized to make withdrawals or transfers in excess of the withdrawal or transfer limitations specified in paragraph (d)(2) of this section for such an account and the account is not a NOW account, or an ATS account or other account that meets the criteria specified in either paragraph (b)(3)(ii) or (iii) of this section.

(3) *Demand deposit* does not include:

(i) Any account that is a time deposit or a savings deposit under this part;

(ii) Any deposit or account on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and either—

(A) Is subject to check, draft, negotiable order of withdrawal, share draft, or similar item, such as an account authorized by 12 U.S.C. 1832(a) (*NOW account*) and a savings deposit described in § 204.2(d)(2), provided that the depositor is eligible to hold a NOW account; or

(B) From which the depositor is authorized to make transfers by preauthorized transfer or telephonic (including data transmission) agreement, order or instruction to another account or to a third party, provided that the depositor is eligible to hold a NOW account;

(iii) Any deposit or account on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and from which withdrawals may be made automatically through payment to the depository institution itself or through transfer of credit to a demand deposit or other account in order to cover checks or drafts drawn upon the institution or to maintain a specified balance in, or to make periodic transfers to such other account, such as accounts authorized by 12 U.S.C. 371a (automatic transfer account or ATS account), provided that the depositor is eligible to hold an ATS account; or

(iv) IBF time deposits meeting the requirements of § 204.8(a)(2).

(c)(1) *Time deposit* means:

(i) A deposit that the depositor does not have a right and is not permitted to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven days' simple interest on amounts withdrawn within the first six days after deposit.[1]

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[1] A time deposit, or a portion thereof, may be paid during the period when an early withdrawal penalty would otherwise be required under this part without imposing an early withdrawal penalty specified by this part:

(a) Where the time deposit is maintained in an individual retirement account established in accordance with 26 U.S.C. 408 and is paid within seven days after establishment of the individual retirement account pursuant to 26 CFR 1.408–6(d)(4), where it is maintained in a Keogh (H.R. 10) plan, or where it is maintained in a *401(k) plan* under 26 U.S.C. 401(k); *Provided* that the depositor forfeits an amount at least equal to the simple interest earned on the amount withdrawn;

(b) Where the depository institution pays all or a portion of a time deposit representing funds contributed to an individual retirement account or a Keogh (H.R.10) plan established pursuant to 26 U.S.C. 408 or 26 U.S.C. 401 or to a *401(k) plan* established pursuant to 26 U.S.C. 401(k) when the individual for whose benefit the account is maintained attains age 59½ or is disabled (as defined in 26 U.S.C. 72(m)(7)) or thereafter;

(c) Where the depository institution pays that portion of a time deposit on which federal deposit insurance has been lost as a result of the merger of two or more federally

Continued

A time deposit from which partial early withdrawals are permitted must impose additional early withdrawal penalties of at least seven days' simple interest on amounts withdrawn within six days after each partial withdrawal. If such additional early withdrawal penalties are not imposed, the account ceases to be a time deposit. The account may become a savings deposit if it meets the requirements for a saving deposit; otherwise it becomes a transaction account. *Time deposit* includes funds—

(A) Payable on a specified date not less than seven days after the date of deposit;

(B) Payable at the expiration of a specified time not less than seven days after the date of deposit;

(C) Payable only upon written notice that is actually required to be given by the depositor not less than seven days prior to withdrawal;

(D) Held in *club* accounts (such as *Christmas club* accounts and *vacation club* accounts that are not maintained as *savings deposits*) that are deposited under written contracts providing that no withdrawal shall be made until a certain number of periodic deposits have been made during a period of not less than three months even though some of the deposits may be made within six days from the end of the period; or

(E) Share certificates and certificates of indebtedness issued by credit unions, and certificate accounts and notice accounts issued by savings and loan associations;

(ii) A *savings deposit;*

(iii) An *IBF time deposit* meeting the requirements of § 204.8(a)(2); and

(iv) Borrowings, regardless of maturity, represented by a promissory note, an acknowledgment of advance, or similar obligation described in § 204.2(a)(1)(vii) that is issued to, or any bankers' acceptance (other than the type described in 12 U.S.C. 372) of the depository institution held by—

(A) Any office located outside the United States of another depository institution or Edge or agreement corporation organized under the laws of the United States;

(B) Any office located outside the United States of a foreign bank;

(C) A foreign national government, or an agency or instrumentality thereof,[2] engaged principally in activities which are ordinarily performed in the United States by governmental entities;

(D) An international entity of which the United States is a member; or

(E) Any other foreign, international, or supranational entity specifically designated by the Board.[3]

(2) A time deposit may be represented by a transferable or nontransferable, or a negotiable or nonnegotiable, certificate, instrument, passbook, or statement, or by book entry or otherwise.

(d)(1) *Savings deposit* means a deposit or account with respect to which the depositor is not required by the deposit contract but may at any time be required by the depository institution to give written notice of an intended withdrawal not less than seven days before withdrawal is made, and that is not payable on a specified date or at the expiration of a specified time after the date of deposit. The term *savings deposit* includes a regular share account at a credit union and a regular account at a savings and loan association.

(2) The term *savings deposit* also means: A deposit or account, such as an account commonly known as a passbook savings account, a statement savings account, or as a money market deposit account (*MMDA*), that otherwise meets the requirements of § 204.2(d)(1) and from which, under the terms of the deposit contract or by practice of the depository institution, the depositor is permitted or authorized to make no

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insured banks in which the depositor previously maintained separate time deposits, for a period of one year from the date of the merger;

(d) Upon the death of any owner of the time deposit funds;

(e) When any owner of the time deposit is determined to be legally incompetent by a court or other administrative body of competent jurisdiction; or

(f) Where a time deposit is withdrawn within ten days after a specified maturity date even though the deposit contract provided for automatic renewal at the maturity date.

[2] Other than states, provinces, municipalities, or other regional or local governmental units or agencies or instrumentalities thereof.

[3] The designated entities are specified in 12 CFR 204.125.

more than six transfers and withdrawals, or a combination of such transfers and withdrawals, per calendar month or statement cycle (or similar period) of at least four weeks, to another account (including a transaction account) of the depositor at the same institution or to a third party by means of a preauthorized or automatic transfer, or telephonic (including data transmission) agreement, order or instruction, and no more than three of the six such transfers may be made by check, draft, debit card, or similar order made by the depositor and payable to third parties. A *preauthorized transfer* includes any arrangement by the depository institution to pay a third party from the account of a depositor upon written or oral instruction (including an order received through an automated clearing house (ACH)) or any arrangement by a depository institution to pay a third party from the account of the depositor at a predetermined time or on a fixed schedule. Such an account is not a *transaction account* by virtue of an arrangement that permits transfers for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer) or that permits transfers of funds from this account to another account of the same depositor at the same institution or permits withdrawals (payments directly to the depositor) from the account when such transfers or withdrawals are made by mail, messenger, automated teller machine, or in person or when such withdrawals are made by telephone (via check mailed to the depositor) regardless of the number of such transfers or withdrawals.[4]

(3) A deposit may continue to be classified as a savings deposit even if the depository institution exercises its right to require notice of withdrawal.

(4) *Savings deposit* does not include funds deposited to the credit of the depository institution's own trust department where the funds involved are utilized to cover checks or drafts. Such funds are *transaction accounts*.

(e) *Transaction account* means a deposit or account from which the depositor or account holder is permitted to make transfers or withdrawals by negotiable or transferable instrument, payment order of withdrawal, telephone transfer, or other similar device for the purpose of making payments or transfers to third persons or others or from which the depositor may make third party payments at an automated teller machine (*ATM*) or a remote service unit, or other electronic device, including by debit card, but the term does not include savings deposits or accounts described in paragraph (d)(2) of this section even though such accounts permit third party transfers. *Transaction account* includes:

(1) Demand deposits;

(2) Deposits or accounts on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and that are subject to check, draft, negotiable order of withdrawal, share draft, or other similar item, except accounts described in paragraph (d)(2) of this section (savings deposits), but including accounts authorized by 12 U.S.C. 1832(a) (NOW accounts).

(3) Deposits or accounts on which the depository institution has reserved the right to require at least seven days'

[4] In order to ensure that no more than the permitted number of withdrawals or transfers are made, for an account to come within the definition in paragraph (d)(2) of this section, a depository institution must either:

(a) Prevent withdrawals or transfers of funds from this account that are in excess of the limits established by paragraph (d)(2) of this section, or

(b) Adopt procedures to monitor those transfers on an *ex post* basis and contact customers who exceed the established limits on more than an occasional basis.

For customers who continue to violate those limits after they have been contacted by the depository institution, the depository institution must either close the account and place the funds in another account that the depositor is eligible to maintain, or take away the transfer and draft capacities of the account.

An account that authorizes withdrawals or transfers in excess of the permitted number is a transaction account regardless of whether the authorized number of transactions are actually made. For accounts described in paragraph (d)(2) of this section, the institution at its option may use, on a consistent basis, either the date on the check, draft, or similar item, or the date the item is paid in applying the limits imposed by that section.

written notice prior to withdrawal or transfer of any funds in the account and from which withdrawals may be made automatically through payment to the depository institution itself or through transfer or credit to a demand deposit or other account in order to cover checks or drafts drawn upon the institution or to maintain a specified balance in, or to make periodic transfers to such accounts, except accounts described in paragraph (d)(2) of this section, but including accounts authorized by 12 U.S.C. 371a (automatic transfer accounts or ATS accounts).

(4) Deposits or accounts on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and under the terms of which, or by practice of the depository institution, the depositor is permitted or authorized to make more than six withdrawals per month or statement cycle (or similar period) of at least four weeks for the purposes of transferring funds to another account of the depositor at the same institution (including *transaction account*) or for making payment to a third party by means of a preauthorized transfer, or telephonic (including data transmission) agreement, order or instruction, except accounts described in paragraph (d)(2) of this section. An account that authorizes more than six such withdrawals in a calendar month, or statement cycle (or similar period) of at least four weeks, is a *transaction account* whether or not more than six such transfers are made during such period. A *preauthorized transfer* includes any arrangement by the depository institution to pay a third party from the account of a depositor upon written or oral instruction (including an order received through an automated clearing house (ACH)), or any arrangement by a depository institution to pay a third party from the account of the depositor at a predetermined time or on a fixed schedule. Such an account is not a *transaction account* by virtue of an arrangement that permits transfers for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer) or that permits transfers of funds from this account to another account of the same depositor at the same institution or permits withdrawals (payments directly to the depositor) from the account when such transfers or withdrawals are made by mail, messenger, automated teller machine or in person or when such withdrawals are made by telephone (via check mailed to the depositor) regardless of the number of such transfers or withdrawals.

(5) Deposits or accounts maintained in connection with an arrangement that permits the depositor to obtain credit directly or indirectly through the drawing of a negotiable or nonnegotiable check, draft, order or instruction or other similar device (including telephone or electronic order or instruction) on the issuing institution that can be used for the purpose of making payments or transfers to third persons or others or to a deposit account of the depositor.

(6) All deposits other than time and savings accounts, including those accounts that are time and savings deposits in form but that the Board has determined, by rule or order, to be transaction accounts.

(f)(1) *Nonpersonal time deposit* means:

(i) A time deposit, including an MMDA or any other savings deposit, representing funds in which any beneficial interest is held by a depositor which is not a natural person;

(ii) A time deposit, including an MMDA or any other savings deposit, that represents funds deposited to the credit of a depositor that is not a natural person, other than a deposit to the credit of a trustee or other fiduciary if the entire beneficial interest in the deposit is held by one or more natural persons;

(iii) A transferable time deposit. A time deposit is transferable unless it contains a specific statement on the certificate, instrument, passbook, statement or other form representing the account that it is not transferable. A time deposit that contains a specific statement that it is not transferable is not regarded as transferable even if the following transactions can be effected: a pledge as collateral for a loan, a

transaction that occurs due to circumstances arising from death, incompetency, marriage, divorce, attachment, or otherwise by operation of law or a transfer on the books or records of the institution; and

(iv) A time deposit represented by a promissory note, an acknowledgment of advance, or similar obligation described in paragraph (a)(1)(vii) of this section that is issued to, or any bankers' acceptance (other than the type described in 12 U.S.C. 372) of the depository institution held by:

(A) Any office located outside the United States of another depository institution or Edge or agreement corporation organized under the laws of the United States;

(B) Any office located outside the United States of a foreign bank;

(C) A foreign national government, or an agency or instrumentality thereof,[5] engaged principally in activities which are ordinarily performed in the United States by governmental entities;

(D) An international entity of which the United States is a member; or

(E) Any other foreign, international, or supranational entity specifically designated by the Board.[6]

(2) *Nonpersonal time deposit* does not include nontransferable time deposits to the credit of or in which the entire beneficial interest is held by an individual pursuant to an individual retirement account or Keogh (H.R. 10) plan under 26 U.S.C. 408, 401, or non-transferable time deposits held by an employer as part of an unfunded deferred-compensation plan established pursuant to subtitle D of the Revenue Act of 1978 (Pub. L. 95–600, 92 Stat. 2763), or a *401(k) plan* under 26 U.S.C. 401(k).

(g) *Natural person* means an individual or a sole proprietorship. The term does not mean a corporation owned by an individual, a partnership or other association.

(h) *Eurocurrency liabilities* means:

(1) For a depository institution or an Edge or Agreement Corporation organized under the laws of the United States, the sum, if positive, of the following:

(i) Net balances due to its non-United States offices and its international banking facilities (*IBFs*) from its United States offices;

(ii)(A) For a depository institution organized under the laws of the United States, assets (including participations) acquired from its United States offices and held by its non-United States offices, by its IBF, or by non-United States offices of an affiliated Edge or Agreement Corporation;[7] or

(B) For an Edge or Agreement Corporation, assets (including participations) acquired from its United States offices and held by its non-United States offices, by its IBF, by non-United States offices of its U.S. or foreign parent institution, or by non-United States offices of an affiliated Edge or Agreement Corporation; and

(iii) Credit outstanding from its non-United States offices to United States residents (other than assets acquired and net balances due from its United States offices), except credit extended (A) from its non-United States offices in the aggregate amount of $100,000 or less to any United States resident, (B) by a non-United States office that at no time during the computation period had credit outstanding to United States residents exceeding $1 million, (C) to an international banking facility, or (D) to an institution that will be maintaining reserves on such credit pursuant to this part. Credit extended from non-United States offices or from IBFs to a foreign branch, office, subsidiary, affiliate of other foreign establishment (*foreign affiliate*) controlled by one or more domestic corporations is not regarded as credit extended to a United States resident if the proceeds will be used to finance the operations outside the United States of the borrower or of other foreign affiliates of the controlling domestic corporation(s).

(2) For a United States branch or agency of a foreign bank, the sum, if positive, of the following:

[5] Other than states, provinces, municipalities, or other regional or local governmental units or agencies or instrumentalities thereof.

[6] The designated entities are specified in 12 CFR 217.126.

[7] This paragraph does not apply to assets that were acquired by an IBF from its establishing entity before the end of the second reserve computation period after its establishment.

(i) Net balances due to its foreign bank (including offices thereof located outside the United States) and its international banking facility after deducting an amount equal to 8 per cent of the following: the United States branch's or agency's total assets less the sum of (A) cash items in process of collection; (B) unposted debits; (C) demand balances due from depository institutions organized under the laws of the United States and from other foreign banks; (D) balances due from foreign central banks; and (E) positive net balances due from its IBF, its foreign bank, and the foreign bank's United States and non-United States offices; and

(ii) Assets (including participations) acquired from the United States branch or agency (other than assets required to be sold by Federal or State supervisory authorities) and held by its foreign bank (including offices thereof located outside the United States), by its parent holding company, by non-United States offices or an IBF of an affiliated Edge or Agreement Corporation, or by its IBFs.[8]

(i)(1) *Cash item in process of collection* means:

(i) Checks in the process of collection, drawn on a bank or other depository institution that are payable immediately upon presentation in the United States, including checks forwarded to a Federal Reserve Bank in process of collection and checks on hand that will be presented for payment or forwarded for collection on the following business day;

(ii) Government checks drawn on the Treasury of the United States that are in the process of collection; and

(iii) Such other items in the process of collection, that are payable immediately upon presentation in the United States and that are customarily cleared or collected by depository institutions as cash items, including:

(A) Drafts payable through another depository institution;

(B) Matured bonds and coupons (including bonds and coupons that have been called and are payable on presentation);

(C) Food coupons and certificates;

(D) Postal and other money orders, and traveler's checks;

(E) Amounts credited to deposit accounts in connection with automated payment arrangements where such credits are made one business day prior to the scheduled payment date to insure that funds are available on the payment date;

(F) Commodity or bill of lading drafts payable immediately upon presentation in the United States;

(G) Returned items and unposted debits; and

(H) Broker security drafts.

(2) *Cash item in process of collection* does not include items handled as noncash collections and credit card sales slips and drafts.

(j) *Net transaction accounts* means the total amount of a depository institution's transaction accounts less the deductions allowed under the provisions of § 204.3.

(k)(1) *Vault cash* means United States currency and coin owned and held by a depository institution that may, at any time, be used to satisfy depositors' claims.

(2) *Vault cash* includes United States currency and coin in transit to a Federal Reserve Bank or a correspondent depository institution for which the reporting depository institution has not yet received credit, and United States currency and coin in transit from a Federal Reserve Bank or a correspondent depository institution when the reporting depository institution's account at the Federal Reserve or correspondent bank has been charged for such shipment.

(3) Silver and gold coin and other currency and coin whose numismatic or bullion value is substantially in excess of face value is not vault cash for purposes of this part.

(l) *Pass through account* means a balance maintained by a depository institution that is not a member bank, by a U.S. branch or agency of a foreign bank, or by an Edge or Agreement Corporation, (1) in an institution that maintains required reserve balances at a Federal Reserve Bank, (2) in a Federal Home Loan Bank, (3) in the National Credit Union Administration Central Liquidity Facility, or (4) in an institution that has been authorized by

[8] See footnote 7.

the Board to pass through required reserve balances if the institution, Federal Home Loan Bank, or National Credit Union Administration Central Liquidity Facility maintains the funds in the form of a balance in a Federal Reserve Bank of which it is a member or at which it maintains an account in accordance with rules and regulations of the Board.

(m)(1) *Depository institution* means:

(i) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)) or any bank that is eligible to apply to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(ii) Any savings bank or mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(f), (g));

(iii) Any insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752(7)) or any credit union that is eligible to apply to become an insured credit union under section 201 of such Act (12 U.S.C. 1781);

(iv) Any member as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422(4)); and

(v) Any insured institution as defined in section 401 of the National Housing Act (12 U.S.C. 1724(a)) or any institution which is eligible to apply to become an insured institution under section 403 of such Act (12 U.S.C. 1726).

(2) *Depository institution* does not include international organizations such as the World Bank, the Inter-American Development Bank, and the Asian Development Bank.

(n) *Member bank* means a depository institution that is a member of the Federal Reserve System.

(o) *Foreign bank* means any bank or other similar institution organized under the laws of any country other than the United States or organized under the laws of Puerto Rico, Guam, American Samoa, the Virgin Islands, or other territory or possession of the United States.

(p) [Reserved]

(q) *Affiliate* includes any corporation, association, or other organization:

(1) Of which a depository institution, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 percent of the numbers of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions;

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a depository institution who own or control either a majority of the shares of such depository institution or more than 50 percent of the number of shares voted for the election of directors of such depository institution at the preceding election, or by trustees for the benefit of the shareholders of any such depository institution;

(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one depository institution; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a depository institution or more than 50 percent of the number of shares voted for the election of directors, trustees or other persons exercising similar functions of a depository institution at the preceding election, or controls in any manner the election of a majority of the directors, trustees, or other persons exercising similar functions of a depository institution, or for the benefit of whose shareholders or members all or substantially all the capital stock of a depository institution is held by trustees.

(r) *United States* means the States of the United States and the District of Columbia.

(s) *United States resident* means (1) any individual residing (at the time of the transaction) in the United States; (2) any corporation, partnership, association or other entity organized in the United States (*domestic corporation*); and (3) any branch or office located in the United States of any entity that is not organized in the United States.

(t) *Any deposit that is payable only at an office located outside the United States* means (1) a deposit of a United States

resident[9] that is in a denomination of $100,000 or more, and as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States or (2) a deposit of a person who is not a United States resident[9] as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States.

(u) *Teller's check* means a check drawn by a depository institution on another depository institution, a Federal Reserve Bank, or a Federal Home Loan Bank, or payable at or through a depository institution, a Federal Reserve Bank, or a Federal Home Loan Bank, and which the drawing depository institution engages or is obliged to pay upon dishonor.

[Reg. D, 45 FR 56018, Aug. 22, 1980, as amended at 46 FR 27092, May 18, 1981; 46 FR 32428, June 23, 1981; 47 FR 44707, Oct. 12, 1982; 48 FR 28973, June 24, 1983; 51 FR 9632, 9635, Mar. 20, 1986; 52 FR 47694, 47695, Dec. 16, 1987; 55 FR 50541, Dec. 7, 1990; 56 FR 15494, Apr. 17, 1991; 57 FR 38427, Aug. 25, 1992; 57 FR 40598, Sept. 4, 1992; 61 FR 69025, Dec. 31, 1996; 63 FR 64841, Nov. 24, 1998]

§ 204.3 Computation and maintenance.

(a) *Maintenance and reporting of required reserves.* (1) *Maintenance.* A depository institution, a U.S. branch or agency of a foreign bank, and an Edge or Agreement corporation shall maintain reserves against its deposits and Eurocurrency liabilities in accordance with the procedures prescribed in this section and § 204.4 and the ratios prescribed in § 204.9. Reserve-deficiency charges shall be assessed for deficiencies in required reserves in accordance with the provisions of § 204.7. For purposes of this part, the obligations of a majority-owned (50 percent or more) U.S. subsidiary (except an Edge or Agreement corporation) of a depository institution shall be regarded as obligations of the parent depository institution.

(2) *Reporting.* (i) Every depository institution, U.S. branch or agency of a foreign bank, and Edge or Agreement corporation shall file a report of deposits (or any other required form or statement) directly with the Federal Reserve Bank of its District, regardless of the manner in which it chooses to maintain required reserve balances. A foreign bank's U.S. branches and agencies and an Edge or Agreement corporation's offices operating within the same state and the same Federal Reserve District shall prepare and file a report of deposits on an aggregated basis.

(ii) A Federal Reserve Bank shall notify the reporting institution of its reserve requirements. Where a pass-through arrangement exists, the Reserve Bank will also notify the pass-through correspondent of its respondent's required reserve balances.

(iii) The Board and the Federal Reserve Banks will not hold a pass-through correspondent responsible for guaranteeing the accuracy of the reports of deposits submitted by its respondents.

(3) *Allocation of low reserve tranche and exemption from reserve requirements.* A depository institution, a foreign bank, or an Edge or Agreement corporation shall, if possible, assign the low reserve tranche and reserve requirement exemption prescribed in § 204.9(a) to only one office or to a group of offices filing a single aggregated report of deposits. The amount of the reserve requirement exemption allocated to an office or group of offices may not exceed the amount of the low reserve tranche allocated to such office or offices. If the low reserve tranche or reserve requirement exemption cannot be fully utilized by a single office or by a group of offices filing a single report of deposits, the unused portion of the tranche or exemption may be assigned to other offices or groups of offices of the same institution until the amount of the tranche (or net transaction accounts) or exemption (or reservable liabilities) is exhausted. The tranche or exemption may be reallocated each year concurrent with implementation of the indexed tranche and exemption,

[9] A deposit of a foreign branch, office, subsidiary, affiliate or other foreign establishment (*foreign affiliate*) controlled by one or more domestic corporations is not regarded as a deposit of a United States resident if the funds serve a purpose in connection with its foreign or international business or that of other foreign affiliates of the controlling domestic corporation(s).

or, if necessary during the course of the year to avoid underutilization of the tranche or exemption, at the beginning of a reserve computation period.

(b) *Form and location of reserves.* (1) A depository institution, a U.S. branch or agency of a foreign bank, and an Edge or Agreement corporation shall hold reserves in the form of vault cash, a balance maintained directly with the Federal Reserve Bank in the Federal Reserve District in which it is located, or, in the case of nonmember institutions, with a pass-through correspondent in accordance with § 204.3(i).

(2) (i) For purposes of this section, a depository institution, a U.S. branch or agency of a foreign bank, or an Edge or Agreement corporation is located in the Federal Reserve District that contains the location specified in the institution's charter, organizing certificate, or license or, if no such location is specified, the location of its head office, unless otherwise determined by the Board under paragraph (b)(2)(ii) of this section.

(ii) If the location specified in paragraph (b)(2)(i) of this section, in the Board's judgment, is ambiguous, would impede the ability of the Board or the Federal Reserve Banks to perform their functions under the Federal Reserve Act, or would impede the ability of the institution to operate efficiently, the Board will determine the Federal Reserve District in which the institution is located, after consultation with the institution and the relevant Federal Reserve Banks. The relevant Federal Reserve Banks are the Federal Reserve Bank whose District contains the location specified in paragraph (b)(2)(i) of this section and the Federal Reserve Bank in whose District the institution is proposed to be located. In making this determination, the Board will consider any applicable laws, the business needs of the institution, the location of the institution's head office, the locations where the institution performs its business, and the locations that would allow the institution, the Board, and the Federal Reserve Banks to perform their functions efficiently and effectively.

(c) *Computation of required reserves for institutions that report on a weekly basis.* (1) Required reserves are computed on the basis of daily average balances of deposits and Eurocurrency liabilities during a 14-day period ending every second Monday (the computation period). Reserve requirements are computed by applying the ratios prescribed in § 204.9 to the classes of deposits and Eurocurrency liabilities of the institution. In determining the reserve balance that is required to be maintained with the Federal Reserve, the average daily vault cash held during the computation period is deducted from the amount of the institution's required reserves.

(2) The reserve balance that is required to be maintained with the Federal Reserve shall be maintained during a 14-day period (the ''maintenance period'') that begins on the third Thursday following the end of a given computation period.

(d) *Computation of required reserves for institutions that report on a quarterly basis.* For a depository institution that is permitted to report quarterly, required reserves are computed on the basis of the depository institution's daily average deposit balances during a seven-day computation period that begins on the third Tuesday of March, June, September, and December. In determining the reserve balance that such a depository institution is required to maintain with the Federal Reserve, the daily average vault cash held during the computation period is deducted from the amount of the institution's required reserves. The reserve balance that is required to be maintained with the Federal Reserve shall be maintained during a corresponding period that begins on the fourth Thursday following the end of the institution's computation period and ends on the fourth Wednesday after the close of the institution's next computation period.

(e) *Computation of transaction accounts.* Overdrafts in demand deposit or other transaction accounts are not to be treated as negative demand deposits or negative transaction accounts and shall not be netted since overdrafts are properly reflected on an institution's books as assets. However, where a customer maintains multiple transaction accounts with a depository institution, overdrafts in one account pursuant to a

bona fide cash management arrangement are permitted to be netted against balances in other related transaction accounts for reserve requirement purposes.

(f) *Deductions allowed in computing reserves.* (1) In determining the reserve balance required under this part, the amount of cash items in process of collection and balances subject to immediate withdrawal due from other depository institutions located in the United States (including such amounts due from United States branches and agencies of foreign banks and Edge and agreement corporations) may be deducted from the amount of gross transaction accounts. The amount that may be deducted may not exceed the amount of gross transaction accounts.

(2) United States branches and agencies of a foreign bank may not deduct balances due from another United States branch or agency of the same foreign bank, and United States offices of an Edge or Agreement Corporation may not deduct balances due from another United States office of the same Edge Corporation.

(3) Balances ''due from other depository institutions'' do not include balances due from Federal Reserve Banks, pass through accounts, or balances (payable in dollars or otherwise) due from banking offices located outside the United States. An institution exercising fiduciary powers may not include in ''balances due from other depository institutions'' amounts of trust funds deposited with other banks and due to it as a trustee or other fiduciary.

(g) *Availability of cash items as reserves.* Cash items forwarded to a Federal Reserve Bank for collection and credit shall not be counted as part of the reserve balance to be carried with the Federal Reserve until the expiration of the time specified in the appropriate time schedule established under Regulation J, ''Collection of Checks and Other Items and Transfers of Funds'' (12 CFR part 210). If a depository institution draws against items before that time, the charge will be made to its reserve account if the balance is sufficient to pay it; any resulting impairment of reserve balances will be subject to the penalties provided by law and to the reserve deficiency charges provided by this part. However, the Federal Reserve Bank may, at its discretion, refuse to permit the withdrawal or other use of credit given in a reserve account for any time for which the Federal Reserve bank has not received payment in actually and finally collected funds.

(h) *Carryover of excesses or deficiencies.* Any excess or deficiency in a depository institution's account that is held directly or indirectly with a Federal Reserve Bank shall be carried over and applied to that account in the next maintenance period as specified in this paragraph. The amount of any such excess or deficiency that is carried over shall not exceed the greater of:

(1) The amount obtained by multiplying .04 times the sum of the depository institution's required reserves and the depository institution's required clearing balance, if any, and then subtracting from this product the depository institution's required charge-free band, if any; or

(2) $50,000, minus the depository institution's required charge-free band, if any. Any carryover not offset during the next period may not be carried over to subsequent periods.

(i) *Pass-through rules.* (1) *Procedure.* (i) A nonmember depository institution, a U.S. branch or agency of a foreign bank, or an Edge or Agreement corporation required to maintain reserve balances (respondent) may select only one institution to pass through its required reserve balances, unless otherwise permitted by Federal Reserve Bank in whose district the respondent is located. Eligible institutions through which respondent required reserve balances may be passed (correspondents) are Federal Home Loan Banks, the National Credit Union Administration Central Liquidity Facility, and depository institutions, U.S. branches or agencies of foreign banks, and Edge and Agreement corporations that maintain required reserve balances at a Federal Reserve office. In addition, the Board reserves the right to permit other institutions, on a case-by-case basis, to serve as pass-through correspondents. The correspondent chosen must subsequently pass through

the required reserve balances of its respondents directly to a Federal Reserve Bank. The correspondent placing funds with a Federal Reserve Bank on behalf of respondents will be responsible for account maintenance as described in paragraphs (i)(2) and (i)(3) of this section.

(ii) Respondents or correspondents may institute, terminate, or change pass-through arrangements for the maintenance of required reserve balances by providing all documentation required for the establishment of the new arrangement or termination of the existing arrangement to the Federal Reserve Banks involved within the time period provided for such a change by those Reserve Banks.

(2) *Account maintenance.* A correspondent that passes through required reserve balances of respondents shall maintain such balances, along with the correspondent's own required reserve balances (if any), in a single commingled account at the Federal Reserve Bank in whose District the correspondent is located, unless otherwise permitted by the Reserve Bank. The balances held by the correspondent in an account at a Reserve Bank are the property of the correspondent and represent a liability of the Reserve Bank solely to the correspondent, regardless of whether the funds represent the reserve balances of another institution that have been passed through the correspondent.

(3) *Responsibilities of parties.* (i) Each individual depository institution, U.S. branch or agency of a foreign bank, or Edge or Agreement corporation is responsible for maintaining its required reserve balance either directly with a Federal Reserve Bank or through a pass-through correspondent.

(ii) A pass-through correspondent shall be responsible for assuring the maintenance of the appropriate aggregate level of its respondents' required reserve balances. A Federal Reserve Bank will compare the total reserve balance required to be maintained in each account with the total actual reserve balance held in such account for purposes of determining required reserve deficiencies, imposing or waiving charges for deficiencies in required reserves, and for other reserve maintenance purposes. A charge for a deficiency in the aggregate level of the required reserve balance will be imposed by the Reserve Bank on the correspondent maintaining the account.

(iii) Each correspondent is required to maintain detailed records for each of its respondents in a manner that permits Federal Reserve Banks to determine whether the respondent has provided a sufficient required reserve balance to the correspondent. A correspondent passing through a respondent's reserve balance shall maintain records and make such reports as the Board or Reserve Bank requires in order to insure the correspondent's compliance with its responsibilities for the maintenance of a respondent's reserve balance. Such records shall be available to the Reserve Banks as required.

(iv) The Federal Reserve Bank may terminate any pass-through relationship in which the correspondent is deficient in its recordkeeping or other responsibilities.

(v) Interest paid on supplemental reserves (if such reserves are required under § 204.6) held by a respondent will be credited to the account maintained by the correspondent.

[45 FR 56018, Aug. 22, 1980, as amended at 45 FR 58100, Sept. 2, 1980; 45 FR 81537, Dec. 11, 1980; 46 FR 32430, June 23, 1981; 47 FR 44707, Oct. 12, 1982; 47 FR 55206, Dec. 8, 1982; 48 FR 17335, 17336, Apr. 22, 1983; 51 FR 9635, Mar. 20, 1986; 55 FR 50541, Dec. 7, 1990; 57 FR 38417, 38427, Aug. 25, 1992; 61 FR 69025, Dec. 31, 1996; 62 FR 34616, June 27, 1997; 62 FR 59778, Nov. 5, 1997; 63 FR 15071, Mar. 30, 1998]

§ 204.4 Transitional adjustments in mergers.

In cases of mergers and consolidations of depository institutions, the amount of reserves that shall be maintained by the surviving institution shall be reduced by an amount determined by multiplying the amount by which the required reserves during the computation period immediately preceding the date of the merger (computed as if the depository institutions had merged) exceeds the sum of the actual required reserves of each depository institution during the same computation period, times the appropriate percentage as specified in the following schedule:

Maintenance periods occurring during quarters following merger or consolidation	Percentage applied to difference to compute amount to be subtracted
1	87.5
2	75.0
3	62.5
4	50.0
5	37.5
6	25.0
7	12.5
8 and succeeding	0

[61 FR 69025, Dec. 31, 1996]

§ 204.5 Emergency reserve requirement.

(a) *Finding by Board*. The Board may impose, after consulting with the appropriate committees of Congress, additional reserve requirements on depository institutions at any ratio on any liability upon a finding by at least five members of the Board that extraordinary circumstances require such action.

(b) *Term*. Any action taken under this section shall be valid for a period not exceeding 180 days, and may be extended for further periods of up to 180 days each by affirmative action of at least five members of the Board for each extension.

(c) *Reports to Congress*. The Board shall transmit promptly to Congress a report of any exercise of its authority under this paragraph and the reasons for the exercise of authority.

(d) *Reserve requirements*. At present, there are no emergency reserve requirements imposed under this section.

[45 FR 56018, Aug. 22, 1980]

§ 204.6 Supplemental reserve requirement.

(a) *Finding by Board*. Upon the affirmative vote of at least five members of the Board and after consultation with the Board of Directors of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration Board, the Board may impose a supplemental reserve requirement on every depository institution of not more than 4 percent of its total transaction accounts. A supplemental reserve requirement may be imposed if:

(1) The sole purpose of the requirement is to increase the amount of reserves maintained to a level essential for the conduct of monetary policy;

(2) The requirement is not imposed for the purpose of reducing the cost burdens resulting from the imposition of basic reserve requirements;

(3) Such requirement is not imposed for the purpose of increasing the amount of balances needed for clearing purposes; and

(4) On the date on which supplemental reserve requirements are imposed, the total amount of basic reserve requirements is not less than the amount of reserves that would be required on transaction accounts and nonpersonal time deposits under the initial reserve ratios established by the Monetary Control Act of 1980 (Pub. L. 96–221) in effect on September 1, 1980.

(b) *Term*. (1) If a supplemental reserve requirement has been imposed for a period of one year or more, the Board shall review and determine the need for continued maintenance of supplemental reserves and shall transmit annual reports to the Congress regarding the need for continuing such requirement.

(2) Any supplemental reserve requirement shall terminate at the close of the first 90-day period after the requirement is imposed during which the average amount of supplemental reserves required are less than the amount of reserves which would be required if the ratios in effect on September 1, 1980, were applied.

(c) *Earnings Participation Account*. A depository institutions's supplemental reserve requirement shall be maintained by the Federal Reserve Banks in an Earnings Participation Account. Such balances shall receive earnings to be paid by the Federal Reserve Banks during each calendar quarter at a rate not to exceed the rate earned on the securities portfolio of the Federal Reserve System during the previous calendar quarter. Additional rules and regulations maybe prescribed by the Board concerning the payment of earnings on Earnings Participation Accounts by Federal Reserve Banks.

(d) *Report to Congress*. The Board shall transmit promptly to the Congress a report stating the basis for exercising its authority to require a supplemental reserve under this section.

(e) *Reserve requirements*. At present, there are no supplemental reserve requirements imposed under this section.

[45 FR 56018, Aug. 22, 1980, as amended at 45 FR 81537, Dec. 11, 1980]

§ 204.7 Penalties.

(a) *Charges for deficiencies*—(1) *Assessment of charges*. Deficiencies in a depository institution's required reserve balance, after application of the carryover provided in § 204.3(h) are subject to reserve deficiency charges. Federal Reserve Banks are authorized to assess charges for deficiencies in required reserves at a rate of 2 percent per year above the lowest rate in effect for borrowings from the Federal Reserve Bank on the first day of the calendar month in which the deficiencies occurred. Charges shall be assessed on the basis of daily average deficiencies during each maintenance period. Reserve Banks may, as an alternative to levying monetary charges, after consideration of the circumstances involved, permit a depository institution to eliminate deficiencies in its required reserve balance by maintaining additional reserves during subsequent reserve maintenance periods.

(2) *Waivers*. (i) Reserve Banks may waive the charges for reserve deficiencies except when the deficiency arises out of a depository institution's gross negligence or conduct that is inconsistent with the principles and purposes of reserve requirements. Each Reserve Bank has adopted guidelines that provide for waivers of small charges. The guidelines also provide for waiving the charge once during a two-year period for any deficiency that does not exceed a certain percentage of the depository institution's required reserves. Decisions by Reserve Banks to waive charges in other situations are based on an evaluation of the circumstances in each individual case and the depository institution's reserve maintenance record. If a depository institution has demonstrated a lack of due regard for the proper maintenance of required reserves, the Reserve Bank may decline to exercise the waiver privilege and assess all charges regardless of amount or reason for the deficiency.

(ii) In individual cases, where a federal supervisory authority waives a liquidity requirement, or waives the penalty for failing to satisfy a liquidity requirement, the Reserve Bank in the District where the involved depository institution is located shall waive the reserve requirement imposed under this part for such depository institution when requested by the federal supervisory authority involved.

(b) *Penalties for Violations*. Violations of this part may be subject to assessment of civil money penalties by the Board under authority of section 19(1) of the Federal Reserve Act (12 U.S.C 505) as implemented in 12 CFR part 263. In addition, the Board and any other Federal financial institution supervisory authority may enforce this part with respect to depository institutions subject to their jurisdiction under authority conferred by law to undertake cease and desist proceedings.

[44 FR 56018, Aug. 22, 1980, as amended at 56 FR 15495, Apr. 17, 1991; 61 FR 69025, Dec. 31, 1996]

§ 204.8 International banking facilities.

(a) *Definitions*. For purposes of this part, the following definitions apply:

(1) *International banking facility* or *IBF* means a set of asset and liability accounts segregated on the books and records of a depository institution, United States branch or agency of a foreign bank, or an Edge or Agreement Corporation that includes only international banking facility time deposits and international banking facility extensions of credit.

(2) *International banking facility time deposit* or *IBF time deposit* means a deposit, placement, borrowing or similar obligation represented by a promissory note, acknowledgment of advance, or similar instrument that is not issued in negotiable or bearer form, and

(i)(A) That must remain on deposit at the IBF at least overnight; and

(B) That is issued to

(*1*) Any office located outside the United States of another depository institution organized under the laws of

the United States or of an Edge or Agreement Corporation;

(*2*) Any office located outside the United States of a foreign bank;

(*3*) A United States office or a non-United States office of the entity establishing the IBF;

(*4*) Another IBF; or

(*5*) A foreign national government, or an agency or instrumentality thereof,[10] engaged principally in activities which are ordinarily performed in the United States by governmental entities; an international entity of which the United States is a member; or any other foreign international or supranational entity specifically designated by the Board;[11] or

(ii) (A) That is payable

(*1*) On a specified date not less than two business days after the date of deposit;

(*2*) Upon expiration of a specified period of time not less than two business days after the date of deposit; or

(*3*) Upon written notice that actually is required to be given by the depositor not less than two business days prior to the date of withdrawal;

(B) That represents funds deposited to the credit of a non-United States resident or a foreign branch, office, subsidiary, affiliate, or other foreign establishment (*foreign affiliate*) controlled by one or more domestic corporations provided that such funds are used only to support the operations outside the United States of the depositor or of its affiliates located outside the United States; and

(C) That is maintained under an agreement or arrangement under which no deposit or withdrawal of less than $100,000 is permitted, except that a withdrawal of less than $100,000 is permitted if such withdrawal closes an account.

(3) *International banking facility extension of credit* or *IBF loan* means any transaction where an IBF supplies funds by making a loan, or placing funds in a deposit account. Such transactions may be represented by a promissory note, security, acknowledgment of advance, due bill, repurchase agreement, or any other form of credit transaction. Such credit may be extended only to:

(i) Any office located outside the United States of another depository institution organized under the laws of the United States or of an Edge or Agreement Corporation;

(ii) Any office located outside the United States of a foreign bank;

(iii) A United States or a non-United States office of the institution establishing the IBF;

(iv) Another IBF;

(v) A foreign national government, or an agency or instrumentality thereof,[12] engaged principally in activities which are ordinarily performed in the United States by governmental entities; an international entity of which the United States is a member; or any other foreign international or supranational entity specifically designated by the Board;[13] or

(vi) A non-United States resident or a foreign branch, office, subsidiary, affiliate or other foreign establishment (*foreign affiliate*) controlled by one or more domestic corporations provided that the funds are used only to finance the operations outside the United States of the borrower or of its affiliates located outside the United States.

(b) *Acknowledgment of use of IBF deposits and extensions of credit.* An IBF shall provide written notice to each of its customers (other than those specified in § 204.8(a)(2)(i)(B) and § 204.8(a)(3)(i) through (v)) at the time a deposit relationship or a credit relationship is first established that it is the policy of the Board of Governors of the Federal Reserve System that deposits received by international banking facilities may be used only to support the depositor's operations outside the United States as specified in § 204.8(a)(2)(ii)(B) and that extensions of credit by IBFs may be used only to finance operations outside of the United States as specified in § 204.8(a)(3)(vi). In the case of loans to or deposits from foreign affiliates of U.S. residents, receipt of such

[10] Other than states, provinces, municipalities, or other regional or local governmental units or agencies or instrumentalities thereof.

[11] The designated entities are specified in 12 CFR 204.125.

[12] See footnote 10.

[13] See footnote 11.

notice must be acknowledged in writing whenever a deposit or credit relationship is first established with the IBF.

(c) *Exemption from reserve requirements.* An institution that is subject to the reserve requirements of this part is not required to maintain reserves against its IBF time deposits or IBF loans. Deposit-taking activities of IBFs are limited to accepting only IBF time deposits and lending activities of IBFs are restricted to making only IBF loans.

(d) *Establishment of an international banking facility.* A depository institution, an Edge or Agreement Corporation or a United States branch or agency of a foreign bank may establish an IBF in any location where it is legally authorized to engage in IBF business. However, only one IBF may be established for each reporting entity that is required to submit a Report of Transaction Accounts, Other Deposits and Vault Cash (Form FR 2900).

(e) *Notification to Federal Reserve.* At least fourteen days prior to the first reserve computation period that an institution intends to establish an IBF it shall notify the Federal Reserve Bank of the district in which it is located of its intent. Such notification shall include a statement of intention by the institution that it will comply with the rules of this part concerning IBFs, including restrictions on sources and uses of funds, and recordkeeping and accounting requirements. Failure to comply with the requirements of this part shall subject the institution to reserve requirements under this part or result in the revocation of the institution's ability to operate an IBF.

(f) *Recordkeeping requirements.* A depository institution shall segregate on its books and records the asset and liability accounts of its IBF and submit reports concerning the operations of its IBF as required by the Board.

[46 FR 32429, June 23, 1981, as amended at 51 FR 9636, Mar. 20, 1986; 56 FR 15495, Apr. 17, 1991; 61 FR 69025, Dec. 31, 1996]

§ 204.9 Reserve requirement ratios.

(a) *Reserve percentages.* The following reserve ratios are prescribed for all depository institutions, Edge and Agreement corporations, and United States branches and agencies of foreign banks:

Category	Reserve requirement [1]
Net transaction accounts:	
$0 to $41.3 million	3 percent of amount.
Over $41.3 million	$1,239,000 plus 10 percent of amount over $41.3 million.
Nonpersonal time deposits	0 percent.
Eurocurrency liabilities	0 percent.

[1] Before deducting the adjustment to be made by the paragraph (b) of this section.

(b) *Exemption from reserve requirements.* Each depository institution, Edge or agreement corporation, and U.S. branch or agency of a foreign bank is subject to a zero percent reserve requirement on an amount of its transaction accounts subject to the low reserve tranche in paragraph (a) of this section not in excess of $5.7 million determined in accordance with § 204.3(a)(3).

[Reg. D, 66 FR 53078, Oct. 19, 2001]

INTERPRETATIONS

§ 204.121 Bankers' banks.

(a)(1) The Federal Reserve Act, as amended by the Monetary Control Act of 1980 (title I of Pub. L. 96–221), imposes Federal reserve requirements on depository institutions that maintain transaction accounts or nonpersonal time deposits. Under section 19(b)(9), however, a depository institution is not required to maintain reserves if it:

(i) Is organized solely to do business with other financial institutions;

(ii) Is owned primarily by the financial institutions with which it does business; and

(iii) Does not do business with the general public.

Depository institutions that satisfy all of these requirements are regarded as *bankers' banks.*

(2) In its application of these requirements to specific institutions, the Board will use the following standards:

(i) A depository institution may be regarded as organized solely to do business with other depository institutions even if, as an incidental part to its activities, it does business to a limited extent with entities other than depository institutions. The extent to which the institution may do business with

other entities and continue to be regarded as a bankers' bank is specified in paragraph (a)(2)(iii) of this section.

(ii) A depository institution will be regarded as being owned primarily by the institutions with which it does business if 75 per cent or more of its capital is owned by other depository institutions. The 75 per cent or more ownership rule applies regardless of the type of depository institution.

(iii) A depository institution will not be regarded as doing business with the general public if it meets two conditions. First, the range of customers with which the institution does business must be limited to depository institutions, including subsidiaries or organizations owned by depository institutions; directors, officers or employees of the same or other depository institutions; individuals whose accounts are acquired at the request of the institution's supervisory authority due to the actual or impending failure of another depository institution; share insurance funds; and depository institution trade associations. Second, the extent to which the depository institution makes loans to, or investments in, the above entities (other than depository institutions) cannot exceed 10 per cent of total assets, and the extent to which it receives deposits (or shares if the institution does not receive deposits) from or issues other liabilities to the above entities (other than depository institutions) cannot exceed 10 per cent of total liabilities (or net worth if the institution does not receive deposits).

If a depository institution is unable to meet all of these requirements on a continuing basis, it will not be regarded as a bankers' bank and will be required to satisfy Federal reserve requirements on all of its transaction accounts and nonpersonal time deposits.

(b) (1) Section 19(c)(1) of the Federal Reserve Act, as amended by the Monetary Control Act of 1980 (title I of Pub. L. 96–221) provides that Federal reserve requirements may be satisfied by the maintenance of vault cash or balances in a Federal Reserve Bank. Depository institutions that are not members of the Federal Reserve System may also satisfy reserve requirements by maintaining a balance in another depository institution that maintains required reserve balances at a Federal Reserve Bank, in a Federal Home Loan Bank, or in the National Credit Union Administration Central Liquidity Facility if the balances maintained by such institutions are subsequently passed through to the Federal Reserve Bank.

(2) On August 27, 1980, the Board announced the procedures that will apply to such pass-through arrangements (45 FR 58099). Section 204.3(i)(1) provides that the Board may permit, on a case-by-case basis, depository institutions that are not themselves required to maintain reserves (*bankers' banks*) to act as pass-through correspondents if certain criteria are satisfied. The Board has determined that a bankers' bank may act as a pass-through correspondent if it enters into an agreement with the Federal Reserve to accept responsibility for the maintenance of pass-through reserve accounts in accordance with Regulation D (12 CFR 204.3(i)) and if the Federal Reserve is satisfied that the quality of management and financial resources of the institution are adequate in order to enable the institution to serve as a pass-through correspondent in accordance with Regulation D. Satisfaction of these criteria will assure that pass-through arrangements are maintained properly without additional financial risk to the Federal Reserve.

(3) In order to determine uniformly the adequacy of managerial and financial resources, the Board will consult with the Federal supervisor for the type of institution under consideration. Because the Board does not possess direct experience with supervising depository institutions other than commerical banks, and does not intend to involve itself in the direct supervision of such institutions, it will request the National Credit Union Administration to review requests from credit unions that qualify as bankers' banks and the Federal Home Loan Bank Board to review requests from savings and loan associations that qualify as bankers' banks, regardless of charter or insurance status. (The Board, itself, will consider requests from all commercial banks that qualify as bankers' banks.) If the Federal supervisor does not find the institution's

managerial or financial resources to be adequate, the Board will not permit the institution to act as a pass-through correspondent. In order to assure the continued adequacy of managerial and financial resources, it is anticipated that the appropriate Federal supervisor will, on a periodic basis, review and evaluate the managerial and financial resources of the institution in order to determine whether it should continue to be permitted to act as a pass-through correspondent. It is anticipated that, with respect to state chartered institutions, the Federal supervisor may discuss the request with the institute State supervisor. The Board believes that this procedure will promote uniformity of treatment for all types of bankers' banks, and provide consistent advice concerning managerial ability and financial strength from supervisory authorities that are in a better position to evaluate these criteria for depository institutions that are not commerical banks.

(4) Requests for a determination as to whether a depository institution will be regarded as a bankers' bank for purposes of the Federal Reserve Act or for permission to act as a pass-through correspondent may be addressed to the Federal Reserve Bank in whose District the main office of the despository institution is located or to the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. The Board will act promptly on all requests received directly or through Federal Reserve Banks.

[45 FR 69879, Oct. 22, 1980]

§ 204.122 Secondary market activities of international banking facilities.

(a) Questions have been raised concerning the extent to which international banking facilities may purchase (or sell) IBF-eligible assets such as loans (including loan participations), securities, CDs, and bankers' acceptances from (or to) third parties. Under the Board's regulations, as specified in § 204.8 of Regulation D, IBFs are limited, with respect to making loans and accepting deposits, to dealing only with certain customers, such as other IBFs and foreign offices of other organizations, and with the entity establishing the IBF. In addition, an IBF may extend credit to a nonbank customer only to finance the borrower's non-U.S. operations and may accept deposits from a nonbank customer that are used only to support the depositor's non-U.S. business.

(b) Consistent with the Board's intent, IBFs may purchase IBF-eligible assets[1] from, or sell such assets to, any domestic or foreign customer provided that the transactions are at arm's length without recourse. However, an IBF of a U.S. depository institution may not purchase assets from, or sell such assets to, any U.S. affiliate of the institution establishing the IBF; an IBF of an Edge or Agreement corporation may not purchase assets from, or sell assets to, any U.S. affiliate of the Edge or Agreement corporation or to U.S. branches of the Edge or Agreement corporation or to U.S. branches of the Edge or Agreement corporation other than the branch[2] establishing the IBF; and an IBF of a U.S. branch or agency of a foreign bank may not purchase assets from, or sell assets to any U.S. affiliates of the foreign bank or to any other U.S. branch or agency of the same foreign bank.[2] (This would not pevent an IBF from purchasing (or selling) assets directly from (or to) any IBF, including an IBF of an affiliate, or to the institution establishing the IBF; such purchases from the institution establishing the IBF would continue to be subject to Eurocurrency reserve requirements except during the initial four-week transition period.) Since repurchase agreements are regarded as loans, transactions involving repurchase agreements are permitted only with customers who are otherwise eligible to deal with IBFs, as specified in Regulation D.

(c) In the case of purchases of assets, in order to determine that the Board's use-of-proceeds requirement has been

[1] In order for an asset to be eligible to be held by an IBF, the obligor or issuer of the instrument, or in the case of bankers' acceptances, the customer and any endorser or acceptor, must be an IBF-eligible customer.

[2] Branches of Edge or Agreement corporations and agencies and branches of foreign banks that file a consolidated report for reserve requirements purposes (FR 2900) are considered to be the establishing entity of an IBF.

met, it is necessary for the IBF (1) to ascertain that the applicable IBF notices and acknowledgments have been provided, or (2) in the case of loans or securities, to review the documentation underlying the loan or security, or accompanying the security (e.g., the prospectus or offering statement), to determine that the proceeds are being used only to finance the obligor's operations outside the U.S., or (3) in the case of loans, to obtain a statement from either the seller or borrower that the proceeds are being used only to finance operations outside the U.S., or in the case of securities, to obtain such a statement from the obligor, or (4) in the case of bankers' acceptances, to review the underlying documentation to determine that the proceeds are being used only to finance the parties' operations outside the United States.

(d) Under the Board's regulations, IBFs are not permitted to issue negotiable Euro-CDs, bankers' acceptances, or similar instruments. Accordingly, consistent with the Board's intent in this area, IBFs may sell such instruments issued by third parties that qualify as IBF-eligible assets provided that the IBF, its establishing institution and any affiliate of the institution establishing the IBF do not endorse, accept, or otherwise guarantee the instrument.

[46 FR 62812, Dec. 29, 1981, as amended at 52 FR 47694, Dec. 16, 1987]

§ 204.123 Sale of Federal funds by investment companies or trusts in which the entire beneficial interest is held exclusively by depository institutions.

(a) The Federal Reserve Act, as amended by the Monetary Control Act of 1980 (Title I of Pub. L. 96–221) imposes Federal Reserve requirements on transaction accounts and nonpersonnel time deposits held by depository institutions. The Board is empowered under the Act to determine what types of obligations shall be deemed a deposit. Regulation D—Reserve Requirements of Depository Institutions exempts from the definition of *deposit* those obligations of a depository institution that are issued or undertaken and held for the account of a domestic office of another depository institution (12 CFR 204.2(a)(1)(vii)(A)(1)). These exemptions from the definition of *deposit* are known collectively as the *Federal funds* or *interbank* exemption.

(b) Title IV of the Depository Institutions Deregulation and Monetary Control Act of 1980 authorizes Federal savings and loan associations to invest in open-ended management investment companies provided the funds' investment portfolios are limited to the types of investments that a Federal savings and loan association could hold without limit as to percentage of assets (12 U.S.C. 1464(c)(1)(Q)). Such investments include mortgages, U.S. Government and agency securities, securities of states and political subdivisions, sales of Federal funds and deposits held at banks insured by the Federal Deposit Insurance Corporation. The Federal Credit Union Act authorizes Federal credit unions to aggregate their funds in trusts provided the trust is limited to such investments that Federal credit unions could otherwise make. Such investments include loans to credit union members, obligations of the U.S. government or secured by the U.S. government, loans to other credit unions, shares or accounts held at savings and loan associations or mutual savings banks insured by FSLIC or FDIC, sales of Federal funds and shares of any central credit union whose investments are specifically authorized by the board of directors of the Federal credit union making the investment (12 U.S.C. 1757(7)).

(c) The Board has considered whether an investment company or trust whose entire beneficial interest is held by depository institutions, as defined in Regulation D, would be eligible for the Federal funds exemption from Reserve requirements and interest rate limitations. The Board has determined that such investment companies or trusts are eligible to participate in the Federal funds market because, in effect, they act as mere conduits for the holders of their beneficial interest. To be regarded by the Board as acting as a conduit and, thus, be eligible for participation in the Federal funds market, an investment company or trust must meet each of the following conditions:

(1) The entire beneficial interest in the investment company or trust must

be held by depository institutions, as defined in Regulation D. These institutions presently may participate directly in the Federal funds market. If the entire beneficial interest in the investment company or trust is held only by depository institutions, the Board will regard the investment company or trust as a mere conduit for the holders of its beneficial interest.

(2) The assets of the investment company or trust must be limited to investments that *all* of the holders of the beneficial interest could make directly without limit.

(3) Holders of the beneficial interest in the investment company or trust must not be allowed to make third party payments from their accounts with the investment company or trust. The Board does not regard an investment company or trust that offers third party payment capabilities or other similar services which actively transform the nature of the funds passing between the holders of the beneficial interest and the Federal funds market as mere conduits.

The Board expects that the above conditions will be included in materials filed by an investment company or trust with the appropriate regulatory agencies.

(d) The Board believes that permitting sales of Federal funds by investment companies or trusts whose beneficial interests are held exclusively by depository institutions, that invest solely in assets that the holders of their beneficial interests can otherwise invest in without limit, and do not provide third party payment capabilities offer the potential for an increased yield for thrifts. This is consistent with Congressional intent to provide thrifts with convenient liquidity vehicles.

[47 FR 8987, Mar. 3, 1982, as amended at 52 FR 47695, Dec. 16, 1987]

§ 204.124 Repurchase agreement involving shares of a money market mutual fund whose portfolio consists wholly of United States Treasury and Federal agency securities.

(a) The Federal Reserve Act, as amended by the Monetary Control Act of 1980 (title I of Pub. L. 96–221) imposes Federal reserve requirements on transaction accounts and nonpersonal time deposits held by depository institutions. The Board is empowered under the Act to determine what types of obligations shall be deemed a deposit (12 U.S.C. 461). Regulation D—Reserve Requirements of Depository Institutions exempts from the definition of *deposit* those obligations of a depository institution that arise from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States government or any agency thereof that the depository institution is obligated to repurchase (12 CFR 204.2(a)(1)(vii)(B)).

(b) The National Bank Act provides that a national bank may purchase for its own account investment securities under limitations and restrictions as the Comptroller may prescribe (12 U.S.C. 24, ¶7). The statute defines investment securities to mean marketable obligations evidencing indebtedness of any person in the form of bonds, notes, and debentures. The Act further limits a national bank's holdings of any one security to no more than an amount equal to 10 percent of the bank's capital stock and surplus. However, these limitations do not apply to obligations issued by the United States, general obligations of any state and certain obligations of Federal agencies. In addition, generally a national bank is not permitted to purchase for its own account stock of any corporation. These restrictions also apply to state member banks (12 U.S.C. 335).

(c) The Comptroller of the Currency has permitted national banks to purchase for their own accounts shares of open-end investment companies that are purchased and sold at par (i.e., money market mutual funds) provided the portfolios of such companies consist solely of securities that a national bank may purchase directly (Banking Bulletin B–83–58). The Board of Governors has permitted state member banks to purchase, to the extent permitted under applicable state law, shares of money market mutual funds (*MMMF*) whose portfolios consist solely of securities that the state member bank may purchase directly (12 CFR 208.123).

(d) The Board has determined that an obligation arising from a repurchase agreement involving shares of a MMMF whose portfolio consists wholly of securities of the United States government or any agency thereof[1] would not be a *deposit* for purposes of Regulations D and Q. The Board believes that a repurchase agreement involving shares of such a MMMF is the functional equivalent of a repurchase agreement directly involving United States government or agency obligations. A purchaser of shares of a MMMF obtains an interest in a *pro rata* portion of the assets that comprise the MMMF's portfolio. Accordingly, regardless of whether the repurchase agreement involves United States government or agency obligations directly or shares in a MMMF whose portfolio consists entirely of United States government or agency obligations, an equitable and undivided interest in United States and agency government obligations is being transferred. Moreover, the Board believes that this interpretation will further the purpose of the exemption in Regulations D and Q for repurchase agreements involving United States government or Federal obligations by enhancing the market for such obligations.

[50 FR 13011, Apr. 2, 1985, as amended at 52 FR 47695, Dec. 16, 1987]

§ 204.125 Foreign, international, and supranational entities referred to in §§ 204.2(c)(1)(iv)(E) and 204.8(a)(2)(i)(B)(5).

The entities referred to in §§ 204.2(c)(1)(iv)(E) and 204.8(a)(2)(i)(B)(5) are:

EUROPE

Bank for International Settlements.
European Atomic Energy Community.
European Central Bank.
European Coal and Steel Community.
The European Communities.
European Development Fund.
European Economic Community.
European Free Trade Association.
European Fund.
European Investment Bank.

LATIN AMERICA

Andean Development Corporation.
Andean Subregional Group.
Caribbean Development Bank.
Caribbean Free Trade Association
Caribbean Regional Development Agency.
Central American Bank for Economic Integration.
The Central American Institute for Industrial Research and Technology.
Central American Monetary Stabilization Fund.
East Caribbean Common Market.
Latin American Free Trade Association.
Organization for Central American States.
Permanent Secretariat of the Central American General Treaty of Economic Integration.
River Plate Basin Commission.

AFRICA

African Development Bank.
Banque Centrale des Etats de l'Afrique Equatorial et du Cameroun.
Banque Centrale des Etats d'Afrique del'Ouest.
Conseil de l'Entente.
East African Community.
Organisation Commune Africaine et Malagache.
Organization of African Unity.
Union des Etats de l'Afrique Centrale.
Union Douaniere et Economique de l'Afrique Centrale.
Union Douaniere des Etats de l'Afrique de l'Ouest.

ASIA

Asia and Pacific Council.
Association of Southeast Asian Nations.
Bank of Taiwan.
Korea Exchange Bank.

MIDDLE EAST

Central Treaty Organization.
Regional Cooperation for Development.

[Reg. D, 52 FR 47695, Dec. 16, 1987, as amended at 56 FR 15495, Apr. 17, 1991; 65 FR 12917, Mar. 10, 2000]

§ 204.126 Depository institution participation in "Federal funds" market.

(a) Under § 204.2(a)(1)(vii)(A), there is an exemption from Regulation D for member bank obligations in nondeposit form to another bank. To assure the effectiveness of the limitations on persons who sell Federal funds to depository institutions, Regulation D applies to nondocumentary obligations undertaken by a depository institution to obtain funds for use in its banking

[1] The term *United States government or any agency thereof* as used herein shall have the same meaning as in § 204.2(a)(1)(vii)(B) of Regulation D, 12 CFR 204.2(a)(1)(vii)(B).

business, as well as to documentary obligations. Under § 204.2(a)(1)(vii) of Regulation D, a depository institution's liability under informal arrangements as well as those formally embodied in a document are within the coverage of Regulation D.

(b) The exemption in § 204.2(a)(1)(vii)(A) applies to obligations owed by a depository institution to a domestic office of any entity listed in that section (the *exempt institutions*). The *exempt institutions* explicitly include another depository institution, foreign bank, Edge or agreement corporation, New York Investment (article XII) Company, the Export-Import Bank of the United States, Minbanc Capital Corp., and certain other credit sources. The term *exempt institutions* also includes subsidiaries of depository institutions:

(1) That engage in businesses in which their parents are authorized to engage; or

(2) The stock of which by statute is explicitly eligible for purchase by national banks.

(c) To assure that this exemption for liabilities to exempt institutions is not used as a means by which nondepository institutions may arrange through an exempt institution to *sell* Federal funds to a depository institution, obligations within the exemption must be issued to an exempt institution for its own account. In view of this requirement, a depository institution that *purchases* Federal funds should ascertain the character (not necessarily the identity) of the actual *seller* in order to justify classification of its liability on the transaction as *Federal funds purchased* rather than as a deposit. Any exempt institution that has given general assurance to the purchasing depository institution that sales by it of Federal funds ordinarily will be for its own account and thereafter executes such transactions for the account of others, should disclose the nature of the actual lender with respect to each such transaction. If it fails to do so, the depository institution would be deemed by the Board as indirectly violating section 19 of the Federal Reserve Act and Regulation D.

[52 FR 47695, Dec. 16, 1987]

§ 204.127 Nondepository participation in "Federal funds" market.

(a) The Board has considered whether the use of *interdepository institution loan participations* (*IDLPs*) which involve participation by third parties other than depository institutions in Federal funds transactions, comes within the exemption from *deposit* classification for certain obligations owed by a depository institution to an institution exempt in § 204.2(a)(1)(vii)(A) of Regulation D. An IDLP transaction is one through which an institution that has sold Federal funds to a depository institution, subsequently *sells* or participates out that obligation to a nondepository third party without notifying the obligated institution.

(b) The Board's interpretation regarding Federal funds transactions (12 CFR 204.126) clarified that a depository institutions's liability must be issued to an exempt institution described in § 204.2(a)(1)(vii)(A) of Regulation D for its own account in order to come within the nondeposit exemption for interdepository liabilities. The Board regards transactions which result in third parties gaining access to the Federal funds market as contrary to the exemption contained in § 204.2(a)(1)(vii)(A) of Regulation D regardless of whether the nondepository institution third party is a party to the initial transaction or thereafter becomes a participant in the transaction through purchase of all or part of the obligation held by the *selling* depository institution.

(c) The Board regards the notice requirements set out in 12 CFR 204.126 as applicable to IDLP-type transactions as described herein so that a depository institution *selling* Federal funds must provide to the purchaser—

(1) Notice of its intention, at the time of the initial transaction, to sell or participate out its loan contract to a nondepository third party, and

(2) Full and prompt notice whenever it (the *selling* depository institution) subsequently sells or participates out its loan contract to a non-depository third party.

[52 FR 47695, Dec. 16, 1987]

§ 204.128 Deposits at foreign branches guaranteed by domestic office of a depository institution.

(a) In accepting deposits at branches abroad, some depository institutions may enter into agreements from time to time with depositors that in effect guarantee payment of such deposits in the United States if the foreign branch is precluded from making payment. The question has arisen whether such deposits are subject to Regulation D, and this interpretation is intended as clarification.

(b) Section 19 of the Federal Reserve Act which establishes reserve requirements does not apply to deposits of a depository institution ''payable only at an office thereof located outside of the States of the United States and the District of Columbia'' (12 U.S.C. 371a; 12 CFR 204.1(c)(5)). The Board rule in 1918 that the requirements of section 19 as to reserves to be carried by member banks do not apply to foreign branches (1918 *Fed. Res. Bull.* 1123). The Board has also defined the phrase *Any deposit that is payable only at an office located outside the United States*, in § 204.2(t) of Regulation D, 12 CFR 204.2(t).

(c) The Board believes that this exemption from reserve requirements should be limited to deposits in foreign branches as to which the depositor is entitled, under his agreement with the depository institution, to demand payment only outside the United States, regardless of special circumstances. The exemption is intended principally to enable foreign branches of U.S. depository institutions to compete on a more nearly equal basis with banks in foreign countries in accordance with the laws and regulations of those countries. A customer who makes a deposit that is payable solely at a foreign branch of the depository institution assumes whatever risk may exist that the foreign country in which a branch is located might impose restrictions on withdrawals. When payment of a deposit in a foreign branch is guaranteed by a promise of payment at an office in the United States if not paid at the foreign office, the depositor no longer assumes this risk but enjoys substantially the same rights as if the deposit had been made in a U.S. office of the depository institution. To assure the effectiveness of Regulation D and to prevent evasions thereof, the Board considers that such guaranteed foreign-branch deposits must be subject to that regulation.

(d) Accordingly, a deposit in a foreign branch of a depository institution that is guaranteed by a domestic office is subject to the reserve requirements of Regulation D the same as if the deposit had been made in the domestic office. This interpretation is not designed in any respect to prevent the head office of a U.S. bank from repaying borrowings from, making advances to, or supplying capital funds to its foreign branches, subject to Eurocurrency liability reserve requirements.

[52 FR 47696, Dec. 16, 1987]

§ 204.130 Eligibility for NOW accounts.

(a) *Summary*. In response to many requests for rulings, the Board has determined to clarify the types of entities that may maintain NOW accounts at member banks.

(b) *Individuals*. (1) Any individual may maintain a NOW account regardless of the purposes that the funds will serve. Thus, deposits of an individual used in his or her business including a sole proprietor or an individual doing business under a trade name is eligible to maintain a NOW account in the individual's name or in the ''DBA'' name. However, other entities organized or operated to make a profit such as corporations, partnerships, associations, business trusts, or other organizations may not maintain NOW accounts.

(2) Pension funds, escrow accounts, security deposits, and other funds held under various agency agreements may also be classified as NOW accounts if the entire beneficial interest is held by individuals or other entities eligible to maintain NOW accounts directly. The Board believes that these accounts are similar in nature to trust accounts and should be accorded identical treatment. Therefore, such funds may be regarded as eligible for classification as NOW accounts.

(c) *Nonprofit organizations*. (1) A nonprofit organization that is operated primarily for religious, philanthropic, charitable, educational, political or other similar purposes may maintain a NOW account. The Board regards the

following kinds of organizations as eligible for NOW accounts under this standard if they are not operated for profit:

(i) Organizations described in section 501(c)(3) through (13), and (19) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 501(c)(3) through (13) and (19));

(ii) Political organizations described in section 527 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 527); and

(iii) Homeowners and condominium owners associations described in section 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 528), including housing cooperative associations that perform similar functions.

(2) All organizations that are operated for profit are not eligible to maintain NOW accounts at depository institutions.

(3) The following types of organizations described in the cited provisions of the Internal Revenue Code are among those not eligible to maintain NOW accounts:

(i) Credit unions and other mutual depository institutions described in section 501(c)(14) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 501(c)(14));

(ii) Mutual insurance companies described in section 501(c)(15) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 501(c)(15));

(iii) Crop financing organizations described in section 501(c)(16) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 501(c)(16));

(iv) Organizations created to function as part of a qualified group legal services plan described in section 501(c)(20) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 501(c)(20)); or

(v) Farmers' cooperatives described in section 521 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) section 521).

(d) *Governmental units*. Governmental units are generally eligible to maintain NOW accounts at member banks. NOW accounts may consist of funds in which the entire beneficial interest is held by the United States, any State of the United States, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

(e) *Funds held by a fiduciary*. Under current provisions, funds held in a fiduciary capacity (either by an individual fiduciary or by a corporate fiduciary such as a bank trust department or a trustee in bankruptcy), including those awaiting distribution or investment, may be held in the form of NOW accounts if all of the beneficiaries are otherwise eligible to maintain NOW accounts. The Board believes that such a classification should continue since fiduciaries are required to invest even temporarily idle balances to the greatest extent feasible in order to responsibly carry out their fiduciary duties. The availability of NOW accounts provides a convenient vehicle for providing a short-term return on temporarily idle trust funds of beneficiaries eligible to maintain accounts in their own names.

(f) *Grandfather provision*. In order to avoid unduly disrupting account relationships, a NOW account established at a member bank on or before August 31, 1981, that represents funds of a nonqualifying entity that previously qualified to maintain a NOW account may continue to be maintained in a NOW account.

[52 FR 47697, Dec. 16, 1987]

§ 204.131 Participation by a depository institution in the secondary market for its own time deposits.

(a) *Background*. In 1982, the Board issued an interpretation concerning the effect of a member bank's purchase of its own time deposits in the secondary market in order to ensure compliance with regulatory restrictions on the payment of interest on time deposits, with the prohibition against payment of interest on demand deposits, and with regulatory requirements designed to distinguish between time deposits and demand deposits for federal reserve requirement purposes (47 FR 37878, Aug. 27, 1982). The interpretation was designed to ensure that the regulatory early withdrawal penalties in Regulation Q used to achieve these three purposes were not evaded through the purchase by a member bank or its affiliate

of a time deposit of the member bank prior to the maturity of the deposit.

(b) Because the expiration of the Depository Institutions Deregulation Act (title II of Pub. L. 96–221) on April 1, 1986, removed the authority to set interest rate ceilings on deposits, one of the purposes for adopting the interpretation was eliminated. The removal of the authority to set interest rate ceilings on deposits required the Board to revise the early withdrawal penalties which were also used to distinguish between types of deposits for reserve requirement purposes. Effective April 1, 1986, the Board amended its Regulation D to incorporate early withdrawal penalties applicable to all depository institutions for this purpose (51 FR 9629, Mar. 20, 1986). Although the new early withdrawal penalties differ from the penalties used to enforce interest rate ceilings, secondary market purchases still effectively shorten the maturities of deposits and may be used to evade reserve requirements. This interpretation replaces the prior interpretation and states the application of the new early withdrawal penalties to purchases by depository institutions and their affiliates of the depository institution's time deposits. The interpretation applies only to situations in which the Board's regulatory penalties apply.

(c) *Secondary market purchases under the rule.* The Board has determined that a depository institution purchasing a time deposit it has issued should be regarded as having paid the time deposit prior to maturity. The effect of the transaction is that the depository institution has cancelled a liability as opposed to having acquired an asset for its portfolio. Thus, the depository institution is required to impose any early withdrawal penalty required by Regulation D on the party from whom it purchases the instrument by deducting the amount of the penalty from the purchase price. The Board recognizes, however, that secondary market sales of time deposits are often done without regard to the identity of the original owner of the deposit. Such sales typically involve a pool of time deposits with the price based on the aggregate face value and average rate of return on the deposits. A depository institution purchasing time deposits from persons other than the person to whom the deposit was originally issued should be aware of the parties named on each of the deposits it is purchasing but through failure to inspect the deposits prior to the purchase may not be aware at the time it purchases a pool of time deposits that it originally issued one or more of the deposits in the pool. In such cases, if a purchasing depository institution does not wish to assess an applicable early withdrawal penalty, the deposit may be sold immediately in the secondary market as an alternative to imposing the early withdrawal penalty.

(d) *Purchases by affiliates.* On a consolidated basis, if an affiliate (as defined in § 204.2(q) of Regulation D) of a depository institution purchases a CD issued by the depository institution, the purchase does not reduce their consolidated liabilities and could be accomplished primarily to assist the depository institution in avoiding the requirements of the Board's Regulation D. Because the effect of the early withdrawal penalty rule could be easily circumvented by purchases of time deposits by affiliates, such purchases are also regarded as an early withdrawals of the time deposit, and the purchase should be treated as if the depository institution made the purchase directly. Thus, the regulatory requirements for early withdrawal penalties apply to affiliates of a depository institution as well as to the institution itself.

(e) *Depository institution acting as broker.* The Board believes that it is permissible for a depository institution to facilitate the secondary market for its own time deposits by finding a purchaser for a time deposit that a customer is trying to sell. In such instances, the depository institution will not be paying out any of its own funds, and the depositor does not have a guarantee that the depository institution will actually be able to find a buyer.

(f) *Third-party market-makers.* A depository institution may also establish and advertise arrangements whereby an unaffiliated third party agrees in advance to purchase time deposits issued by the institution. The Board would not regard these transactions as inconsistent with the purposes that the early withdrawal penalty is intended to

serve unless a depository institution pays a fee to the third party purchaser as compensation for making the purchases or to remove the risk from purchasing the deposits. In this regard, any interim financing provided to such a third party by a depository institution in connection with the institution's secondary market activity involving the institution's time deposits must be made substantially on the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other similarly situated persons and may not involve more than the normal risk of repayment.

(g) *Reciprocal arrangements*. Finally, while a depository institution may enter into an arrangement with an unaffiliated third party wherein the third party agrees to stand ready to purchase time deposits held by the depository institution's customers, the Board will regard a reciprocal arrangement with another depository institution for purchase of each other's time deposits as a circumvention of the early withdrawal penalty rule and the purposes it is designed to serve.

[52 FR 47697, Dec. 16, 1987]

§ 204.132 Treatment of loan strip participations.

(a) Effective March 31, 1988, the glossary section of the instructions for the Report of Condition and Income (FFIEC 031–034; OMB control number 7100–0036; available from a depository institution's primary federal regulator) (*Call Report*) was amended to clarify that certain short-term loan participation arrangements (sometimes known or styled as *loan strips* or *strip participations*) are regarded as borrowings rather than sales for Call Report purposes in certain circumstances. Through this interpretation, the Board is clarifying that such transactions should be treated as deposits for purposes of Regulation D.

(b) These transactions involve the sale (or placement) of a short-term loan by a depository institution that has been made under a long-term commitment of the depository institution to advance funds. For example, a 90-day loan made under a five-year revolving line of credit may be sold to or placed with a third party by the depository institution originating the loan. The depository institution originating the loan is obligated to renew the 90-day note itself (by advancing funds to its customer at the end of the 90-day period) in the event the original participant does not wish to renew the credit. Since, under these arrangements, the depository institution is obligated to make another loan at the end of 90 days (absent any event of default on the part of the borrower), the depository institution selling the loan or participation in effect must buy back the loan or participation at the maturity of the 90-day loan sold to or funded by the purchaser at the option of the purchaser. Accordingly, these transactions bear the essential characteristics of a repurchase agreement and, therefore, are reportable and reservable under Regulation D.

(c) Because many of these transactions give rise to deposit liabilities in the form of promissory notes, acknowledgments of advance or similar obligations (written or oral) as described in § 204.2(a)(1)(vii) of Regulation D, the exemptions from the definition of *deposit* incorporated in that section may apply to the liability incurred by a depository institution when it offers or originates a loan strip facility. Thus, for example, loan strips sold to domestic offices of other depository institutions are exempt from Regulation D under § 204.2(a)(1)(vii)(A)(*1*) because they are obligations issued or undertaken and held for the account of a U.S. office of another depository institution. Similarly, some of these transactions result in Eurocurrency liabilities and are reportable and reservable as such.

[53 FR 24931, July 1, 1988]

§ 204.133 Multiple savings deposits treated as a transaction account.

(a) *Authority*. Under section 19(a) of the Federal Reserve Act, the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. Under

section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others. This interpretation is adopted under these authorities.

(b) *Background.* Under Regulation D, 12 CFR 204.2(d)(2), the term ''savings deposit'' includes a deposit or an account that meets the requirements of § 204.2(d)(1) and from which, under the terms of the deposit contract or by practice of the depository institution, the depositor is permitted or authorized to make up to six transfers or withdrawals per month or statement cycle of at least four weeks. The depository institution may authorize up to three of these six transfers to be made by check, draft, debit card, or similar order drawn by the depositor and payable to third parties. If more than six transfers (or more than three third party transfers by check, etc.) are permitted or authorized per month or statement cycle, the depository institution may not classify the account as a savings deposit. If the depositor, during the period, makes more than six transfers or withdrawals (or more than three third party transfers by check, etc.), the depository institution may, depending upon the facts and circumstances, be required by Regulation D (Footnote 5 at § 204.2(d)(2)) to reclassify or close the account.

(c) *Use of multiple savings deposits.* Depository institutions have asked for guidance as to when a depositor may maintain more than one savings deposit and be permitted to make all the transfers or withdrawals authorized for savings deposits under Regulation D from each savings deposit. The Board has determined that, if a depository institution suggests or otherwise promotes the establishment of or operation of multiple savings accounts with transfer capabilities in order to permit transfers and withdrawals in excess of those permitted by Regulation D for an individual savings account, the accounts generally should be considered to be transaction accounts. This determination applies regardless of whether the deposits have entirely separate account numbers or are subsidiary accounts of a master deposit account. Multiple savings accounts, however, should not be considered to be transaction accounts if there is a legitimate purpose, other than increasing the number of transfers or withdrawals, for opening more than one savings deposit.

(d) *Examples.* The distinction between appropriate and inappropriate uses of multiple accounts is illustrated by the following examples:

Example 1. (i) X wishes to open an account that maximizes his interest earnings but also permits X to draw up to ten checks a month against the account. X's Bank suggests an arrangement under which X establishes four savings deposits at Bank. Under the arrangement, X deposits funds in the first account and then draws three checks against that account. X then instructs Bank to transfer all funds in excess of the amount of the three checks to the second account and draws an additional three checks. Funds are continually shifted between accounts when additional checks are drawn so that no more than three checks are drawn against each account each month.

(ii) Suggesting the use of four savings accounts in the name of X in this example is designed solely to permit the customer to exceed the transfer limitations on savings accounts. Accordingly, the savings accounts should be classified as transaction accounts.

Example 2. (i) X is trustee of separate trusts for each of his four children. X's Bank suggests that X, as trustee, open a savings deposit in a depository institution for each of his four children in order to ensure an independent accounting of the funds held by each trust.

(ii) X's Bank's suggestion to use four savings deposits in the name of X in this example is appropriate, and the third party transfers from one account should not be considered in determining whether the transfer and withdrawal limit was exceeded on any other account. X established a legitimate purpose, the segregation of the trust assets, for each account separate from the need to make third party transfers. Furthermore, there is no indication, such as by the direct or indirect transfer of funds from one account to another, that the accounts are being used for any purpose other than to make transfers to the appropriate trust.

Example 3. (i) X opens four savings accounts with Bank. X regularly draws up to three checks against each account and transfers funds between the accounts in order to ensure that the checks on the separate accounts are covered. X's Bank did not suggest or otherwise promote the arrangement.

(ii) X's Bank may treat the multiple accounts as savings deposits for Regulation D purposes, even if it discovers that X is using

the accounts to increase the transfer limits applicable to savings accounts because X's Bank did not suggest or otherwise promote the establishment of or operation of the arrangement.

[57 FR 38427, Aug. 25, 1992]

§ 204.134 Linked time deposits and transaction accounts.

(a) *Authority*. Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)), the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b)(2) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others. This interpretation is adopted under these authorities.

(b) *Linked time deposits and transaction accounts*. Some depository institutions are offering or proposing to offer account arrangements under which a group of participating depositors maintain transaction accounts and time deposits with a depository institution in an arrangement under which each depositor may draw checks up to the aggregate amount held by that depositor in these accounts. Under this account arrangement, at the end of the day funds over a specified balance in each depositor's transaction account are swept from the transaction account into a commingled time deposit. A separate time deposit is opened on each business day with the balance of deposits received that day, as well as the proceeds of any time deposit that has matured that day that are not used to pay checks or withdrawals from the transaction accounts. The time deposits, which generally have maturities of seven days, are staggered so that one or more time deposits mature each business day. Funds are apportioned among the various time deposits in a manner calculated to minimize the possibility that the funds available on any given day would be insufficient to pay all items presented.

(1) The time deposits involved in such an arrangement may be held directly by the depositor or indirectly through a trust or other arrangement. The individual depositor's interest in time deposits may be identifiable, with an agreement by the depositors that balances held in the arrangement may be used to pay checks drawn by other depositors participating in the arrangement, or the depositor may have an undivided interest in a series of time deposits.

(2) Each day funds from the maturing time deposits are available to pay checks or other charges to the depositor's transaction account. The depository institution's decision concerning whether to pay checks drawn on an individual depositor's transaction account is based on the aggregate amount of funds that the depositor has invested in the arrangement, including any amount that may be invested in unmatured time deposits. Only if checks drawn by all participants in the arrangement exceed the total balance of funds available that day (i.e. funds from the time deposit that has matured that day as well as any deposits made to participating accounts during the day) is a time deposit withdrawn prior to maturity so as to incur an early withdrawal penalty. The arrangement may be marketed as providing the customer unlimited access to its funds with a high rate of interest.

(c) *Determination*. In these arrangements, the aggregate deposit balances of all participants generally vary by a comparatively small amount, allowing the time deposits maturing on any day safely to cover any charges to the depositors' transaction accounts and avoiding any early withdrawal penalties. Thus, this arrangement substitutes time deposit balances for transaction accounts balances with no practical restrictions on the depositors' access to their funds, and serves no business purpose other than to allow the payment of higher interest through the avoidance of reserve requirements. As the time deposits may be used to provide funds indirectly for the purposes of making payments or transfers to third persons, the Board

has determined that the time deposits should be considered to be transaction accounts for the purposes of Regulation D.

[57 FR 38428, Aug. 25, 1992]

§ 204.135 Shifting funds between depository institutions to make use of the low reserve tranche.

(a) *Authority.* Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)) the Board is authorized to define terms used in section 19, and to prescribe regulations to implement and to prevent evasions of the requirements of that section. Section 19(b)(2) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. In addition to its authority to define terms under section 19(a), section 19(g) of the Federal Reserve Act also give the Board the specific authority to define terms relating to deductions allowed in reserve computation, including ''balances due from other banks.'' This interpretation is adopted under these authorities.

(b) *Background.* (1) Currently, the Board requires reserves of zero, three, or ten percent on transaction accounts, depending upon the amount of transaction deposits in the depository institution, and of zero percent on nonpersonal time deposits. In determining its reserve balance under Regulation D, a depository institution may deduct the balances it maintains in another depository institution located in the United States if those balances are subject to immediate withdrawal by the depositing depository institution (§ 204.3(f)). This deduction is commonly known as the ''due from'' deduction. In addition, Regulation D at § 204.2(a)(1)(vii)(A) exempts from the definition of ''deposit'' any liability of a depository institution on a promissory note or similar obligation that is issued or undertaken and held for the account of an office located in the United States of another depository institution. Transactions falling within this exemption from the definition of ''deposit'' include federal funds or ''fed funds'' transactions.

(2) Under section 19(b)(2) of the Federal Reserve Act (12 U.S.C. 461(b)(2)), the Board is required to impose reserves of three percent on total transaction deposits at or below an amount determined under a formula. Transaction deposits falling within this amount are in the ''low reserve tranche.'' Currently the low reserve tranche runs up to $42.2 million. Under section 19(b)(11) of the Federal Reserve Act (12 U.S.C. 461(b)(11)) the Board is also required to impose reserves of zero percent on reservable liabilities at or below an amount determined under a formula. Currently that amount is $3.6 million.

(c) *Shifting funds between depository institutions.* The Board is aware that certain depository institutions with transaction account balances in an amount greater than the low reserve tranche have entered into transactions with affiliated depository institutions that have transaction account balances below the maximum low reserve tranche amount. These transactions are intended to lower the transaction reserves of the larger depository institution and leave the economic position of the smaller depository institutions unaffected, and have no apparent purpose other than to reduce required reserves of the larger institution. The larger depository institution places funds in a demand deposit at a small domestic depository institution. The larger depository institution considers those funds to be subject to the ''due from'' deduction, and accordingly reduces its transaction reserves in the amount of the demand deposit. The larger depository institution then reduces its transaction account reserves by 10 percent of the deposited amount. The small depository institution, because it is within the low reserve tranche, must maintain transaction account reserves of 3 percent on the funds deposited by the larger depository institution. The small depository institution then transfers all but 3 percent of the funds deposited by the larger depository institution back to the larger depository institution in a transaction that qualifies as a ''fed funds'' transaction. The 3 percent not transferred to the larger depository institution is the amount of the larger depository institution's deposit that the small depository institution must maintain as transaction account reserves. Because the larger depository institution books this second part of the transaction as a

''fed funds'' transaction, the larger depository institution does not maintain reserves on the funds that it receives back from the small depository institution. As a consequence, the larger depository institution has available for its use 97 percent of the amount transferred to the small depository institution. Had the larger depository institution not entered into the transaction, it would have maintained transaction account reserves of 10 percent on that amount, and would have had only 90 percent of that amount for use in its business.

(d) *Determination*. The Board believes that the practice described above generally is a device to evade the reserves imposed by Regulation D. Consequently, the Board has determined that, in the circumstances described above, the larger depository institution depositing funds in the smaller institution may not take a ''due from'' deduction on account of the funds in the demand deposit account if, and to the extent that, funds flow back to the larger depository institution from the small depository institution by means of a transaction that is exempt from transaction account reserve requirements.

[57 FR 38429, Aug. 25, 1992]

§ 204.136 Treatment of trust overdrafts for reserve requirement reporting purposes.

(a) *Authority*. Under section 19(a) of the Federal Reserve Act (12 U.S.C. 461(a)), the Board is authorized to define the terms used in section 19, and to prescribe regulations to implement and prevent evasions of the requirements of that section. Section 19(b) establishes general reserve requirements on transaction accounts and nonpersonal time deposits. Under section 19(b)(1)(F), the Board also is authorized to determine, by regulation or order, that an account or deposit is a transaction account if such account is used directly or indirectly for the purpose of making payments to third persons or others. This interpretation is adopted under these authorities.

(b) *Netting of trust account balances*. (1) Not all depository institutions have treated overdrafts in trust accounts administered by a trust department in the same manner when calculating the balance in a commingled transaction account in the depository institution for the account of the trust department of the institution. In some cases, depository institutions carry the aggregate of the positive balances in the individual trust accounts as the balance on which reserves are computed for the commingled account. In other cases depository institutions net positive balances in some trust accounts against negative balances in other trust accounts, thus reducing the balance in the commingled account and lowering the reserve requirements. Except in limited circumstances, negative balances in individual trust accounts should not be netted against positive balances in other trust accounts when determining the balance in a trust department's commingled transaction account maintained in a depository institution's commercial department. The netting of positive and negative balances has the effect of reducing the aggregate of a commingled transaction account reported by the depository institution to the Federal Reserve and reduces the reserves the institution must hold against transaction accounts under Regulation D. Unless the governing trust agreement or state law authorizes the depository institution, as trustee, to lend money in one trust to another trust, the negative balances in effect, for purposes of Regulation D, represent a loan from the depository institution. Consequently, negative balances in individual trust accounts should not be netted against positive balances in other individual trust accounts, and the balance in any transaction account containing commingled trust balances should reflect positive or zero balances for each individual trust.

(2) For example, where a trust department engages in securities lending activities for trust accounts, overdrafts might occur because of the trust department's attempt to ''normalize'' the effects of timing delays between the depository institution's receipt of the cash collateral from the broker and the trust department's posting of the transaction to the lending trust account. When securities are lent from a trust customer to a broker that pledges cash as collateral, the broker usually

transfers the cash collateral to the depository institution on the day that the securities are made available. While the institution has the use of the funds from the time of the transfer, the trust department's normal posting procedures may not reflect receipt of the cash collateral by the individual account until the next day. On the day that the loan is terminated, the broker returns the securities to the lending trust account and the trust customer's account is debited for the amount of the cash collateral that is returned by the depository institution to the broker. The trust department, however, often does not liquidate the investment made with the cash collateral until the day after the loan terminates, a delay that normally causes a one day overdraft in the trust account. Regulation D requires that, on the day the loan is terminated, the depository institution regard the negative balance in the customer's account as zero for reserve requirement reporting purposes and not net the overdraft against positive balances in other accounts.

(c) *Procedures.* In order to meet the requirements of Regulation D, a depository institution must have procedures to determine the aggregate of trust department transaction account balances for Regulation D on a daily basis. The procedures must consider only the positive balances in individual trust accounts without netting negative balances except in those limited circumstances where loans are legally permitted from one trust to another, or where offsetting is permitted pursuant to trust law or written agreement, or where the amount that caused the overdraft is still available in a settlement, suspense or other trust account within the trust department and may be used to offset the overdraft.

[57 FR 38429, Aug. 25, 1992]

PART 205—ELECTRONIC FUND TRANSFERS (REGULATION E)

Sec.

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SUPPLEMENT I TO PART 205—OFFICIAL STAFF INTERPRETATIONS

AUTHORITY: 15 U.S.C. 1693b.

SOURCE: Reg. E, 61 FR 19669, May 2, 1996, unless otherwise noted.

§ 205.1 Authority and purpose.

(a) *Authority.* The regulation in this part, known as Regulation E, is issued by the Board of Governors of the Federal Reserve System pursuant to the Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*). The information-collection requirements have been approved by the Office of Management and Budget under 44 U.S.C. 3501 *et seq.* and have been assigned OMB No. 7100–0200.

(b) *Purpose.* This part carries out the purposes of the Electronic Fund Transfer Act, which establishes the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer services and of financial institutions that offer these services. The primary objective of the act and this part is the protection of individual consumers engaging in electronic fund transfers.

§ 205.2 Definitions.

For purposes of this part, the following definitions apply:

(a)(1) *Access device* means a card, code, or other means of access to a consumer's account, or any combination

thereof, that may be used by the consumer to initiate electronic fund transfers.

(2) An access device becomes an *accepted access device* when the consumer:

(i) Requests and receives, or signs, or uses (or authorizes another to use) the access device to transfer money between accounts or to obtain money, property, or services;

(ii) Requests validation of an access device issued on an unsolicited basis; or

(iii) Receives an access device in renewal of, or in substitution for, an accepted access device from either the financial institution that initially issued the device or a successor.

(b)(1) *Account* means a demand deposit (checking), savings, or other consumer asset account (other than an occasional or incidental credit balance in a credit plan) held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes.

(2) The term does not include an account held by a financial institution under a bona fide trust agreement.

(c) *Act* means the Electronic Fund Transfer Act (title IX of the Consumer Credit Protection Act, 15 U.S.C. 1693 *et seq.*).

(d) *Business day* means any day on which the offices of the consumer's financial institution are open to the public for carrying on substantially all business functions.

(e) *Consumer* means a natural person.

(f) *Credit* means the right granted by a financial institution to a consumer to defer payment of debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.

(g) *Electronic fund transfer* is defined in § 205.3.

(h) *Electronic terminal* means an electronic device, other than a telephone operated by a consumer, through which a consumer may initiate an electronic fund transfer. The term includes, but is not limited to, point-of-sale terminals, automated teller machines, and cash dispensing machines.

(i) *Financial institution* means a bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer, or that issues an access device and agrees with a consumer to provide electronic fund transfer services.

(j) *Person* means a natural person or an organization, including a corporation, government agency, estate, trust, partnership, proprietorship, cooperative, or association.

(k) *Preauthorized electronic fund transfer* means an electronic fund transfer authorized in advance to recur at substantially regular intervals.

(l) *State* means any state, territory, or possession of the United States; the District of Columbia; the Commonwealth of Puerto Rico; or any political subdivision of the above in this paragraph (l).

(m) *Unauthorized electronic fund transfer* means an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit. The term does not include an electronic fund transfer initiated:

(1) By a person who was furnished the access device to the consumer's account by the consumer, unless the consumer has notified the financial institution that transfers by that person are no longer authorized;

(2) With fraudulent intent by the consumer or any person acting in concert with the consumer; or

(3) By the financial institution or its employee.

§ 205.3 Coverage.

(a) *General.* This part applies to any electronic fund transfer that authorizes a financial institution to debit or credit a consumer's account. Generally, this part applies to financial institutions. For purposes of §§ 205.10 (b), (d), and (e) and 205.13, this part applies to any person.

(b) *Electronic fund transfer*. The term electronic fund transfer means any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account. The term includes, but is not limited to:

(1) Point-of-sale transfers;

(2) Automated teller machine transfers;

(3) Direct deposits or withdrawals of funds;

(4) Transfers initiated by telephone; and

(5) Transfers resulting from debit card transactions, whether or not initiated through an electronic terminal.

(c) *Exclusions from coverage.* The term electronic fund transfer does not include:

(1) *Checks.* Any transfer of funds originated by check, draft, or similar paper instrument; or any payment made by check, draft, or similar paper instrument at an electronic terminal.

(2) *Check guarantee or authorization.* Any transfer of funds that guarantees payment or authorizes acceptance of a check, draft, or similar paper instrument but that does not directly result in a debit or credit to a consumer's account.

(3) *Wire or other similar transfers.* Any transfer of funds through Fedwire or through a similar wire transfer system that is used primarily for transfers between financial institutions or between businesses.

(4) *Securities and commodities transfers.* Any transfer of funds the primary purpose of which is the purchase or sale of a security or commodity, if the security or commodity is:

(i) Regulated by the Securities and Exchange Commission or the Commodity Futures Trading Commission;

(ii) Purchased or sold through a broker-dealer regulated by the Securities and Exchange Commission or through a futures commission merchant regulated by the Commodity Futures Trading Commission; or

(iii) Held in book-entry form by a Federal Reserve Bank or federal agency.

(5) *Automatic transfers by account-holding institution.* Any transfer of funds under an agreement between a consumer and a financial institution which provides that the institution will initiate individual transfers without a specific request from the consumer:

(i) Between a consumer's accounts within the financial institution;

(ii) From a consumer's account to an account of a member of the consumer's family held in the same financial institution; or

(iii) Between a consumer's account and an account of the financial institution, except that these transfers remain subject to § 205.10(e) regarding compulsory use and sections 915 and 916 of the act regarding civil and criminal liability.

(6) *Telephone-initiated transfers.* Any transfer of funds that:

(i) Is initiated by a telephone communication between a consumer and a financial institution making the transfer; and

(ii) Does not take place under a telephone bill-payment or other written plan in which periodic or recurring transfers are contemplated.

(7) *Small institutions.* Any preauthorized transfer to or from an account if the assets of the account-holding financial institution were $100 million or less on the preceding December 31. If assets of the account-holding institution subsequently exceed $100 million, the institution's exemption for preauthorized transfers terminates one year from the end of the calendar year in which the assets exceed $100 million. Preauthorized transfers exempt under this paragraph (c)(7) remain subject to § 205.10(e) regarding compulsory use and sections 915 and 916 of the act regarding civil and criminal liability.

§ 205.4 General disclosure requirements; jointly offered services.

(a)(1) *Form of disclosures.* Disclosures required under this part shall be clear and readily understandable, in writing, and in a form the consumer may keep. A financial institution may use commonly accepted or readily understandable abbreviations in complying with the disclosure requirements of this part.

(2) *Foreign language disclosures.* Disclosures required under this part may be made in a language other than English, provided that the disclosures are made available in English upon the consumer's request.

(b) *Additional information; disclosures required by other laws.* A financial institution may include additional information and may combine disclosures required by other laws (such as the Truth in Lending Act (15 U.S.C. 1601 et seq.)

or the Truth in Savings Act (12 U.S.C. 4301 et seq.)) with the disclosures required by this part.

(c) *Electronic communication*. For rules governing the electronic delivery of disclosures, including the definition of electronic communication, see § 205.17.

(d) *Multiple accounts and account holders*—(1) *Multiple accounts*. A financial institution may combine the required disclosures into a single statement for a consumer who holds more than one account at the institution.

(2) *Multiple account holders*. For joint accounts held by two or more consumers, a financial institution need provide only one set of the required disclosures and may provide them to any of the account holders.

(e) *Services offered jointly*. Financial institutions that provide electronic fund transfer services jointly may contract among themselves to comply with the requirements that this part imposes on any or all of them. An institution need make only the disclosures required by §§ 205.7 and 205.8 that are within its knowledge and within the purview of its relationship with the consumer for whom it holds an account.

[Reg. E, 61 FR 19669, May 2, 1996, as amended at 63 FR 14532, Mar. 25, 1998; 66 FR 17793, Apr. 4, 2001]

§ 205.5 Issuance of access devices.

(a) *Solicited issuance*. Except as provided in paragraph (b) of this section, a financial institution may issue an access device to a consumer only:

(1) In response to an oral or written request for the device; or

(2) As a renewal of, or in substitution for, an accepted access device whether issued by the institution or a successor.

(b) *Unsolicited issuance*. A financial institution may distribute an access device to a consumer on an unsolicited basis if the access device is:

(1) Not validated, meaning that the institution has not yet performed all the procedures that would enable a consumer to initiate an electronic fund transfer using the access device;

(2) Accompanied by a clear explanation that the access device is not validated and how the consumer may dispose of it if validation is not desired;

(3) Accompanied by the disclosures required by § 205.7, of the consumer's rights and liabilities that will apply if the access device is validated; and

(4) Validated only in response to the consumer's oral or written request for validation, after the institution has verified the consumer's identity by a reasonable means.

§ 205.6 Liability of consumer for unauthorized transfers.

(a) *Conditions for liability*. A consumer may be held liable, within the limitations described in paragraph (b) of this section, for an unauthorized electronic fund transfer involving the consumer's account only if the financial institution has provided the disclosures required by § 205.7(b)(1), (2), and (3). If the unauthorized transfer involved an access device, it must be an accepted access device and the financial institution must have provided a means to identify the consumer to whom it was issued.

(b) *Limitations on amount of liability*. A consumer's liability for an unauthorized electronic fund transfer or a series of related unauthorized transfers shall be determined as follows:

(1) *Timely notice given*. If the consumer notifies the financial institution within two business days after learning of the loss or theft of the access device, the consumer's liability shall not exceed the lesser of $50 or the amount of unauthorized transfers that occur before notice to the financial institution.

(2) *Timely notice not given*. If the consumer fails to notify the financial institution within two business days after learning of the loss or theft of the access device, the consumer's liability shall not exceed the lesser of $500 or the sum of:

(i) $50 or the amount of unauthorized transfers that occur within the two business days, whichever is less; and

(ii) The amount of unauthorized transfers that occur after the close of two business days and before notice to the institution, provided the institution establishes that these transfers would not have occurred had the consumer notified the institution within that two-day period.

(3) *Periodic statement; timely notice not given*. A consumer must report an unauthorized electronic fund transfer that appears on a periodic statement within 60 days of the financial institution's transmittal of the statement to avoid liability for subsequent transfers. If the consumer fails to do so, the consumer's liability shall not exceed the amount of the unauthorized transfers that occur after the close of the 60 days and before notice to the institution, and that the institution establishes would not have occurred had the consumer notified the institution within the 60-day period. When an access device is involved in the unauthorized transfer, the consumer may be liable for other amounts set forth in paragraphs (b)(1) or (b)(2) of this section, as applicable.

(4) *Extension of time limits*. If the consumer's delay in notifying the financial institution was due to extenuating circumstances, the institution shall extend the times specified above to a reasonable period.

(5) *Notice to financial institution*. (i) Notice to a financial institution is given when a consumer takes steps reasonably necessary to provide the institution with the pertinent information, whether or not a particular employee or agent of the institution actually receives the information.

(ii) The consumer may notify the institution in person, by telephone, or in writing.

(iii) Written notice is considered given at the time the consumer mails the notice or delivers it for transmission to the institution by any other usual means. Notice may be considered constructively given when the institution becomes aware of circumstances leading to the reasonable belief that an unauthorized transfer to or from the consumer's account has been or may be made.

(6) *Liability under state law or agreement*. If state law or an agreement between the consumer and the financial institution imposes less liability than is provided by this section, the consumer's liability shall not exceed the amount imposed under the state law or agreement.

§ 205.7 Initial disclosures.

(a) *Timing of disclosures*. A financial institution shall make the disclosures required by this section at the time a consumer contracts for an electronic fund transfer service or before the first electronic fund transfer is made involving the consumer's account.

(b) *Content of disclosures*. A financial institution shall provide the following disclosures, as applicable:

(1) *Liability of consumer*. A summary of the consumer's liability, under § 205.6 or under state or other applicable law or agreement, for unauthorized electronic fund transfers.

(2) *Telephone number and address*. The telephone number and address of the person or office to be notified when the consumer believes that an unauthorized electronic fund transfer has been or may be made.

(3) *Business days*. The financial institution's business days.

(4) *Types of transfers; limitations*. The type of electronic fund transfers that the consumer may make and any limitations on the frequency and dollar amount of transfers. Details of the limitations need not be disclosed if confidentiality is essential to maintain the security of the electronic fund transfer system.

(5) *Fees*. Any fees imposed by the financial institution for electronic fund transfers or for the right to make transfers.

(6) *Documentation*. A summary of the consumer's right to receipts and periodic statements, as provided in § 205.9, and notices regarding preauthorized transfers as provided in §§ 205.10(a), and 205.10(d).

(7) *Stop payment*. A summary of the consumer's right to stop payment of a preauthorized electronic fund transfer and the procedure for placing a stop-payment order, as provided in § 205.10(c).

(8) *Liability of institution*. A summary of the financial institution's liability to the consumer under section 910 of the act for failure to make or to stop certain transfers.

(9) *Confidentiality*. The circumstances under which, in the ordinary course of business, the financial institution may provide information concerning the consumer's account to third parties.

(10) *Error resolution.* A notice that is substantially similar to Model Form A–3 as set out in Appendix A of this part concerning error resolution.

(11) *ATM fees.* A notice that a fee may be imposed by an automated teller machine operator as defined in § 205.16(a)(1), when the consumer initiates an electronic fund transfer or makes a balance inquiry, and by any network used to complete the transaction.

[Reg. E, 61 FR 19669, May 2, 1996, as amended at 66 FR 13412, Mar. 6, 2001]

§ 205.8 Change in terms notice; error resolution notice.

(a) *Change in terms notice*—(1) *Prior notice required.* A financial institution shall mail or deliver a written notice to the consumer, at least 21 days before the effective date, of any change in a term or condition required to be disclosed under § 205.7(b) if the change would result in:

(i) Increased fees for the consumer;

(ii) Increased liability for the consumer;

(iii) Fewer types of available electronic fund transfers; or

(iv) Stricter limitations on the frequency or dollar amount of transfers.

(2) *Prior notice exception.* A financial institution need not give prior notice if an immediate change in terms or conditions is necessary to maintain or restore the security of an account or an electronic fund transfer system. If the institution makes such a change permanent and disclosure would not jeopardize the security of the account or system, the institution shall notify the consumer in writing on or with the next regularly scheduled periodic statement or within 30 days of making the change permanent.

(b) *Error resolution notice.* For accounts to or from which electronic fund transfers can be made, a financial institution shall mail or deliver to the consumer, at least once each calendar year, an error resolution notice substantially similar to the model form set forth in Appendix A of this part (Model Form A–3). Alternatively, an institution may include an abbreviated notice substantially similar to the model form error resolution notice set forth in Appendix A of this part (Model Form A–3), on or with each periodic statement required by § 205.9(b).

§ 205.9 Receipts at electronic terminals; periodic statements.

(a) *Receipts at electronic terminals.* A financial institution shall make a receipt available to a consumer at the time the consumer initiates an electronic fund transfer at an electronic terminal. The receipt shall set forth the following information, as applicable:

(1) *Amount.* The amount of the transfer. A transaction fee may be included in this amount, provided the amount of the fee is disclosed on the receipt and displayed on or at the terminal.

(2) *Date.* The date the consumer initiates the transfer.

(3) *Type.* The type of transfer and the type of the consumer's account(s) to or from which funds are transferred. The type of account may be omitted if the access device used is able to access only one account at that terminal.

(4) *Identification.* A number or code that identifies the consumer's account or accounts, or the access device used to initiate the transfer. The number or code need not exceed four digits or letters to comply with the requirements of this paragraph (a)(4).

(5) *Terminal location.* The location of the terminal where the transfer is initiated, or an identification such as a code or terminal number. Except in limited circumstances where all terminals are located in the same city or state, if the location is disclosed, it shall include the city and state or foreign country and one of the following:

(i) The street address; or

(ii) A generally accepted name for the specific location; or

(iii) The name of the owner or operator of the terminal if other than the account-holding institution.

(6) *Third party transfer.* The name of any third party to or from whom funds are transferred.

(b) *Periodic statements.* For an account to or from which electronic fund transfers can be made, a financial institution shall send a periodic statement for each monthly cycle in which an electronic fund transfer has occurred; and shall send a periodic statement at least quarterly if no transfer has occurred.

The statement shall set forth the following information, as applicable:

(1) *Transaction information.* For each electronic fund transfer occurring during the cycle:

(i) The amount of the transfer;

(ii) The date the transfer was credited or debited to the consumer's account;

(iii) The type of transfer and type of account to or from which funds were transferred;

(iv) For a transfer initiated by the consumer at an electronic terminal (except for a deposit of cash or a check, draft, or similar paper instrument), the terminal location described in paragraph (a)(5) of this section; and

(v) The name of any third party to or from whom funds were transferred.

(2) *Account number.* The number of the account.

(3) *Fees.* The amount of any fees assessed against the account during the statement period for electronic fund transfers, for the right to make transfers, or for account maintenance.

(4) *Account balances.* The balance in the account at the beginning and at the close of the statement period.

(5) *Address and telephone number for inquiries.* The address and telephone number to be used for inquiries or notice of errors, preceded by ''Direct inquiries to'' or similar language. The address and telephone number provided on an error resolution notice under § 205.8(b) given on or with the statement satisfies this requirement.

(6) *Telephone number for preauthorized transfers.* A telephone number the consumer may call to ascertain whether preauthorized transfers to the consumer's account have occurred, if the financial institution uses the telephone-notice option under

§ 205.10(a)(1)(iii).

(c) *Exceptions to the periodic statement requirement for certain accounts*—(1) *Preauthorized transfers to accounts.* For accounts that may be accessed only by preauthorized transfers to the account the following rules apply:

(i) *Passbook accounts.* For passbook accounts, the financial institution need not provide a periodic statement if the institution updates the passbook upon presentation or enters on a separate document the amount and date of each electronic fund transfer since the passbook was last presented.

(ii) *Other accounts.* For accounts other than passbook accounts, the financial institution must send a periodic statement at least quarterly.

(2) *Intra-institutional transfers.* For an electronic fund transfer initiated by the consumer between two accounts of the consumer in the same institution, documenting the transfer on a periodic statement for one of the two accounts satisfies the periodic statement requirement.

(3) *Relationship between paragraphs (c)(1) and (c)(2) of this section.* An account that is accessed by preauthorized transfers to the account described in paragraph (c)(1) of this section and by intra-institutional transfers described in paragraph (c)(2) of this section, but by no other type of electronic fund transfers, qualifies for the exceptions provided by paragraph (c)(1) of this section .

(d) *Documentation for foreign-initiated transfers.* The failure by a financial institution to provide a terminal receipt for an electronic fund transfer or to document the transfer on a periodic statement does not violate this part if:

(1) The transfer is not initiated within a state; and

(2) The financial institution treats an inquiry for clarification or documentation as a notice of error in accordance with § 205.11.

§ 205.10 Preauthorized transfers.

(a) *Preauthorized transfers to consumer's account*—(1) *Notice by financial institution.* When a person initiates preauthorized electronic fund transfers to a consumer's account at least once every 60 days, the account-holding financial institution shall provide notice to the consumer by:

(i) *Positive notice.* Providing oral or written notice of the transfer within two business days after the transfer occurs; or

(ii) *Negative notice.* Providing oral or written notice, within two business days after the date on which the transfer was scheduled to occur, that the transfer did not occur; or

(iii) *Readily-available telephone line.* Providing a readily available telephone

line that the consumer may call to determine whether the transfer occurred and disclosing the telephone number on the initial disclosure of account terms and on each periodic statement.

(2) *Notice by payor*. A financial institution need not provide notice of a transfer if the payor gives the consumer positive notice that the transfer has been initiated.

(3) *Crediting*. A financial institution that receives a preauthorized transfer of the type described in paragraph (a)(1) of this section shall credit the amount of the transfer as of the date the funds for the transfer are received.

(b) *Written authorization for preauthorized transfers from consumer's account*. Preauthorized electronic fund transfers from a consumer's account may be authorized only by a writing signed or similarly authenticated by the consumer. The person that obtains the authorization shall provide a copy to the consumer.

(c) *Consumer's right to stop payment*—(1) *Notice*. A consumer may stop payment of a preauthorized electronic fund transfer from the consumer's account by notifying the financial institution orally or in writing at least three business days before the scheduled date of the transfer.

(2) *Written confirmation*. The financial institution may require the consumer to give written confirmation of a stop-payment order within 14 days of an oral notification. An institution that requires written confirmation shall inform the consumer of the requirement and provide the address where confirmation must be sent when the consumer gives the oral notification. An oral stop-payment order ceases to be binding after 14 days if the consumer fails to provide the required written confirmation.

(d) *Notice of transfers varying in amount*—(1) *Notice*. When a preauthorized electronic fund transfer from the consumer's account will vary in amount from the previous transfer under the same authorization or from the preauthorized amount, the designated payee or the financial institution shall send the consumer written notice of the amount and date of the transfer at least 10 days before the scheduled date of transfer.

(2) *Range*. The designated payee or the institution shall inform the consumer of the right to receive notice of all varying transfers, but may give the consumer the option of receiving notice only when a transfer falls outside a specified range of amounts or only when a transfer differs from the most recent transfer by more than an agreed-upon amount.

(e) *Compulsory use*—(1) *Credit*. No financial institution or other person may condition an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund transfers, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account.

(2) *Employment or government benefit*. No financial institution or other person may require a consumer to establish an account for receipt of electronic fund transfers with a particular institution as a condition of employment or receipt of a government benefit.

§ 205.11 Procedures for resolving errors.

(a) *Definition of error*—(1) *Types of transfers or inquiries covered*. The term *error* means:

(i) An unauthorized electronic fund transfer;

(ii) An incorrect electronic fund transfer to or from the consumer's account;

(iii) The omission of an electronic fund transfer from a periodic statement;

(iv) A computational or bookkeeping error made by the financial institution relating to an electronic fund transfer;

(v) The consumer's receipt of an incorrect amount of money from an electronic terminal;

(vi) An electronic fund transfer not identified in accordance with §§ 205.9 or 205.10(a); or

(vii) The consumer's request for documentation required by §§ 205.9 or 205.10(a) or for additional information or clarification concerning an electronic fund transfer, including a request the consumer makes to determine whether an error exists under paragraphs (a)(1) (i) through (vi) of this section.

(2) *Types of inquiries not covered.* The term *error* does not include:

(i) A routine inquiry about the consumer's account balance;

(ii) A request for information for tax or other recordkeeping purposes; or

(iii) A request for duplicate copies of documentation.

(b) *Notice of error from consumer*—(1) *Timing; contents.* A financial institution shall comply with the requirements of this section with respect to any oral or written notice of error from the consumer that:

(i) Is received by the institution no later than 60 days after the institution sends the periodic statement or provides the passbook documentation, required by § 205.9, on which the alleged error is first reflected;

(ii) Enables the institution to identify the consumer's name and account number; and

(iii) Indicates why the consumer believes an error exists and includes to the extent possible the type, date, and amount of the error, except for requests described in paragraph (a)(1)(vii) of this section.

(2) *Written confirmation.* A financial institution may require the consumer to give written confirmation of an error within 10 business days of an oral notice. An institution that requires written confirmation shall inform the consumer of the requirement and provide the address where confirmation must be sent when the consumer gives the oral notification.

(3) *Request for documentation or clarifications.* When a notice of error is based on documentation or clarification that the consumer requested under paragraph (a)(1)(vii) of this section, the consumer's notice of error is timely if received by the financial institution no later than 60 days after the institution sends the information requested.

(c) *Time limits and extent of investigation*—(1) *Ten-day period.* A financial institution shall investigate promptly and, except as otherwise provided in this paragraph (c), shall determine whether an error occurred within 10 business days of receiving a notice of error. The institution shall report the results to the consumer within three business days after completing its investigation. The institution shall correct the error within one business day after determining that an error occurred.

(2) *Forty-five day period.* If the financial institution is unable to complete its investigation within 10 business days, the institution may take up to 45 days from receipt of a notice of error to investigate and determine whether an error occurred, provided the institution does the following:

(i) Provisionally credits the consumer's account in the amount of the alleged error (including interest where applicable) within 10 business days of receiving the error notice. If the financial institution has a reasonable basis for believing that an unauthorized electronic fund transfer has occurred and the institution has satisfied the requirements of § 205.6(a), the institution may withhold a maximum of $50 from the amount credited. An institution need not provisionally credit the consumer's account if:

(A) The institution requires but does not receive written confirmation within 10 business days of an oral notice of error; or

(B) The alleged error involves an account that is subject to Regulation T (Securities Credit by Brokers and Dealers, 12 CFR part 220);

(ii) Informs the consumer, within two business days after the provisional crediting, of the amount and date of the provisional crediting and gives the consumer full use of the funds during the investigation;

(iii) Corrects the error, if any, within one business day after determining that an error occurred; and

(iv) Reports the results to the consumer within three business days after completing its investigation (including, if applicable, notice that a provisional credit has been made final).

(3) *Extension of time periods.* The time periods in paragraphs (c)(1) and (c)(2) of this section are extended as follows:

(i) The applicable time is 20 business days in place of 10 business days under paragraphs (c)(1) and (c)(2) of this section if the notice of error involves an electronic fund transfer to or from the account within 30 days after the first deposit to the account was made.

(ii) The applicable time is 90 days in place of 45 days under paragraph (c)(2) of this section, for completing an investigation, if a notice of error involves an electronic fund transfer that:

(A) Was not initiated within a state;

(B) Resulted from a point-of-sale debit card transaction; or

(C) Occurred within 30 days after the first deposit to the account was made.

(4) *Investigation*. With the exception of transfers covered by § 205.14, a financial institution's review of its own records regarding an alleged error satisfies the requirements of this section if:

(i) The alleged error concerns a transfer to or from a third party; and

(ii) There is no agreement between the institution and the third party for the type of electronic fund transfer involved.

(d) *Procedures if financial institution determines no error or different error occurred*. In addition to following the procedures specified in paragraph (c) of this section, the financial institution shall follow the procedures set forth in this paragraph (d) if it determines that no error occurred or that an error occurred in a manner or amount different from that described by the consumer:

(1) *Written explanation*. The institution's report of the results of its investigation shall include a written explanation of the institution's findings and shall note the consumer's right to request the documents that the institution relied on in making its determination. Upon request, the institution shall promptly provide copies of the documents.

(2) *Debiting provisional credit*. Upon debiting a provisionally credited amount, the financial institution shall:

(i) Notify the consumer of the date and amount of the debiting;

(ii) Notify the consumer that the institution will honor checks, drafts, or similar instruments payable to third parties and preauthorized transfers from the consumer's account (without charge to the consumer as a result of an overdraft) for five business days after the notification. The institution shall honor items as specified in the notice, but need honor only items that it would have paid if the provisionally credited funds had not been debited.

(e) *Reassertion of error*. A financial institution that has fully complied with the error resolution requirements has no further responsibilities under this section should the consumer later reassert the same error, except in the case of an error asserted by the consumer following receipt of information provided under paragraph (a)(1)(vii) of this section.

[Reg. E, 61 FR 19669, May 2, 1996, as amended at 63 FR 52118, Sept. 29, 1998]

§ 205.12 Relation to other laws.

(a) *Relation to Truth in Lending*. (1) The Electronic Fund Transfer Act and this part govern:

(i) The addition to an accepted credit card, as defined in Regulation Z (12 CFR 226.12(a)(2), footnote 21), of the capability to initiate electronic fund transfers;

(ii) The issuance of an access device that permits credit extensions (under a preexisting agreement between a consumer and a financial institution) only when the consumer's account is overdrawn or to maintain a specified minimum balance in the consumer's account; and

(iii) A consumer's liability for an unauthorized electronic fund transfer and the investigation of errors involving an extension of credit that occurs under an agreement between the consumer and a financial institution to extend credit when the consumer's account is overdrawn or to maintain a specified minimum balance in the consumer's account.

(2) The Truth in Lending Act and Regulation Z (12 CFR part 226), which prohibit the unsolicited issuance of credit cards, govern:

(i) The addition of a credit feature to an accepted access device; and

(ii) Except as provided in paragraph (a)(1)(ii) of this section, the issuance of a credit card that is also an access device.

(b) *Preemption of inconsistent state laws*—(1) *Inconsistent requirements*. The Board shall determine, upon its own motion or upon the request of a state, financial institution, or other interested party, whether the act and this part preempt state law relating to electronic fund transfers. Only state laws that are inconsistent with the act and

this part are preempted and then only to the extent of the inconsistency. A state law is not inconsistent with the act and this part if it is more protective of consumers.

(2) *Standards for determination.* State law is inconsistent with the requirements of the act and this part if it:

(i) Requires or permits a practice or act prohibited by the federal law;

(ii) Provides for consumer liability for unauthorized electronic fund transfers that exceeds the limits imposed by the federal law;

(iii) Allows longer time periods than the federal law for investigating and correcting alleged errors, or does not require the financial institution to credit the consumer's account during an error investigation in accordance with § 205.11(c)(2)(i); or

(iv) Requires initial disclosures, periodic statements, or receipts that are different in content from those required by the federal law except to the extent that the disclosures relate to consumer rights granted by the state law and not by the federal law.

(c) *State exemptions*—(1) *General rule.* Any state may apply for an exemption from the requirements of the act or this part for any class of electronic fund transfers within the state. The Board shall grant an exemption if it determines that:

(i) Under state law the class of electronic fund transfers is subject to requirements substantially similar to those imposed by the federal law; and

(ii) There is adequate provision for state enforcement.

(2) *Exception.* To assure that the federal and state courts continue to have concurrent jurisdiction, and to aid in implementing the act:

(i) No exemption shall extend to the civil liability provisions of section 915 of the act; and

(ii) When the Board grants an exemption, the state law requirements shall constitute the requirements of the federal law for purposes of section 915 of the act, except for state law requirements not imposed by the federal law.

§ 205.13 Administrative enforcement; record retention.

(a) *Enforcement by federal agencies.* Compliance with this part is enforced by the agencies listed in Appendix B of this part.

(b) *Record retention.* (1) Any person subject to the act and this part shall retain evidence of compliance with the requirements imposed by the act and this part for a period of not less than two years from the date disclosures are required to be made or action is required to be taken.

(2) Any person subject to the act and this part having actual notice that it is the subject of an investigation or an enforcement proceeding by its enforcement agency, or having been served with notice of an action filed under sections 910, 915, or 916(a) of the act, shall retain the records that pertain to the investigation, action, or proceeding until final disposition of the matter unless an earlier time is allowed by court or agency order.

§ 205.14 Electronic fund transfer service provider not holding consumer's account.

(a) *Provider of electronic fund transfer service.* A person that provides an electronic fund transfer service to a consumer but that does not hold the consumer's account is subject to all requirements of this part if the person:

(1) Issues a debit card (or other access device) that the consumer can use to access the consumer's account held by a financial institution; and

(2) Has no agreement with the account-holding institution regarding such access.

(b) *Compliance by service provider.* In addition to the requirements generally applicable under this part, the service provider shall comply with the following special rules:

(1) *Disclosures and documentation.* The service provider shall give the disclosures and documentation required by §§ 205.7, 205.8, and 205.9 that are within the purview of its relationship with the consumer. The service provider need not furnish the periodic statement required by § 205.9(b) if the following conditions are met:

(i) The debit card (or other access device) issued to the consumer bears the service provider's name and an address or telephone number for making inquiries or giving notice of error;

(ii) The consumer receives a notice concerning use of the debit card that is substantially similar to the notice contained in Appendix A of this part;

(iii) The consumer receives, on or with the receipts required by § 205.9(a), the address and telephone number to be used for an inquiry, to give notice of an error, or to report the loss or theft of the debit card;

(iv) The service provider transmits to the account-holding institution the information specified in § 205.9(b)(1), in the format prescribed by the automated clearinghouse system used to clear the fund transfers;

(v) The service provider extends the time period for notice of loss or theft of a debit card, set forth in § 205.6(b) (1) and (2), from two business days to four business days after the consumer learns of the loss or theft; and extends the time periods for reporting unauthorized transfers or errors, set forth in §§ 205.6(b)(3) and 205.11(b)(1)(i), from 60 days to 90 days following the transmittal of a periodic statement by the account-holding institution.

(2) *Error resolution.* (i) The service provider shall extend by a reasonable time the period in which notice of an error must be received, specified in § 205.11(b)(1)(i), if a delay resulted from an initial attempt by the consumer to notify the account-holding institution.

(ii) The service provider shall disclose to the consumer the date on which it initiates a transfer to effect a provisional credit in accordance with § 205.11(c)(2)(ii).

(iii) If the service provider determines an error occurred, it shall transfer funds to or from the consumer's account, in the appropriate amount and within the applicable time period, in accordance with § 205.11(c)(2)(i).

(iv) If funds were provisionally credited and the service provider determines no error occurred, it may reverse the credit. The service provider shall notify the account-holding institution of the period during which the account-holding institution must honor debits to the account in accordance with § 205.11(d)(2)(ii). If an overdraft results, the service provider shall promptly reimburse the account-holding institution in the amount of the overdraft.

(c) *Compliance by account-holding institution.* The account-holding institution need not comply with the requirements of the act and this part with respect to electronic fund transfers initiated through the service provider except as follows:

(1) *Documentation.* The account-holding institution shall provide a periodic statement that describes each electronic fund transfer initiated by the consumer with the access device issued by the service provider. The account-holding institution has no liability for the failure to comply with this requirement if the service provider did not provide the necessary information; and

(2) *Error resolution.* Upon request, the account-holding institution shall provide information or copies of documents needed by the service provider to investigate errors or to furnish copies of documents to the consumer. The account-holding institution shall also honor debits to the account in accordance with § 205.11(d)(2)(ii).

§ 205.15 Electronic fund transfer of government benefits.

(a) *Government agency subject to regulation.* (1) A government agency is deemed to be a financial institution for purposes of the act and this part if directly or indirectly it issues an access device to a consumer for use in initiating an electronic fund transfer of government benefits from an account, other than needs-tested benefits in a program established under state or local law or administered by a state or local agency. The agency shall comply with all applicable requirements of the act and this part, except as provided in this section.

(2) For purposes of this section, the term *account* means an account established by a government agency for distributing government benefits to a consumer electronically, such as through automated teller machines or point-of-sale terminals, but does not include an account for distributing needs-tested benefits in a program established under state or local law or administered by a state or local agency.

(b) *Issuance of access devices.* For purposes of this section, a consumer is deemed to request an access device

when the consumer applies for government benefits that the agency disburses or will disburse by means of an electronic fund transfer. The agency shall verify the identity of the consumer receiving the device by reasonable means before the device is activated.

(c) *Alternative to periodic statement.* A government agency need not furnish the periodic statement required by § 205.9(b) if the agency makes available to the consumer:

(1) The consumer's account balance, through a readily available telephone line and at a terminal (such as by providing balance information at a balance-inquiry terminal or providing it, routinely or upon request, on a terminal receipt at the time of an electronic fund transfer); and

(2) A written history of the consumer's account transactions that is provided promptly in response to an oral or written request and that covers at least 60 days preceding the date of a request by the consumer.

(d) *Modified requirements.* A government agency that does not furnish periodic statements, in accordance with paragraph (c) of this section, shall comply with the following special rules:

(1) *Initial disclosures.* The agency shall modify the disclosures under § 205.7(b) by disclosing:

(i) *Account balance.* The means by which the consumer may obtain information concerning the account balance, including a telephone number. The agency provides a notice substantially similar to the notice contained in paragraph A–5 in Appendix A of this part.

(ii) *Written account history.* A summary of the consumer's right to receive a written account history upon request, in place of the periodic statement required by § 205.7(b)(6), and the telephone number to call to request an account history. This disclosure may be made by providing a notice substantially similar to the notice contained in paragraph A–5 in Appendix A of this part.

(iii) *Error resolution.* A notice concerning error resolution that is substantially similar to the notice contained in paragraph A–5 in Appendix A of this part, in place of the notice required by § 205.7(b)(10).

(2) *Annual error resolution notice.* The agency shall provide an annual notice concerning error resolution that is substantially similar to the notice contained in paragraph A–5 in appendix A, in place of the notice required by § 205.8(b).

(3) *Limitations on liability.* For purposes of § 205.6(b)(3), regarding a 60-day period for reporting any unauthorized transfer that appears on a periodic statement, the 60-day period shall begin with transmittal of a written account history or other account information provided to the consumer under paragraph (c) of this section.

(4) *Error resolution.* The agency shall comply with the requirements of § 205.11 in response to an oral or written notice of an error from the consumer that is received no later than 60 days after the consumer obtains the written account history or other account information, under paragraph (c) of this section, in which the error is first reflected.

[Reg. E, 61 FR 19669, May 2, 1996, as amended at 62 FR 43469, Aug. 14, 1997]

§ 205.16 Disclosures at automated teller machines.

(a) *Definition. Automated teller machine operator* means any person that operates an automated teller machine at which a consumer initiates an electronic fund transfer or a balance inquiry and that does not hold the account to or from which the transfer is made, or about which an inquiry is made.

(b) *General.* An automated teller machine operator that imposes a fee on a consumer for initiating an electronic fund transfer or a balance inquiry shall:

(1) Provide notice that a fee will be imposed for providing electronic fund transfer services or a balance inquiry; and

(2) Disclose the amount of the fee.

(c) *Notice requirement.* An automated teller machine operator must comply with the following:

(1) *On the machine.* Post the notice required by paragraph (b)(1) of this section in a prominent and conspicuous

location on or at the automated teller machine; and

(2) *Screen or paper notice*. Provide the notice required by paragraphs (b)(1) and (b)(2) of this section either by showing it on the screen of the automated teller machine or by providing it on paper, before the consumer is committed to paying a fee.

(d) *Temporary exemption*. Through December 31, 2004, the notice requirement in paragraph (c)(2) of this section does not apply to any automated teller machine that lacks the technical capability to provide such information.

(e) *Imposition of fee*. An automated teller machine operator may impose a fee on a consumer for initiating an electronic fund transfer or a balance inquiry only if

(1) The consumer is provided the notices required under paragraph (c) of this section, and

(2) The consumer elects to continue the transaction or inquiry after receiving such notices.

[Reg. E, 66 FR 13412, Mar. 6, 2001]

§ 205.17 Requirements for electronic communication.

(a) *Definition*. *Electronic communication* means a message transmitted electronically between a financial institution and a consumer in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor.

(b) *General rule*. In accordance with the Electronic Signatures in Global and National Commerce Act (the E-Sign Act), 15 U.S.C. 7001 *et seq.*, and the rules of this part, a financial institution may provide by electronic communication any disclosure required by this part to be in writing.

(c) *Address or location to receive electronic communication*. A financial institution that uses electronic communication to provide disclosures required by this part shall:

(1) Send the disclosure to the consumer's electronic address; or

(2) Make the disclosure available at another location such as an Internet web site; and

(i) Alert the consumer of the disclosure's availability by sending a notice to the consumer's electronic address (or to a postal address, at the financial institution's option). The notice shall identify the account involved and the address of the Internet web site or other location where the disclosure is available; and

(ii) Make the disclosure available for at least 90 days from the date the disclosure first becomes available or from the date of the notice alerting the consumer of the disclosure, whichever comes later.

(d) *Redelivery*. When a disclosure provided by electronic communication is returned to a financial institution undelivered, the financial institution shall take reasonable steps to attempt redelivery using information in its files.

(e) *Persons other than financial institutions*. Persons other than a financial institution that are required to comply with this part may use electronic communication in accordance with the requirements of § 205.17, as applicable.

[Reg. E, 66 FR 17793, Apr. 4, 2001]

APPENDIX A TO PART 205—MODEL DISCLOSURE CLAUSES AND FORMS

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A–1—MODEL CLAUSES FOR UNSOLICITED ISSUANCE (§ 205.5(B)(2))

(a) *Accounts using cards*. You cannot use the enclosed card to transfer money into or out of your account until we have validated it. If you do not want to use the card, please (destroy it at once by cutting it in half).

[Financial institution may add validation instructions here.]

(b) *Accounts using codes*. You cannot use the enclosed code to transfer money into or out of your account until we have validated it. If you do not want to use the code, please (destroy this notice at once).

[Financial institution may add validation instructions here.]

A–2—MODEL CLAUSES FOR INITIAL DISCLOSURES (§ 205.7(B))

(a) *Consumer Liability (§ 205.7(b)(1))*. (Tell us AT ONCE if you believe your [card] [code]

has been lost or stolen. Telephoning is the best way of keeping your possible losses down. You could lose all the money in your account (plus your maximum overdraft line of credit). If you tell us within 2 business days, you can lose no more than $50 if someone used your [card][code] without your permission. (If you believe your [card] [code] has been lost or stolen, and you tell us within 2 business days after you learn of the loss or theft, you can lose no more than $50 if someone used your [card] [code] without your permission.)

If you do NOT tell us within 2 business days after you learn of the loss or theft of your [card] [code], and we can prove we could have stopped someone from using your [card] [code] without your permission if you had told us, you could lose as much as $500.

Also, if your statement shows transfers that you did not make, tell us at once. If you do not tell us within 60 days after the statement was mailed to you, you may not get back any money you lost after the 60 days if we can prove that we could have stopped someone from taking the money if you had told us in time.

If a good reason (such as a long trip or a hospital stay) kept you from telling us, we will extend the time periods.

(b) *Contact in event of unauthorized transfer (§ 205.7(b)(2))*. If you believe your [card] [code] has been lost or stolen or that someone has transferred or may transfer money from your account without your permission, call:

[Telephone number]

or write:

[Name of person or office to be notified]

[Address]

(c) *Business days (§ 205.7(b)(3))*. For purposes of these disclosures, our business days are (Monday through Friday) (Monday through Saturday) (any day including Saturdays and Sundays). Holidays are (not) included.

(d) *Transfer types and limitations (§ 205.7(b)(4))*—(1) *Account access*. You may use your [card][code] to:

(i) Withdraw cash from your [checking] [or] [savings] account.

(ii) Make deposits to your [checking] [or] [savings] account.

(iii) Transfer funds between your checking and savings accounts whenever you request.

(iv) Pay for purchases at places that have agreed to accept the [card] [code].

(v) Pay bills directly [by telephone] from your [checking] [or] [savings] account in the amounts and on the days you request.

Some of these services may not be available at all terminals.

(2) *Limitations on frequency of transfers*.—(i) You may make only [insert number, e.g., 3] cash withdrawals from our terminals each [insert time period, e.g., week].

(ii) You can use your telephone bill-payment service to pay [insert number] bills each [insert time period] [telephone call].

(iii) You can use our point-of-sale transfer service for [insert number] transactions each [insert time period].

(iv) For security reasons, there are limits on the number of transfers you can make using our [terminals] [telephone bill-payment service] [point-of-sale transfer service].

(3) *Limitations on dollar amounts of transfers*—(i) You may withdraw up to [insert dollar amount] from our terminals each [insert time period] time you use the [card] [code].

(ii) You may buy up to [insert dollar amount] worth of goods or services each [insert time period] time you use the [card] [code] in our point-of-sale transfer service.

(e) *Fees (§ 205.7(b)(5))*—(1) *Per transfer charge*. We will charge you [insert dollar amount] for each transfer you make using our [automated teller machines] [telephone bill-payment service] [point-of-sale transfer service].

(2) *Fixed charge*. We will charge you [insert dollar amount] each [insert time period] for our [automated teller machine service] [telephone bill-payment service] [point-of-sale transfer service].

(3) *Average or minimum balance charge*. We will only charge you for using our [automated teller machines] [telephone bill-payment service] [point-of-sale transfer service] if the [average] [minimum] balance in your [checking account] [savings account] [accounts] falls below [insert dollar amount]. If it does, we will charge you [insert dollar amount] each [transfer] [insert time period].

(f) *Confidentiality (§ 205.7(b)(9))*. We will disclose information to third parties about your account or the transfers you make:

(i) Where it is necessary for completing transfers, or

(ii) In order to verify the existence and condition of your account for a third party, such as a credit bureau or merchant, or

(iii) In order to comply with government agency or court orders, or

(iv) If you give us your written permission.

(g) *Documentation (§ 205.7(b)(6))*—(1) *Terminal transfers*. You can get a receipt at the time you make any transfer to or from your account using one of our [automated teller machines] [or] [point-of-sale terminals].

(2) *Preauthorized credits*. If you have arranged to have direct deposits made to your account at least once every 60 days from the same person or company, (we will let you know if the deposit is [not] made.) [the person or company making the deposit will tell you every time they send us the money] [you can call us at (insert telephone number) to find out whether or not the deposit has been made].

(3) *Periodic statements*. You will get a [monthly] [quarterly] account statement (unless there are no transfers in a particular

month. In any case you will get the statement at least quarterly).

(4) *Passbook account where the only possible electronic fund transfers are preauthorized credits*. If you bring your passbook to us, we will record any electronic deposits that were made to your account since the last time you brought in your passbook.

(h) *Preauthorized payments (§ 205.7(b) (6), (7) and (8); § 205.10(d))*—(1) *Right to stop payment and procedure for doing so*. If you have told us in advance to make regular payments out of your account, you can stop any of these payments. Here's how:

Call us at [insert telephone number], or write us at [insert address], in time for us to receive your request 3 business days or more before the payment is scheduled to be made. If you call, we may also require you to put your request in writing and get it to us within 14 days after you call. (We will charge you [insert amount] for each stop-payment order you give.)

(2) *Notice of varying amounts*. If these regular payments may vary in amount, [we] [the person you are going to pay] will tell you, 10 days before each payment, when it will be made and how much it will be. (You may choose instead to get this notice only when the payment would differ by more than a certain amount from the previous payment, or when the amount would fall outside certain limits that you set.)

(3) *Liability for failure to stop payment of preauthorized transfer*. If you order us to stop one of these payments 3 business days or more before the transfer is scheduled, and we do not do so, we will be liable for your losses or damages.

(i) *Financial institution's liability (§ 205.7(b)(8))*. If we do not complete a transfer to or from your account on time or in the correct amount according to our agreement with you, we will be liable for your losses or damages. However, there are some exceptions. We will not be liable, for instance:

(1) If, through no fault of ours, you do not have enough money in your account to make the transfer.

(2) If the transfer would go over the credit limit on your overdraft line.

(3) If the automated teller machine where you are making the transfer does not have enough cash.

(4) If the [terminal] [system] was not working properly and you knew about the breakdown when you started the transfer.

(5) If circumstances beyond our control (such as fire or flood) prevent the transfer, despite reasonable precautions that we have taken.

(6) There may be other exceptions stated in our agreement with you.

(j) *ATM fees (§ 205.7(b)(11))*. When you use an ATM not owned by us, you may be charged a fee by the ATM operator [or any network used] (and you may be charged a fee for a balance inquiry even if you do not complete a fund transfer).

A–3—Model Forms for Error Resolution Notice (§§ 205.7(b)(10) and 205.8(b))

(a) *Initial and annual error resolution notice (§§ 205.7(b)(10) and 205.8(b))*.

In Case of Errors or Questions About Your Electronic Transfers Telephone us at [insert telephone number] Write us at [insert address] [or E-mail us at [insert electronic mail address]] as soon as you can, if you think your statement or receipt is wrong or if you need more information about a transfer listed on the statement or receipt. We must hear from you no later than 60 days after we sent the FIRST statement on which the problem or error appeared.

(1) Tell us your name and account number (if any).

(2) Describe the error or the transfer you are unsure about, and explain as clearly as you can why you believe it is an error or why you need more information.

(3) Tell us the dollar amount of the suspected error.

If you tell us orally, we may require that you send us your complaint or question in writing within 10 business days.

We will determine whether an error occurred within 10 business days after we hear from you and will correct any error promptly. If we need more time, however, we may take up to 45 days to investigate your complaint or question. If we decide to do this, we will credit your account within 10 business days for the amount you think is in error, so that you will have the use of the money during the time it takes us to complete our investigation. If we ask you to put your complaint or question in writing and we do not receive it within 10 business days, we may not credit your account.

For errors involving new accounts, point-of-sale, or foreign-initiated transactions, we may take up to 90 days to investigate your complaint or question. For new accounts, we may take up to 20 business days to credit your account for the amount you think is in error.

We will tell you the results within three business days after completing our investigation. If we decide that there was no error, we will send you a written explanation. You may ask for copies of the documents that we used in our investigation.

(b) *Error resolution notice on periodic statements (§ 205.8(b))*.

A–4—Model Form For Service-providing Institutions (§ 205.14(b)(1)(ii))

ALL QUESTIONS ABOUT TRANSACTIONS MADE WITH YOUR (NAME OF CARD) CARD MUST BE DIRECTED TO US (NAME OF SERVICE PROVIDER), AND NOT

TO THE BANK OR OTHER FINANCIAL INSTITUTION WHERE YOU HAVE YOUR ACCOUNT. We are responsible for the [name of service] service and for resolving any errors in transactions made with your [name of card] card.

We will not send you a periodic statement listing transactions that you make using your [name of card] card. The transactions will appear only on the statement issued by your bank or other financial institution. SAVE THE RECEIPTS YOU ARE GIVEN WHEN YOU USE YOUR [NAME OF CARD] CARD, AND CHECK THEM AGAINST THE ACCOUNT STATEMENT YOU RECEIVE FROM YOUR BANK OR OTHER FINANCIAL INSTITUTION. If you have any questions about one of these transactions, call or write us at [telephone number and address] [the telephone number and address indicated below].

IF YOUR [NAME OF CARD] CARD IS LOST OR STOLEN, NOTIFY US AT ONCE by calling or writing to us at [telephone number and address].

A–5—Model Forms for Government Agencies (§ 205.15(d)(1) and (2))

(a) *Disclosure by government agencies of information about obtaining account balances and account histories (§ 205.15(d)(1)(i) and (ii)).*

You may obtain information about the amount of benefits you have remaining by calling [telephone number]. That information is also available [on the receipt you get when you make a transfer with your card at (an ATM)(a POS terminal)][when you make a balance inquiry at an ATM][when you make a balance inquiry at specified locations].

You also have the right to receive a written summary of transactions for the 60 days preceding your request by calling [telephone number]. [Optional: Or you may request the summary by contacting your caseworker.]

(b) *Disclosure of error resolution procedures for government agencies that do not provide periodic statements (§ 205.15(d)(1)(iii) and (d)(2)).*

In Case of Errors or Questions About Your Electronic Transfers Telephone us at [telephone number] Write us at [insert address] [or E-mail us at [insert electronic mail address]] as soon as you can, if you think an error has occurred in your [EBT][agency's name for program] account. We must hear from you no later than 60 days after you learn of the error. You will need to tell us:

- Your name and [case] [file] number.
- Why you believe there is an error, and the dollar amount involved.
- Approximately when the error took place.

If you tell us orally, we may require that you send us your complaint or question in writing within 10 business days.

We will determine whether an error occurred within 10 business days after we hear from you and will correct any error promptly. If we need more time, however, we may take up to 45 days to investigate your complaint or question. If we decide to do this, we will credit your account within 10 business days for the amount you think is in error, so that you will have the use of the money during the time it takes us to complete our investigation. If we ask you to put your complaint or question in writing and we do not receive it within 10 business days, we may not credit your account.

For errors involving new accounts, point-of-sale, or foreign-initiated transactions, we may take up to 90 days to investigate your complaint or question. For new accounts, we may take up to 20 business days to credit your account for the amount you think is in error.

We will tell you the results within three business days after completing our investigation. If we decide that there was no error, we will send you a written explanation. You may ask for copies of the documents that we used in our investigation.

If you need more information about our error resolution procedures, call us at [telephone number][the telephone number shown above].

[Reg. E, 61 FR 19669, May 2, 1996, as amended at 63 FR 52118, Sept. 29, 1998; 66 FR 13412, Mar. 6, 2001; 66 FR 17793, Apr. 4, 2001]

Appendix B to Part 205—Federal Enforcement Agencies

The following list indicates which Federal agency enforces Regulation E (12 CFR part 205) for particular classes of institutions. Any questions concerning compliance by a particular institution should be directed to the appropriate enforcing agency. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

National banks, and Federal branches and Federal agencies of foreign banks

District office of the Office of the Comptroller of the Currency where the institution is located.

State member banks, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act

Federal Reserve Bank serving the District in which the institution is located.

Nonmember insured banks and insured state branches of foreign banks

Federal Deposit Insurance Corporation regional director for the region in which the institution is located.

Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally-chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund)

Office of Thrift Supervision Regional Director for the region in which the institution is located.

Federal Credit Unions

Division of Consumer Affairs, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428

Air Carriers

Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, S.W., Washington, D.C. 20590.

Brokers and Dealers

Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549.

Retailers, Consumer Finance Companies, Certain Other Financial Institutions, and all others not covered above

Federal Trade Commission, Electronic Fund Transfers, Washington, D.C. 20580.

APPENDIX C TO PART 205—ISSUANCE OF STAFF INTERPRETATIONS

OFFICIAL STAFF INTERPRETATIONS

Pursuant to section 915(d) of the act, the Board has designated the director and other officials of the Division of Consumer and Community Affairs as officials ''duly authorized'' to issue, at their discretion, official staff interpretations of this part. Except in unusual circumstances, such interpretations will not be issued separately but will be incorporated in an official commentary to this part, which will be amended periodically.

REQUESTS FOR ISSUANCE OF OFFICIAL STAFF INTERPRETATIONS

A request for an official staff interpretation shall be in writing and addressed to the Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. The request shall contain a complete statement of all relevant facts concerning the issue, including copies of all pertinent documents.

SCOPE OF INTERPRETATIONS

No staff interpretations will be issued approving financial institutions' forms or statements. This restriction does not apply to forms or statements whose use is required or sanctioned by a government agency.

SUPPLEMENT I TO PART 205—OFFICIAL STAFF INTERPRETATIONS

SECTION 205.2—DEFINITIONS

2(a) Access Device

1. *Examples.* The term access device includes debit cards, personal identification numbers (PINs), telephone transfer and telephone bill payment codes, and other means that may be used by a consumer to initiate an electronic fund transfer (EFT) to or from a consumer account. The term does not include magnetic tape or other devices used internally by a financial institution to initiate electronic transfers.

2. *Checks used to capture information.* The term ''access device'' does not include a check or draft used to capture the MICR (Magnetic Ink Character Recognition) encoding to initiate a one-time ACH debit. For example, if a consumer authorizes a one-time ACH debit from the consumer's account using a blank, partially completed, or fully completed and signed check for the merchant to capture the routing, account, and serial numbers to initiate the debit, the check is not an access device. (Although the check is not an access device under Regulation E, the transaction is nonetheless covered by the regulation. See comment 3(b)–1(v).)

2(b) Account

1. *Consumer asset account.* The term consumer asset account includes:

i. Club accounts, such as vacation clubs. In many cases, however, these accounts are exempt from the regulation under §205.3(c)(5) because all electronic transfers to or from the account have been preauthorized by the consumer and involve another account of the consumer at the same institution.

ii. A retail repurchase agreement (repo), which is a loan made to a financial institution by a consumer that is collateralized by government or government-insured securities.

2. Examples of accounts not covered by Regulation E (12 CFR part 205) include:

i. Profit-sharing and pension accounts established under a trust agreement, which are exempt under §205.2(b)(2).

ii. Escrow accounts, such as those established to ensure payment of items such as

real estate taxes, insurance premiums, or completion of repairs or improvements.

iii. Accounts for accumulating funds to purchase U.S. savings bonds.

Paragraph 2(b)(2)

1. *Bona fide trust agreements.* The term bona fide trust agreement is not defined by the act or regulation; therefore, financial institutions must look to state or other applicable law for interpretation.

2. *Custodial agreements.* An account held under a custodial agreement that qualifies as a trust under the Internal Revenue Code, such as an individual retirement account, is considered to be held under a trust agreement for purposes of Regulation E.

2(d) Business Day

1. *Duration.* A business day includes the entire 24-hour period ending at midnight, and a notice required by the regulation is effective even if given outside normal business hours. The regulation does not require, however, that a financial institution make telephone lines available on a 24-hour basis.

2. *Substantially all business functions.* ''Substantially all business functions'' include both the public and the back-office operations of the institution. For example, if the offices of an institution are open on Saturdays for handling some consumer transactions (such as deposits, withdrawals, and other teller transactions), but not for performing internal functions (such as investigating account errors), then Saturday is not a business day for that institution. In this case, Saturday does not count toward the business-day standard set by the regulation for reporting lost or stolen access devices, resolving errors, etc.

3. *Short hours.* A financial institution may determine, at its election, whether an abbreviated day is a business day. For example, if an institution engages in substantially all business functions until noon on Saturdays instead of its usual 3:00 p.m. closing, it may consider Saturday a business day.

4. *Telephone line.* If a financial institution makes a telephone line available on Sundays for reporting the loss or theft of an access device, but performs no other business functions, Sunday is not a business day under the ''substantially all business functions'' standard.

2(h) Electronic Terminal

1. *Point-of-sale (POS) payments initiated by telephone.* Because the term electronic terminal excludes a telephone operated by a consumer, a financial institution need not provide a terminal receipt when:

i. A consumer uses a debit card at a public telephone to pay for the call.

ii. A consumer initiates a transfer by a means analogous in function to a telephone, such as by home banking equipment or a facsimile machine.

2. *POS terminals.* A POS terminal that captures data electronically, for debiting or crediting to a consumer's asset account, is an electronic terminal for purposes of Regulation E even if no access device is used to initiate the transaction. (See §205.9 for receipt requirements.)

3. *Teller-operated terminals.* A terminal or other computer equipment operated by an employee of a financial institution is not an electronic terminal for purposes of the regulation. However, transfers initiated at such terminals by means of a consumer's access device (using the consumer's PIN, for example) are EFTs and are subject to other requirements of the regulation. If an access device is used only for identification purposes or for determining the account balance, the transfers are not EFTs for purposes of the regulation.

2(k) Preauthorized Electronic Fund Transfer

1. *Advance authorization.* A ''preauthorized electronic fund transfer'' under Regulation E is one authorized by the consumer in advance of a transfer that will take place on a recurring basis, at substantially regular intervals, and will require no further action by the consumer to initiate the transfer. In a bill-payment system, for example, if the consumer authorizes a financial institution to make monthly payments to a payee by means of EFTs, and the payments take place without further action by the consumer, the payments are preauthorized EFTs. In contrast, if the consumer must take action each month to initiate a payment (such as by entering instructions on a touch-tone telephone or home computer), the payments are not preauthorized EFTs.

2(m) Unauthorized Electronic Fund Transfer

1. *Transfer by institution's employee.* A consumer has no liability for erroneous or fraudulent transfers initiated by an employee of a financial institution.

2. *Authority.* If a consumer furnishes an access device and grants authority to make transfers to a person (such as a family member or co-worker) who exceeds the authority given, the consumer is fully liable for the transfers unless the consumer has notified the financial institution that transfers by that person are no longer authorized.

3. *Access device obtained through robbery or fraud.* An unauthorized EFT includes a transfer initiated by a person who obtained the access device from the consumer through fraud or robbery.

4. *Forced initiation.* An EFT at an automated teller machine (ATM) is an unauthorized transfer if the consumer has been induced by force to initiate the transfer.

5. *Reversal of direct deposits*. The reversal of a direct deposit made in error is not an unauthorized EFT when it involves:

i. A credit made to the wrong consumer's account;

ii. A duplicate credit made to a consumer's account; or

iii. A credit in the wrong amount (for example, when the amount credited to the consumer's account differs from the amount in the transmittal instructions).

SECTION 205.3—COVERAGE

3(a) General

1. *Accounts covered*. The requirements of the regulation apply only to an account for which an agreement for EFT services to or from the account has been entered into between:

i. The consumer and the financial institution (including an account for which an access device has been issued to the consumer, for example);

ii. The consumer and a third party (for preauthorized debits or credits, for example), when the account-holding institution has received notice of the agreement and the fund transfers have begun.

2. *Automated clearing house (ACH) membership*. The fact that membership in an ACH requires a financial institution to accept EFTs to accounts at the institution does not make every account of that institution subject to the regulation.

3. *Foreign applicability*. Regulation E applies to all persons (including branches and other offices of foreign banks located in the United States) that offer EFT services to residents of any state, including resident aliens. It covers any account located in the United States through which EFTs are offered to a resident of a state. This is the case whether or not a particular transfer takes place in the United States and whether or not the financial institution is chartered in the United States or a foreign country. The regulation does not apply to a foreign branch of a U.S. bank unless the EFT services are offered in connection with an account in a state as defined in §205.2(l).

3(b) Electronic Fund Transfer

1. *Fund transfers covered*. The term electronic fund transfer includes:

i. A deposit made at an ATM or other electronic terminal (including a deposit in cash or by check) provided a specific agreement exists between the financial institution and the consumer for EFTs to or from the account to which the deposit is made.

ii. A transfer sent via ACH. For example, social security benefits under the U.S. Treasury's direct-deposit program are covered, even if the listing of payees and payment amounts reaches the account-holding institution by means of a computer printout from a correspondent bank.

iii. A preauthorized transfer credited or debited to an account in accordance with instructions contained on magnetic tape, even if the financial institution holding the account sends or receives a composite check.

iv. A transfer from the consumer's account resulting from a debit-card transaction at a merchant location, even if no electronic terminal is involved at the time of the transaction, if the consumer's asset account is subsequently debited for the amount of the transfer.

v. A transfer via ACH where a consumer has provided a check to enable the merchant or other payee to capture the routing, account, and serial numbers to initiate the transfer, whether the check is blank, partially completed, or fully completed and signed; whether the check is presented at POS or is mailed to a merchant or other payee or lockbox and later converted to an EFT; or whether the check is retained by the consumer, the merchant or other payee, or the payee's financial institution.

vi. A payment made by a bill payer under a bill-payment service available to a consumer via computer or other electronic means, unless the terms of the bill-payment service explicitly state that all payments, or all payments to a particular payee or payees, will be solely by check, draft, or similar paper instrument drawn on the consumer's account, and the payee or payees that will be paid in this manner are identified to the consumer.

2. *Fund transfers not covered*. The term electronic fund transfer does not include:

i. A payment that does not debit or credit a consumer asset account, such as a payroll allotment to a creditor to repay a credit extension (which is deducted from salary).

ii. A payment made in currency by a consumer to another person at an electronic terminal.

iii. A preauthorized check drawn by the financial institution on the consumer's account (such as an interest or other recurring payment to the consumer or another party), even if the check is computer-generated.

3. *Authorization of one-time EFT initiated using MICR encoding on a check*. A consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding), where the consumer receives notice that the transaction will be processed as an EFT and completes the transaction. Examples of notice include, but are not limited to, signage at POS and written statements.

3(c) Exclusions From Coverage

Paragraph 3(c)(1)—Checks

1. *Re-presented checks*. The electronic representment of a returned check is not covered by Regulation E because the transaction originated by check. Regulation E does apply, however, to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account.

2. *Check used to capture information for a one-time EFT*. See comment 3(b)–1(v).

Paragraph 3(c)(2)—Check Guarantee or Authorization

1. *Memo posting*. Under a check guarantee or check authorization service, debiting of the consumer's account occurs when the check or draft is presented for payment. These services are exempt from coverage, even when a temporary hold on the account is memo-posted electronically at the time of authorization.

Paragraph 3(c)(3)—Wire or Other Similar Transfers

1. *Fedwire and ACH*. If a financial institution makes a fund transfer to a consumer's account after receiving funds through Fedwire or a similar network, the transfer by ACH is covered by the regulation even though the Fedwire or network transfer is exempt.

2. *Article 4A*. Financial institutions that offer telephone-initiated Fedwire payments are subject to the requirements of UCC section 4A–202, which encourages verification of Fedwire payment orders pursuant to a security procedure established by agreement between the consumer and the receiving bank. These transfers are not subject to Regulation E and the agreement is not considered a telephone plan if the service is offered separately from a telephone bill-payment or other prearranged plan subject to Regulation E. The Board's Regulation J (12 CFR part 210) specifies the rules applicable to funds handled by Federal Reserve Banks. To ensure that the rules for all fund transfers through Fedwire are consistent, the Board used its preemptive authority under UCC section 4A–107 to determine that subpart B of Regulation J (12 CFR part 210), including the provisions of Article 4A, applies to all fund transfers through Fedwire, even if a portion of the fund transfer is governed by the EFTA. The portion of the fund transfer that is governed by the EFTA is not governed by subpart B of Regulation J (12 CFR part 210).

3. *Similar fund transfer systems*. Fund transfer systems that are similar to Fedwire include the Clearing House Interbank Payments System (CHIPS), Society for Worldwide Interbank Financial Telecommunication (SWIFT), Telex, and transfers made on the books of correspondent banks.

Paragraph 3(c)(4)—Securities and Commodities Transfers

1. *Coverage*. The securities exemption applies to securities and commodities that may be sold by a registered broker-dealer or futures commission merchant, even when the security or commodity itself is not regulated by the Securities and Exchange Commission or the Commodity Futures Trading Commission.

2. *Example of exempt transfer*. The exemption applies to a transfer involving a transfer initiated by a telephone order to a stockbroker to buy or sell securities or to exercise a margin call.

3. *Examples of nonexempt transfers*. The exemption does not apply to a transfer involving:

i. A debit card or other access device that accesses a securities or commodities account such as a money market mutual fund and that the consumer uses for purchasing goods or services or for obtaining cash.

ii. A payment of interest or dividends into the consumer's account (for example, from a brokerage firm or from a Federal Reserve Bank for government securities).

Paragraph 3(c)(5)—Automatic Transfers by Account-Holding Institution

1. *Automatic transfers exempted*. The exemption applies to:

i. Electronic debits or credits to consumer accounts for check charges, stop-payment charges, NSF charges, overdraft charges, provisional credits, error adjustments, and similar items that are initiated automatically on the occurrence of certain events.

ii. Debits to consumer accounts for group insurance available only through the financial institution and payable only by means of an aggregate payment from the institution to the insurer.

iii. EFTs between a thrift institution and its paired commercial bank in the state of Rhode Island, which are deemed under state law to be intra-institutional.

iv. Automatic transfers between a consumer's accounts within the same financial institution, even if the account holders on the two accounts are not identical.

2. *Automatic transfers not exempted*. Transfers between accounts of the consumer at affiliated institutions (such as between a bank and its subsidiary or within a holding company) are not intra-institutional transfers, and thus do not qualify for the exemption.

Paragraph 3(c)(6)—Telephone-Initiated Transfers

1. *Written plan or agreement.* A transfer that the consumer initiates by telephone is covered by Regulation E if the transfer is made under a written plan or agreement between the consumer and the financial institution making the transfer. A written statement available to the public or to account holders that describes a service allowing a consumer to initiate transfers by telephone constitutes a plan—for example, a brochure, or material included with periodic statements. The following, however, do not by themselves constitute a written plan or agreement:

i. A hold-harmless agreement on a signature card that protects the institution if the consumer requests a transfer.

ii. A legend on a signature card, periodic statement, or passbook that limits the number of telephone-initiated transfers the consumer can make from a savings account because of reserve requirements under Regulation D (12 CFR part 204).

iii. An agreement permitting the consumer to approve by telephone the rollover of funds at the maturity of an instrument.

2. *Examples of covered transfers.* When a written plan or agreement has been entered into, a transfer initiated by a telephone call from a consumer is covered even though:

i. An employee of the financial institution completes the transfer manually (for example, by means of a debit memo or deposit slip).

ii. The consumer is required to make a separate request for each transfer.

iii. The consumer uses the plan infrequently.

iv. The consumer initiates the transfer via a facsimile machine.

v. The consumer initiates the transfer using a financial institution's audio-response or voice-response telephone system.

Paragraph 3(c)(7)—Small Institutions

1. *Coverage.* This exemption is limited to preauthorized transfers; institutions that offer other EFTs must comply with the applicable sections of the regulation as to such services. The preauthorized transfers remain subject to sections 913, 915, and 916 of the act and § 205.10(e), and are therefore exempt from UCC Article 4A.

SECTION 205.4—GENERAL DISCLOSURE REQUIREMENTS; JOINTLY OFFERED SERVICES

4(a) Form of Disclosures

1. *General.* Although no particular rules govern type size, number of pages, or the relative conspicuousness of various terms, the disclosures must be in a clear and readily understandable written form that the consumer may retain. Numbers or codes are considered readily understandable if explained elsewhere on the disclosure form.

2. *Foreign language disclosures.* Disclosures may be made in languages other than English, provided they are available in English upon request.

SECTION 205.5—ISSUANCE OF ACCESS DEVICES

1. *Coverage.* The provisions of this section limit the circumstances under which a financial institution may issue an access device to a consumer. Making an additional account accessible through an existing access device is equivalent to issuing an access device and is subject to the limitations of this section.

5(a) Solicited Issuance

Paragraph 5(a)(1)

1. *Joint account.* For a joint account, a financial institution may issue an access device to each account holder if the requesting holder specifically authorizes the issuance.

2. *Permissible forms of request.* The request for an access device may be written or oral (for example, in response to a telephone solicitation by a card issuer).

Paragraph 5(a)(2)

1. *One-for-one rule.* In issuing a renewal or substitute access device, a financial institution may not provide additional devices. For example, only one new card and PIN may replace a card and PIN previously issued. If the replacement device permits either additional or fewer types of electronic fund transfer services, a change-in-terms notice or new disclosures are required.

2. *Renewal or substitution by a successor institution.* A successor institution is an entity that replaces the original financial institution (for example, following a corporate merger or acquisition) or that acquires accounts or assumes the operation of an EFT system.

5(b) Unsolicited Issuance

1. *Compliance.* A financial institution may issue an unsolicited access device (such as the combination of a debit card and PIN) if the institution's ATM system has been programmed not to accept the access device until after the consumer requests and the institution validates the device. Merely instructing a consumer not to use an unsolicited debit card and PIN until after the institution verifies the consumer's identity does not comply with the regulation.

2. *PINS.* A financial institution may impose no liability on a consumer for unauthorized transfers involving an unsolicited access device until the device becomes an ''accepted access device'' under the regulation. A card and PIN combination may be treated as an accepted access device once the consumer has used it to make a transfer.

3. *Functions of PIN.* If an institution issues a PIN at the consumer's request, the issuance may constitute both a way of validating the debit card and the means to identify the consumer (required as a condition of imposing liability for unauthorized transfers).

4. *Verification of identity.* To verify the consumer's identity, a financial institution may use any reasonable means, such as a photograph, fingerprint, personal visit, signature comparison, or personal information about the consumer. However, even if reasonable means were used, if an institution fails to verify correctly the consumer's identity and an imposter succeeds in having the device validated, the consumer is not liable for any unauthorized transfers from the account.

SECTION 205.6—LIABILITY OF CONSUMER FOR UNAUTHORIZED TRANSFERS

6(a) Conditions for Liability

1. *Means of identification.* A financial institution may use various means for identifying the consumer to whom the access device is issued, including but not limited to:

i. Electronic or mechanical confirmation (such as a PIN).

ii. Comparison of the consumer's signature, fingerprint, or photograph.

2. *Multiple users.* When more than one access device is issued for an account, the financial institution may, but need not, provide a separate means to identify each user of the account.

6(b) Limitations on Amount of Liability

1. *Application of liability provisions.* There are three possible tiers of consumer liability for unauthorized EFTs depending on the situation. A consumer may be liable for (1) up to $50; (2) up to $500; or (3) an unlimited amount depending on when the unauthorized EFT occurs. More than one tier may apply to a given situation because each corresponds to a different (sometimes overlapping) time period or set of conditions.

2. *Consumer negligence.* Negligence by the consumer cannot be used as the basis for imposing greater liability than is permissible under Regulation E. Thus, consumer behavior that may constitute negligence under state law, such as writing the PIN on a debit card or on a piece of paper kept with the card, does not affect the consumer's liability for unauthorized transfers. (However, refer to comment 2(m)–2 regarding termination of the authority of given by the consumer to another person.)

3. *Limits on liability.* The extent of the consumer's liability is determined solely by the consumer's promptness in reporting the loss or theft of an access device. Similarly, no agreement between the consumer and an institution may impose greater liability on the consumer for an unauthorized transfer than the limits provided in Regulation E.

Paragraph 6(b)(1)—Timely Notice Given

1. *$50 limit applies.* The basic liability limit is $50. For example, the consumer's card is lost or stolen on Monday and the consumer learns of the loss or theft on Wednesday. If the consumer notifies the financial institution within two business days of learning of the loss or theft (by midnight Friday), the consumer's liability is limited to $50 or the amount of the unauthorized transfers that occurred before notification, whichever is less.

2. *Knowledge of loss or theft of access device.* The fact that a consumer has received a periodic statement that reflects unauthorized transfers may be a factor in determining whether the consumer had knowledge of the loss or theft, but cannot be deemed to represent conclusive evidence that the consumer had such knowledge.

3. *Two-business-day rule.* The two-business-day period does not include the day the consumer learns of the loss or theft or any day that is not a business day. The rule is calculated based on two 24-hour periods, without regard to the financial institution's business hours or the time of day that the consumer learns of the loss or theft. For example, a consumer learns of the loss or theft at 6 p.m. on Friday. Assuming that Saturday is a business day and Sunday is not, the two-business-day period begins on Saturday and expires at 11:59 p.m. on Monday, not at the end of the financial institution's business day on Monday.

Paragraph 6(b)(2)—Timely Notice Not Given

1. *$500 limit applies.* The second tier of liability is $500. For example, the consumer's card is stolen on Monday and the consumer learns of the theft that same day. The consumer reports the theft on Friday. The $500 limit applies because the consumer failed to notify the financial institution within two business days of learning of the theft (which would have been by midnight Wednesday). How much the consumer is actually liable for, however, depends on when the unauthorized transfers take place. In this example, assume a $100 unauthorized transfer was made on Tuesday and a $600 unauthorized transfer on Thursday. Because the consumer is liable for the amount of the loss that occurs within the first two business days (but no more than $50), plus the amount of the unauthorized transfers that occurs after the first two business days and before the consumer gives notice, the consumer's total liability is $500 ($50 of the $100 transfer plus $450 of the $600 transfer, in this example). But if $600 was taken on Tuesday and $100 on Thursday, the consumer's maximum liability would be $150 ($50 of the $600 plus $100).

Paragraph 6(b)(3)—Periodic Statement; Timely Notice Not Given

1. *Unlimited liability applies.* The standard of unlimited liability applies if unauthorized transfers appear on a periodic statement, and may apply in conjunction with the first two tiers of liability. If a periodic statement shows an unauthorized transfer made with a lost or stolen debit card, the consumer must notify the financial institution within 60 calendar days after the periodic statement was sent; otherwise, the consumer faces unlimited liability for all unauthorized transfers made after the 60-day period. The consumer's liability for unauthorized transfers before the statement is sent, and up to 60 days following, is determined based on the first two tiers of liability: up to $50 if the consumer notifies the financial institution within two business days of learning of the loss or theft of the card and up to $500 if the consumer notifies the institution after two business days of learning of the loss or theft.

2. *Transfers not involving access device.* The first two tiers of liability do not apply to unauthorized transfers from a consumer's account made without an access device. If, however, the consumer fails to report such unauthorized transfers within 60 calendar days of the financial institution's transmittal of the periodic statement, the consumer may be liable for any transfers occurring after the close of the 60 days and before notice is given to the institution. For example, a consumer's account is electronically debited for $200 without the consumer's authorization and by means other than the consumer's access device. If the consumer notifies the institution within 60 days of the transmittal of the periodic statement that shows the unauthorized transfer, the consumer has no liability. However, if in addition to the $200, the consumer's account is debited for a $400 unauthorized transfer on the 61st day and the consumer fails to notify the institution of the first unauthorized transfer until the 62nd day, the consumer may be liable for the full $400.

Paragraph 6(b)(4)—Extension of Time Limits

1. *Extenuating circumstances.* Examples of circumstances that require extension of the notification periods under this section include the consumer's extended travel or hospitalization.

Paragraph 6(b)(5)—Notice to Financial Institution

1. *Receipt of notice.* A financial institution is considered to have received notice for purposes of limiting the consumer's liability if notice is given in a reasonable manner, even if the consumer notifies the institution but uses an address or telephone number other than the one specified by the institution.

2. *Notice by third party.* Notice to a financial institution by a person acting on the consumer's behalf is considered valid under this section. For example, if a consumer is hospitalized and unable to report the loss or theft of an access device, notice is considered given when someone acting on the consumer's behalf notifies the bank of the loss or theft. A financial institution may require appropriate documentation from the person representing the consumer to establish that the person is acting on the consumer's behalf.

3. *Content of notice.* Notice to a financial institution is considered given when a consumer takes reasonable steps to provide the institution with the pertinent account information. Even when the consumer is unable to provide the account number or the card number in reporting a lost or stolen access device or an unauthorized transfer, the notice effectively limits the consumer's liability if the consumer otherwise identifies sufficiently the account in question. For example, the consumer may identify the account by the name on the account and the type of account in question.

SECTION 205.7—INITIAL DISCLOSURES

7(a) Timing of Disclosures

1. *Early disclosures.* Disclosures given by a financial institution earlier than the regulation requires (for example, when the consumer opens a checking account) need not be repeated when the consumer later enters into an agreement with a third party who will initiate preauthorized transfers to or from the consumer's account, unless the terms and conditions differ from those that the institution previously disclosed. On the other hand, if an agreement is directly between the consumer and the account-holding institution, disclosures must be given in close proximity to the event requiring disclosure, for example, when the consumer contracts for a new service.

2. *Lack of advance notice of a transfer.* Where a consumer authorizes a third party to debit or credit the consumer's account, an account-holding institution that has not received advance notice of the transfer or transfers must provide the required disclosures as soon as reasonably possible after the first debit or credit is made, unless the institution has previously given the disclosures.

3. *Addition of new accounts.* If a consumer opens a new account permitting EFTs at a financial institution, and the consumer already has received Regulation E disclosures for another account at that institution, the institution need only disclose terms and conditions that differ from those previously given.

4. *Addition of EFT services.* If an EFT service is added to a consumer's account and is subject to terms and conditions different

from those described in the initial disclosures, disclosures for the new service are required. The disclosures must be provided when the consumer contracts for the new service or before the first EFT is made using the new service.

5. *Addition of service in interchange systems.* If a financial institution joins an interchange or shared network system (which provides access to terminals operated by other institutions), disclosures are required for additional EFT services not previously available to consumers if the terms and conditions differ from those previously disclosed.

6. *Disclosures covering all EFT services offered.* An institution may provide disclosures covering all EFT services that it offers, even if some consumers have not arranged to use all services.

7(b) Content of Disclosures

Paragraph 7(b)(1)—Liability of Consumer

1. *No liability imposed by financial institution.* If a financial institution chooses to impose zero liability for unauthorized EFTs, it need not provide the liability disclosures. If the institution later decides to impose liability, however, it must first provide the disclosures.

2. *Preauthorized transfers.* If the only EFTs from an account are preauthorized transfers, liability could arise if the consumer fails to report unauthorized transfers reflected on a periodic statement. To impose such liability on the consumer, the institution must have disclosed the potential liability and the telephone number and address for reporting unauthorized transfers.

3. *Additional information.* At the institution's option, the summary of the consumer's liability may include advice on promptly reporting unauthorized transfers or the loss or theft of the access device.

Paragraph 7(b)(2)—Telephone Number and Address

1. *Disclosure of telephone numbers.* An institution may use the same or different telephone numbers in the disclosures for the purpose of:

i. Reporting the loss or theft of an access device or possible unauthorized transfers;

ii. Inquiring about the receipt of a preauthorized credit;

iii. Stopping payment of a preauthorized debit;

iv. Giving notice of an error.

2. *Location of telephone number.* The telephone number need not be incorporated into the text of the disclosure; for example, the institution may instead insert a reference to a telephone number that is readily available to the consumer, such as ''Call your branch office. The number is shown on your periodic statement.'' However, an institution must provide a specific telephone number and address, on or with the disclosure statement, for reporting a lost or stolen access device or a possible unauthorized transfer.

Paragraph 7(b)(4)—Types of Transfers; Limitations

1. *Security limitations.* Information about limitations on the frequency and dollar amount of transfers generally must be disclosed in detail, even if related to security aspects of the system. If the confidentiality of certain details is essential to the security of an account or system, these details may be withheld (but the fact that limitations exist must still be disclosed). For example, an institution limits cash ATM withdrawals to $100 per day. The institution may disclose that daily withdrawal limitations apply and need not disclose that the limitations may not always be in force (such as during periods when its ATMs are off-line).

2. *Restrictions on certain deposit accounts.* A limitation on account activity that restricts the consumer's ability to make EFTs must be disclosed even if the restriction also applies to transfers made by nonelectronic means. For example, Regulation D (12 CFR Part 204) restricts the number of payments to third parties that may be made from a money market deposit account; an institution that does not execute fund transfers in excess of those limits must disclose the restriction as a limitation on the frequency of EFTs.

3. *Preauthorized transfers.* Financial institutions are not required to list preauthorized transfers among the types of transfers that a consumer can make.

Paragraph 7(b)(5)—Fees

1. *Disclosure of EFT fees.* An institution is required to disclose all fees for EFTs or the right to make them. Others fees (for example, minimum-balance fees, stop-payment fees, or account overdrafts) may, but need not, be disclosed (but see Regulation DD, 12 CFR Part 230. An institution is not required to disclose fees for inquiries made at an ATM since no transfer of funds is involved.

2. *Fees also applicable to non-EFT.* A per-item fee for EFTs must be disclosed even if the same fee is imposed on nonelectronic transfers. If a per-item fee is imposed only under certain conditions, such as when the transactions in the cycle exceed a certain number, those conditions must be disclosed. Itemization of the various fees may be provided on the disclosure statement or on an accompanying document that is referenced in the statement.

3. *Interchange system fees.* Fees paid by the account-holding institution to the operator of a shared or interchange ATM system need not be disclosed, unless they are imposed on

the consumer by the account-holding institution. Fees for use of an ATM that are debited directly from the consumer's account by an institution other than the account-holding institution (for example, fees included in the transfer amount) need not be disclosed. (See §205.7(b)(11) for the general notice requirement regarding fees that may be imposed by ATM operators and by a network used to complete the transfer.)

Paragraph 7(b)(9)—Confidentiality

1. *Information provided to third parties.* An institution must describe the circumstances under which any information relating to an account to or from which EFTs are permitted will be made available to third parties, not just information concerning those EFTs. The term ''third parties'' includes affiliates such as other subsidiaries of the same holding company.

Paragraph 7(b)(10)—Error Resolution

1. *Substantially similar.* The error resolution notice must be substantially similar to the model form in appendix A of part 205. An institution may use different wording so long as the substance of the notice remains the same, may delete inapplicable provisions (for example, the requirement for written confirmation of an oral notification), and may substitute substantive state law requirements affording greater consumer protection than Regulation E.

2. *Extended time-period for certain transactions.* To take advantage of the longer time periods for resolving errors under §205.11(c)(3) (for new accounts as defined in Regulation CC (12 CFR part 229), transfers initiated outside the United States, or transfers resulting from POS debit-card transactions), a financial institution must have disclosed these longer time periods. Similarly, an institution that relies on the exception from provisional crediting in §205.11(c)(2) for accounts subject to Regulation T (12 CFR part 220) must have disclosed accordingly.

SECTION 205.8—CHANGE-IN-TERMS NOTICE; ERROR RESOLUTION NOTICE

8(a) Change-in-Terms Notice

1. *Form of notice.* No specific form or wording is required for a change-in-terms notice. The notice may appear on a periodic statement, or may be given by sending a copy of a revised disclosure statement, provided attention is directed to the change (for example, in a cover letter referencing the changed term).

2. *Changes not requiring notice.* The following changes do not require disclosure:

i. Closing some of an institution's ATMs;

ii. Cancellation of an access device.

3. *Limitations on transfers.* When the initial disclosures omit details about limitations because secrecy is essential to the security of the account or system, a subsequent increase in those limitations need not be disclosed if secrecy is still essential. If, however, an institution had no limits in place when the initial disclosures were given and now wishes to impose limits for the first time, it must disclose at least the fact that limits have been adopted. (See also §205.7(b)(4) and the related commentary.)

4. *Change in telephone number or address.* When a financial institution changes the telephone number or address used for reporting possible unauthorized transfers, a change-in-terms notice is required only if the institution will impose liability on the consumer for unauthorized transfers under §205.6. (See also §205.6(a) and the related commentary.)

8(b) Error Resolution Notice

1. *Change between annual and periodic notice.* If an institution switches from an annual to a periodic notice, or vice versa, the first notice under the new method must be sent no later than 12 months after the last notice sent under the old method.

2. *Exception for new accounts.* For new accounts, disclosure of the longer error resolution time periods under §205.11(c)(3) is not required in the annual error resolution notice or in the notice that may be provided with each periodic statement as an alternative to the annual notice.

SECTION 205.9—RECEIPTS AT ELECTRONIC TERMINALS; PERIODIC STATEMENTS

9(a) Receipts at Electronic Terminals

1. *Receipts furnished only on request.* The regulation requires that a receipt be ''made available.'' A financial institution may program its electronic terminals to provide a receipt only to consumers who elect to receive one.

2. *Third party providing receipt.* An account-holding institution may make terminal receipts available through third parties such as merchants or other financial institutions.

3. *Inclusion of promotional material.* A financial institution may include promotional material on receipts if the required information is set forth clearly (for example, by separating it from the promotional material). In addition, a consumer may not be required to surrender the receipt or that portion containing the required disclosures in order to take advantage of a promotion.

4. *Transfer not completed.* The receipt requirement does not apply to a transfer that is initiated but not completed (for example, if the ATM is out of currency or the consumer decides not to complete the transfer).

5. *Receipts not furnished due to inadvertent error*. If a receipt is not provided to the consumer because of a bona fide unintentional error, such as when a terminal runs out of paper or the mechanism jams, no violation results if the financial institution maintains procedures reasonably adapted to avoid such occurrences.

6. *Multiple transfers*. If the consumer makes multiple transfers at the same time, the financial institution may document them on a single or on separate receipts.

Paragraph 9(a)(1)—Amount

1. *Disclosure of transaction fee*. The required display of a fee amount on or at the terminal may be accomplished by displaying the fee on a sign at the terminal or on the terminal screen for a reasonable duration. Displaying the fee on a screen provides adequate notice, as long as a consumer is given the option to cancel the transaction after receiving notice of a fee. (See §205.16 for the notice requirements applicable to ATM operators that impose a fee for providing EFT services.)

2. *Relationship between §205.9(a)(1) and §205.16*. The requirements of §§205.9(a)(1) and 205.16 are similar but not identical.

i. Section 205.9(a)(1) requires that if the amount of the transfer as shown on the receipt will include the fee, then the fee must be disclosed either on a sign on or at the terminal, or on the terminal screen. Section 205.16 requires disclosure both on a sign on or at the terminal (in a prominent and conspicuous location) and on the terminal screen. Section 205.16 permits disclosure on a paper notice as an alternative to the on-screen disclosure.

ii. The disclosure of the fee on the receipt under §205.9(a)(1) cannot be used to comply with the alternative paper disclosure procedure under §205.16, if the receipt is provided at the completion of the transaction because, pursuant to the statute, the paper notice must be provided before the consumer is committed to paying the fee.

iii. Section 205.9(a)(1) applies to any type of electronic terminal as defined in Regulation E (for example, to POS terminals as well as to ATMs), while §205.16 applies only to ATMs.

Paragraph 9(a)(2)—Date

1. *Calendar date*. The receipt must disclose the calendar date on which the consumer uses the electronic terminal. An accounting or business date may be disclosed in addition if the dates are clearly distinguished.

Paragraph 9(a)(3)—Type

1. *Identifying transfer and account*. Examples identifying the type of transfer and the type of the consumer's account include ''withdrawal from checking,'' ''transfer from savings to checking,'' or ''payment from savings.''

2. *Exception*. Identification of an account is not required when the consumer can access only one asset account at a particular time or terminal, even if the access device can normally be used to access more than one account. For example, the consumer may be able to access only one particular account at terminals not operated by the account-holding institution, or may be able to access only one particular account when the terminal is off-line. The exception is available even if, in addition to accessing one asset account, the consumer also can access a credit line.

3. *Access to multiple accounts*. If the consumer can use an access device to make transfers to or from different accounts of the same type, the terminal receipt must specify which account was accessed, such as ''withdrawal from checking I'' or ''withdrawal from checking II.'' If only one account besides the primary checking account can be debited, the receipt can identify the account as ''withdrawal from other account.''

4. *Generic descriptions*. Generic descriptions may be used for accounts that are similar in function, such as share draft or NOW accounts and checking accounts. In a shared system, for example, when a credit union member initiates transfers to or from a share draft account at a terminal owned or operated by a bank, the receipt may identify a withdrawal from the account as a ''withdrawal from checking.''

5. *Point-of-sale transactions*. There is no prescribed terminology for identifying a transfer at a merchant's POS terminal. A transfer may be identified, for example, as a purchase, a sale of goods or services, or a payment to a third party. When a consumer obtains cash from a POS terminal in addition to purchasing goods, or obtains cash only, the documentation need not differentiate the transaction from one involving the purchase of goods.

Paragraph 9(a)(5)—Terminal Location

1. *Options for identifying terminal*. The institution may provide either:

i. The city, state or foreign country, and the information in §§205.9(a)(5) (i), (ii), or (iii), or

ii. A number or a code identifying the terminal. If the institution chooses the second option, the code or terminal number identifying the terminal where the transfer is initiated may be given as part of a transaction code.

2. *Omission of city name*. The city may be omitted if the generally accepted name (such as a branch name) contains the city name.

3. *Omission of a state*. A state may be omitted from the location information on the receipt if:

i. All the terminals owned or operated by the financial institution providing the statement (or by the system in which it participates) are located in that state, or

ii. All transfers occur at terminals located within 50 miles of the financial institutions's main office.

4. *Omission of a city and state.* A city and state may be omitted if all the terminals owned or operated by the financial institution providing the statement (or by the system in which it participates) are located in the same city.

Paragraph 9(a)(5)(i)

1. *Street address.* The address should include number and street (or intersection); the number (or intersecting street) may be omitted if the street alone uniquely identifies the terminal location.

Paragraph 9(a)(5)(ii)

1. *Generally accepted name.* Examples of a generally accepted name for a specific location include a branch of the financial institution, a shopping center, or an airport.

Paragraph 9(a)(5)(iii)

1. *Name of owner or operator of terminal.* Examples of an owner or operator of a terminal are a financial institution or a retail merchant.

Paragraph 9(a)(6)—Third Party Transfer

1. *Omission of third-party name.* The receipt need not disclose the third-party name if the name is provided by the consumer in a form that is not machine readable (for example, if the consumer indicates the payee by depositing a payment stub into the ATM). If, on the other hand, the consumer keys in the identity of the payee, the receipt must identify the payee by name or by using a code that is explained elsewhere on the receipt.

2. *Receipt as proof of payment.* Documentation required under the regulation constitutes prima facie proof of a payment to another person, except in the case of a terminal receipt documenting a deposit.

9(b) Periodic Statements

1. *Periodic cycles.* Periodic statements may be sent on a cycle that is shorter than monthly. The statements must correspond to periodic cycles that are reasonably equal, that is, do not vary by more than four days from the regular cycle. The requirement of reasonably equal cycles does not apply when an institution changes cycles for operational or other reasons, such as to establish a new statement day or date.

2. *Interim statements.* Generally, a financial institution must provide periodic statements for each monthly cycle in which an EFT occurs, and at least quarterly if a transfer has not occurred. Where EFTs occur between regularly-scheduled cycles, interim statements must be provided. For example, if an institution issues quarterly statements at the end of March, June, September and December, and the consumer initiates an EFT in February, an interim statement for February must be provided. If an interim statement contains interest or rate information, the institution must comply with Regulation DD, 12 CFR 230.6.

3. *Inactive accounts.* A financial institution need not send statements to consumers whose accounts are inactive as defined by the institution.

4. *Statement pickup.* A financial institution may permit, but may not require, consumers to pick up their periodic statements at the financial institution.

5. *Periodic statements limited to EFT activity.* A financial institution that uses a passbook as the primary means for displaying account activity, but also allows the account to be debited electronically, may provide a periodic statement requirement that reflects only the EFTs and other required disclosures (such as charges, account balances, and address and telephone number for inquiries). (See §205.9(c)(1)(i) for the exception applicable to preauthorized transfers for passbook accounts.)

6. *Codes and accompanying documents.* To meet the documentation requirements for periodic statements, a financial institution may:

i. Include copies of terminal receipts to reflect transfers initiated by the consumer at electronic terminals;

ii. Enclose posting memos, deposit slips, and other documents that, together with the statement, disclose all the required information;

iii. Use codes for names of third parties or terminal locations and explain the information to which the codes relate on an accompanying document.

Paragraph 9(b)(1)—Transaction Information

1. *Information obtained from others.* While financial institutions must maintain reasonable procedures to ensure the integrity of data obtained from another institution, a merchant, or other third parties, verification of each transfer that appears on the periodic statement is not required.

Paragraph 9(b)(1)(i)

1. *Incorrect deposit amount.* If a financial institution determines that the amount actually deposited at an ATM is different from the amount entered by the consumer, the institution need not immediately notify the consumer of the discrepancy. The periodic statement reflecting the deposit may show either the correct amount of the deposit or the amount entered by the consumer along with the institution's adjustment.

Paragraph 9(b)(1)(iii)

1. *Type of transfer*. There is no prescribed terminology for describing a type of transfer. Placement of the amount of the transfer in the debit or the credit column is sufficient if other information on the statement, such as a terminal location or third-party name, enables the consumer to identify the type of transfer.

Paragraph 9(b)(1)(iv)

1. *Nonproprietary terminal in network*. An institution need not reflect on the periodic statement the street addresses, identification codes, or terminal numbers for transfers initiated in a shared or interchange system at a terminal operated by an institution other than the account-holding institution. The statement must, however, specify the entity that owns or operates the terminal, plus the city and state.

Paragraph 9(b)(1)(v)

1. *Recurring payments by government agency*. The third-party name for recurring payments from federal, state, or local governments need not list the particular agency. For example, ''U.S. gov't'' or ''N.Y. sal'' will suffice.

2. *Consumer as third-party payee*. If a consumer makes an electronic fund transfer to another consumer, the financial institution must identify the recipient by name (not just by an account number, for example).

3. *Terminal location/third party*. A single entry may be used to identify both the terminal location and the name of the third party to or from whom funds are transferred. For example, if a consumer purchases goods from a merchant, the name of the party to whom funds are transferred (the merchant) and the location of the terminal where the transfer is initiated will be satisfied by a disclosure such as ''XYZ Store, Anytown, Ohio.''

4. *Account-holding institution as third party*. Transfers to the account-holding institution (by ATM, for example) must show the institution as the recipient, unless other information on the statement (such as, ''loan payment from checking'') clearly indicates that the payment was to the account-holding institution.

5. *Consistency in third-party identity*. The periodic statement must disclose a third-party name as it appeared on the receipt, whether it was, for example, the ''dba'' (doing business as) name of the third party or the parent corporation's name.

6. *Third-party identity on deposits at electronic terminal*. A financial institution need not identify third parties whose names appear on checks, drafts, or similar paper instruments deposited to the consumer's account at an electronic terminal.

Paragraph 9(b)(3)—Fees

1. *Disclosure of fees*. The fees disclosed may include fees for EFTs and for other nonelectronic services, and both fixed fees and per-item fees; they may be given as a total or may be itemized in part or in full.

2. *Fees in interchange system*. An account-holding institution must disclose any fees it imposes on the consumer for EFTs, including fees for ATM transactions in an interchange or shared ATM system. Fees for use of an ATM imposed on the consumer by an institution other than the account-holding institution and included in the amount of the transfer by the terminal-operating institution need not be separately disclosed on the periodic statement.

3. *Finance charges*. The requirement to disclose any fees assessed against the account does not include a finance charge imposed on the account during the statement period.

Paragraph 9(b)(4)—Account Balances

1. *Opening and closing balances*. The opening and closing balances must reflect both EFTs and other account activity.

Paragraph 9(b)(5)—Address and Telephone Number for Inquiries

1. *Telephone number*. A single telephone number, preceded by the ''direct inquiries to'' language, will satisfy the requirements of § 205.9(b)(5) and (6).

Paragraph 9(b)(6)—Telephone Number for Preauthorized Transfers

1. *Telephone number*. See comment 9(b)(5)–1.

9(c) Exceptions to the Periodic Statement Requirements for Certain Accounts

1. *Transfers between accounts*. The regulation provides an exception from the periodic statement requirement for certain intra-institutional transfers between a consumer's accounts. The financial institution must still comply with the applicable periodic statement requirements for any other EFTs to or from the account. For example, a Regulation E statement must be provided quarterly for an account that also receives payroll deposits electronically, or for any month in which an account is also accessed by a withdrawal at an ATM.

Paragraph 9(c)(1)—Preauthorized Transfers to Accounts

1. *Accounts that may be accessed only by preauthorized transfers to the account*. The exception for ''accounts that may be accessed only by preauthorized transfers to the account'' includes accounts that can be accessed by means other than EFTs, such as checks. If, however, an account may be accessed by any EFT other than preauthorized credits to the account, such as

preauthorized debits or ATM transactions, the account does not qualify for the exception.

2. *Reversal of direct deposits.* For direct-deposit-only accounts, a financial institution must send a periodic statement at least quarterly. A reversal of a direct deposit to correct an error does not trigger the monthly statement requirement when the error represented a credit to the wrong consumer's account, a duplicate credit, or a credit in the wrong amount. (See also comment 2(m)–5.)

9(d) Documentation for Foreign-Initiated Transfers

1. *Foreign-initiated transfers.* An institution must make a good faith effort to provide all required information for foreign-initiated transfers. For example, even if the institution is not able to provide a specific terminal location, it should identify the country and city in which the transfer was initiated.

SECTION 205.10—PREAUTHORIZED TRANSFERS

10(a) Preauthorized Transfers to Consumer's Account

Paragraph 10(a)(1)—Notice by Financial Institution

1. *Content.* No specific language is required for notice regarding receipt of a preauthorized transfer. Identifying the deposit is sufficient; however, simply providing the current account balance is not.

2. *Notice of credit.* A financial institution may use different methods of notice for various types or series of preauthorized transfers, and the institution need not offer consumers a choice of notice methods.

3. *Positive notice.* A periodic statement sent within two business days of the scheduled transfer, showing the transfer, can serve as notice of receipt.

4. *Negative notice.* The absence of a deposit entry (on a periodic statement sent within two business days of the scheduled transfer date) will serve as negative notice.

5. *Telephone notice.* If a financial institution uses the telephone notice option, it should be able in most instances to verify during a consumer's initial call whether a transfer was received. The institution must respond within two business days to any inquiry not answered immediately.

6. *Phone number for passbook accounts.* The financial institution may use any reasonable means necessary to provide the telephone number to consumers with passbook accounts that can only be accessed by preauthorized credits and that do not receive periodic statements. For example, it may print the telephone number in the passbook, or include the number with the annual error resolution notice.

7. *Telephone line availability.* To satisfy the readily-available standard, the financial institution must provide enough telephone lines so that consumers get a reasonably prompt response. The institution need only provide telephone service during normal business hours. Within its primary service area, an institution must provide a local or toll-free telephone number. It need not provide a toll-free number or accept collect long-distance calls from outside the area where it normally conducts business.

10(b) Written Authorization for Preauthorized Transfers From Consumer's Account

1. *Preexisting authorizations.* The financial institution need not require a new authorization before changing from paper-based to electronic debiting when the existing authorization does not specify that debiting is to occur electronically or specifies that the debiting will occur by paper means. A new authorization also is not required when a successor institution begins collecting payments.

2. *Authorization obtained by third party.* The account-holding financial institution does not violate the regulation when a third-party payee fails to obtain the authorization in writing or fails to give a copy to the consumer; rather, it is the third-party payee that is in violation of the regulation.

3. *Written authorization for preauthorized transfers.* The requirement that preauthorized EFTs be authorized by the consumer ''only by a writing'' cannot be met by a payee's signing a written authorization on the consumer's behalf with only an oral authorization from the consumer. A tape recording of a telephone conversation with a consumer who agrees to preauthorized debits also does not constitute written authorization for purposes of this provision.

4. *Use of a confirmation form.* A financial institution or designated payee may comply with the requirements of this section in various ways. For example, a payee may provide the consumer with two copies of a preauthorization form, and ask the consumer to sign and return one and to retain the second copy.

5. *Similarly authenticated.* The similarly authenticated standard permits signed, written authorizations to be provided electronically. The writing and signature requirements of this section are satisfied by complying with the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 *et seq.*, which defines electronic records and electronic signatures. Examples of electronic signatures include, but are not limited to, digital signatures and security codes. A security code need not originate with the account-holding institution. The authorization process should evidence the consumer's identity and assent to the authorization. The person that obtains the authorization must provide a copy of the terms of the authorization to the consumer either electronically or

in paper form. Only the consumer may authorize the transfer and not, for example, a third-party merchant on behalf of the consumer.

6. *Requirements of an authorization.* An authorization is valid if it is readily identifiable as such and the terms of the preauthorized transfer are clear and readily understandable.

7. *Bona fide error.* Consumers sometimes authorize third-party payees, by telephone or on-line, to submit recurring charges against a credit card account. If the consumer indicates use of a credit card account when in fact a debit card is being used, the payee does not violate the requirement to obtain a written authorization if the failure to obtain written authorization was not intentional and resulted from a bona fide error, and if the payee maintains procedures reasonably adapted to avoid any such error. If the payee is unable to determine, at the time of the authorization, whether a credit or debit card number is involved, and later finds that the card used is a debit card, the payee must obtain a written and signed or (where appropriate) a similarly authenticated authorization as soon as reasonably possible, or cease debiting the consumer's account.

10(c) Consumer's Right To Stop Payment

1. *Stop-payment order.* The financial institution must honor an oral stop-payment order made at least three business days before a scheduled debit. If the debit item is resubmitted, the institution must continue to honor the stop-payment order (for example, by suspending all subsequent payments to the payee-originator until the consumer notifies the institution that payments should resume).

2. *Revocation of authorization.* Once a financial institution has been notified that the consumer's authorization is no longer valid, it must block all future payments for the particular debit transmitted by the designated payee-originator. The institution may not wait for the payee-originator to terminate the automatic debits. The institution may confirm that the consumer has informed the payee-originator of the revocation (for example, by requiring a copy of the consumer's revocation as written confirmation to be provided within fourteen days of an oral notification). If the institution does not receive the required written confirmation within the fourteen-day period, it may honor subsequent debits to the account.

10(d) Notice of Transfers Varying in Amount

Paragraph 10(d)(1)—Notice

1. *Preexisting authorizations.* A financial institution holding the consumer's account does not violate the regulation if the designated payee fails to provide notice of varying amounts.

Paragraph 10(d)(2)—Range

1. *Range.* A financial institution or designated payee that elects to offer the consumer a specified range of amounts for debiting (in lieu of providing the notice of transfers varying in amount) must provide an acceptable range that could be anticipated by the consumer. For example, if the transfer is for payment of a gas bill, an appropriate range might be based on the highest bill in winter and the lowest bill in summer.

10(e) Compulsory Use

Paragraph 10(e)(1)—Credit

1. *Loan payments.* Creditors may not require repayment of loans by electronic means on a preauthorized, recurring basis. A creditor may offer a program with a reduced annual percentage rate or other cost-related incentive for an automatic repayment feature, provided the program with the automatic payment feature is not the only loan program offered by the creditor for the type of credit involved. Examples include:

i. Mortgages with graduated payments in which a pledged savings account is automatically debited during an initial period to supplement the monthly payments made by the borrower.

ii. Mortgage plans calling for preauthorized biweekly payments that are debited electronically to the consumer's account and produce a lower total finance charge.

2. *Overdraft.* A financial institution may require the automatic repayment of an overdraft credit plan even if the overdraft extension is charged to an open-end account that may be accessed by the consumer in ways other than by overdrafts.

Paragraph 10(e)(2)—Employment or Government Benefit

1. *Payroll.* An employer (including a financial institution) may not require its employees to receive their salary by direct deposit to any particular institution. An employer may require direct deposit of salary by electronic means if employees are allowed to choose the institution that will receive the direct deposit. Alternatively, an employer may give employees the choice of having their salary deposited at a particular institution (designated by the employer) or receiving their salary by another means, such as by check or cash.

SECTION 205.11—PROCEDURES FOR RESOLVING ERRORS

11(a) Definition of Error

1. *Terminal location*. With regard to deposits at an ATM, a consumer's request for the terminal location or other information triggers the error resolution procedures, but the financial institution need only provide the ATM location if it has captured that information.

2. *Verifying an account debit or credit*. If the consumer contacts the financial institution to ascertain whether a payment (for example, in a home-banking or bill-payment program) or any other type of EFT was debited to the account, or whether a deposit made via ATM, preauthorized transfer, or any other type of EFT was credited to the account, without asserting an error, the error resolution procedures do not apply.

3. *Loss or theft of access device*. A financial institution is required to comply with the error resolution procedures when a consumer reports the loss or theft of an access device if the consumer also alleges possible unauthorized use as a consequence of the loss or theft.

4. *Error asserted after account closed*. The financial institution must comply with the error resolution procedures when a consumer properly asserts an error, even if the account has been closed.

5. *Request for documentation or information*. A request for documentation or other information must be treated as an error unless it is clear that the consumer is requesting a duplicate copy for tax or other record-keeping purposes.

11(b) Notice of Error From Consumer

Paragraph 11(b)(1)—Timing; Contents

1. *Content of error notice*. The notice of error is effective even if it does not contain the consumer's account number, so long as the financial institution is able to identify the account in question. For example, the consumer could provide a Social Security number or other unique means of identification.

2. *Investigation pending receipt of information*. While a financial institution may request a written, signed statement from the consumer relating to a notice of error, it may not delay initiating or completing an investigation pending receipt of the statement.

3. *Statement held for consumer*. When a consumer has arranged for periodic statements to be held until picked up, the statement for a particular cycle is deemed to have been transmitted on the date the financial institution first makes the statement available to the consumer.

4. *Failure to provide statement*. When a financial institution fails to provide the consumer with a periodic statement, a request for a copy is governed by this section if the consumer gives notice within 60 days from the date on which the statement should have been transmitted.

5. *Discovery of error by institution*. The error resolution procedures of this section apply when a notice of error is received from the consumer, and not when the financial institution itself discovers and corrects an error.

6. *Notice at particular phone number or address*. A financial institution may require the consumer to give notice only at the telephone number or address disclosed by the institution, provided the institution maintains reasonable procedures to refer the consumer to the specified telephone number or address if the consumer attempts to give notice to the institution in a different manner.

Paragraph 11(b)(2)—Written Confirmation

1. *Written confirmation-of-error notice*. If the consumer sends a written confirmation of error to the wrong address, the financial institution must process the confirmation through normal procedures. But the institution need not provisionally credit the consumer's account if the written confirmation is delayed beyond 10 business days in getting to the right place because it was sent to the wrong address.

11(c) Time Limits and Extent of Investigation

1. *Notice to consumer*. Unless otherwise indicated in this section, the financial institution may provide the required notices to the consumer either orally or in writing.

2. *Written confirmation of oral notice*. A financial institution must begin its investigation promptly upon receipt of an oral notice. It may not delay until it has received a written confirmation.

3. *Charges for error resolution*. If a billing error occurred, whether as alleged or in a different amount or manner, the financial institution may not impose a charge related to any aspect of the error-resolution process (including charges for documentation or investigation). Since the act grants the consumer error-resolution rights, the institution should avoid any chilling effect on the good-faith assertion of errors that might result if charges are assessed when no billing error has occurred.

4. *Correction without investigation*. A financial institution may make, without investigation, a final correction to a consumer's account in the amount or manner alleged by the consumer to be in error, but must comply with all other applicable requirements of § 205.11.

5. *Correction notice*. A financial institution may include the notice of correction on a

periodic statement that is mailed or delivered within the 10-business-day or 45-calendar-day time limits and that clearly identifies the correction to the consumer's account. The institution must determine whether such a mailing will be prompt enough to satisfy the requirements of this section, taking into account the specific facts involved.

6. *Correction of an error.* If the financial institution determines an error occurred, within either the 10-day or 45-day period, it must correct the error (subject to the liability provisions of §§205.6 (a) and (b)) including, where applicable, the crediting of interest and the refunding of any fees imposed by the institution. In a combined credit/EFT transaction, for example, the institution must refund any finance charges incurred as a result of the error. The institution need not refund fees that would have been imposed whether or not the error occurred.

7. *Extent of required investigation.* A financial institution complies with its duty to investigate, correct, and report its determination regarding an error described in §205.11(a)(1)(vii) by transmitting the requested information, clarification, or documentation within the time limits set forth in §205.11(c). If the institution has provisionally credited the consumer's account in accordance with §205.11(c)(2), it may debit the amount upon transmitting the requested information, clarification, or documentation.

Paragraph 11(c)(2)(i)

1. *Compliance with all requirements.* Financial institutions exempted from provisionally crediting a consumer's account under §205.11(c)(2)(i) (A) and (B) must still comply with all other requirements of §205.11.

Paragraph 11(c)(3)—Extension of Time Periods

1. *POS debit card transactions.* The extended deadlines for investigating errors resulting from POS debit card transactions apply to all debit card transactions, including those for cash only, at merchants' POS terminals, and also including mail and telephone orders. The deadlines do not apply to transactions at an ATM, however, even though the ATM may be in a merchant location.

Paragraph 11(c)(4)—Investigation

1. *Third parties.* When information or documentation requested by the consumer is in the possession of a third party with whom the financial institution does not have an agreement, the institution satisfies the error resolution requirement by so advising the consumer within the specified time period.

2. *Scope of investigation.* When an alleged error involves a payment to a third party under the financial institution's telephone bill-payment plan, a review of the institution's own records is sufficient, assuming no agreement exists between the institution and the third party concerning the bill-payment service.

3. *POS transfers.* When a consumer alleges an error involving a transfer to a merchant via a POS terminal, the institution must verify the information previously transmitted when executing the transfer. For example, the financial institution may request a copy of the sales receipt to verify that the amount of the transfer correctly corresponds to the amount of the consumer's purchase.

4. *Agreement.* An agreement that a third party will honor an access device is an agreement for purposes of this paragraph. A financial institution does not have an agreement for purposes of §205.11(c)(4)(ii) solely because it participates in transactions that occur under the federal recurring payments programs, or that are cleared through an ACH or similar arrangement for the clearing and settlement of fund transfers generally, or because it agrees to be bound by the rules of such an arrangement.

11(d) Procedures if Financial Institution Determines No Error or Different Error Occurred

1. *Error different from that alleged.* When a financial institution determines that an error occurred in a manner or amount different from that described by the consumer, it must comply with the requirements of both §205.11 (c) and (d), as relevant. The institution may give the notice of correction and the explanation separately or in a combined form.

Paragraph 11(d)(1)—Written Explanation

1. *Request for documentation.* When a consumer requests copies of documents, the financial institution must provide the copies in an understandable form. If an institution relied on magnetic tape it must convert the applicable data into readable form, for example, by printing it and explaining any codes.

Paragraph 11(d)(2)—Debiting Provisional Credit

1. *Alternative procedure for debiting of credited funds.* The financial institution may comply with the requirements of this section by notifying the consumer that the consumer's account will be debited five business days from the transmittal of the notification, specifying the calendar date on which the debiting will occur.

2. *Fees for overdrafts.* The financial institution may not impose fees for items it is required to honor under §205.11. It may, however, impose any normal transaction or item fee that is unrelated to an overdraft resulting from the debiting. If the account is still overdrawn after five business days, the institution may impose the fees or finance

charges to which it is entitled, if any, under an overdraft credit plan.

11(e) Reassertion of Error

1. *Withdrawal of error; right to reassert.* The financial institution has no further error resolution responsibilities if the consumer voluntarily withdraws the notice alleging an error. A consumer who has withdrawn an allegation of error has the right to reassert the allegation unless the financial institution had already complied with all of the error resolution requirements before the allegation was withdrawn. The consumer must do so, however, within the original 60-day period.

SECTION 205.12—RELATION TO OTHER LAWS

12(a) Relation to Truth in Lending

1. *Determining applicable regulation.* i. For transactions involving access devices that also function as credit cards, whether Regulation E or Regulation Z (12 CFR part 226) applies depends on the nature of the transaction. For example, if the transaction solely involves an extension of credit, and does not include a debit to a checking account (or other consumer asset account), the liability limitations and error resolution requirements of Regulation Z apply. If the transaction debits a checking account only (with no credit extended), the provisions of Regulation E apply. If the transaction debits a checking account but also draws on an overdraft line of credit attached to the account, Regulation E's liability limitations apply, in addition to §§ 226.13 (d) and (g) of Regulation Z (which apply because of the extension of credit associated with the overdraft feature on the checking account). If a consumer's access device is also a credit card and the device is used to make unauthorized withdrawals from a checking account, but also is used to obtain unauthorized cash advances directly from a line of credit that is separate from the checking account, both Regulation E and Regulation Z apply.

ii. The following examples illustrate these principles:

A. A consumer has a card that can be used either as a credit card or a debit card. When used as a debit card, the card draws on the consumer's checking account. When used as a credit card, the card draws only on a separate line of credit. If the card is stolen and used as a credit card to make purchases or to get cash advances at an ATM from the line of credit, the liability limits and error resolution provisions of Regulation Z apply; Regulation E does not apply.

B. In the same situation, if the card is stolen and is used as a debit card to make purchases or to get cash withdrawals at an ATM from the checking account, the liability limits and error resolution provisions of Regulation E apply; Regulation Z does not apply.

C. In the same situation, assume the card is stolen and used both as a debit card and as a credit card; for example, the thief makes some purchases using the card as a debit card, and other purchases using the card as a credit card. Here, the liability limits and error resolution provisions of Regulation E apply to the unauthorized transactions in which the card was used as a debit card, and the corresponding provisions of Regulation Z apply to the unauthorized transactions in which the card was used as a credit card.

D. Assume a somewhat different type of card, one that draws on the consumer's checking account and can also draw on an overdraft line of credit attached to the checking account. There is no separate line of credit, only the overdraft line, associated with the card. In this situation, if the card is stolen and used, the liability limits and the error resolution provisions of Regulation E apply. In addition, if the use of the card has resulted in accessing the overdraft line of credit, the error resolution provisions of § 226.13(d) and (g) of Regulation Z also apply, but not the other error resolution provisions of Regulation Z.

2. *Issuance rules.* For access devices that also constitute credit cards, the issuance rules of Regulation E apply if the only credit feature is a preexisting credit line attached to the asset account to cover overdrafts (or to maintain a specified minimum balance). Regulation Z (12 CFR part 226) rules apply if there is another type of credit feature, for example, one permitting direct extensions of credit that do not involve the asset account.

12(b) Preemption of Inconsistent State Laws

1. *Specific determinations.* The regulation prescribes standards for determining whether state laws that govern EFTs are preempted by the act and the regulation. A state law that is inconsistent may be preempted even if the Board has not issued a determination. However, nothing in § 205.12(b) provides a financial institution with immunity for violations of state law if the institution chooses not to make state disclosures and the Board later determines that the state law is not preempted.

2. *Preemption determination.* The Board determined that certain provisions in the state law of Michigan are preempted by the federal law, effective March 30, 1981:

i. Definition of unauthorized use. Section 5(4) is preempted to the extent that it relates to the section of state law governing consumer liability for unauthorized use of an access device.

ii. Consumer liability for unauthorized use of an account. Section 14 is inconsistent with § 205.6 and is less protective of the consumer than the federal law. The state law places liability on the consumer for the unauthorized use of an account in cases involving the consumer's negligence. Under the federal law, a

consumer's liability for unauthorized use is not related to the consumer's negligence and depends instead on the consumer's promptness in reporting the loss or theft of the access device.

iii. Error resolution. Section 15 is preempted because it is inconsistent with §205.11 and is less protective of the consumer than the federal law. The state law allows financial institutions up to 70 days to resolve errors, whereas the federal law generally requires errors to be resolved within 45 days.

iv. Receipts and periodic statements. Sections 17 and 18 are preempted because they are inconsistent with §205.9. The state provisions require a different disclosure of information than does the federal law. The receipt provision is also preempted because it allows the consumer to be charged for receiving a receipt if a machine cannot furnish one at the time of a transfer.

SECTION 205.13—ADMINISTRATIVE ENFORCEMENT; RECORD RETENTION

13(b) Record Retention

1. *Requirements.* A financial institution need not retain records that it has given disclosures and documentation to each consumer; it need only retain evidence demonstrating that its procedures reasonably ensure the consumers' receipt of required disclosures and documentation.

SECTION 205.14—ELECTRONIC FUND TRANSFER SERVICE PROVIDER NOT HOLDING CONSUMER'S ACCOUNT

14(a) Electronic Fund Transfer Service Providers Subject to Regulation

1. *Applicability.* This section applies only when a service provider issues an access device to a consumer for initiating transfers to or from the consumer's account at a financial institution and the two entities have no agreement regarding this EFT service. If the service provider does not issue an access device to the consumer for accessing an account held by another institution, it does not qualify for the treatment accorded by §205.14. For example, this section does not apply to an institution that initiates preauthorized payroll deposits to consumer accounts on behalf of an employer. By contrast, §205.14 can apply to an institution that issues a code for initiating telephone transfers to be carried out through the ACH from a consumer's account at another institution. This is the case even if the consumer has accounts at both institutions.

2. *ACH agreements.* The ACH rules generally do not constitute an agreement for purposes of this section. However, an ACH agreement under which members specifically agree to honor each other's debit cards is an ''agreement,'' and thus this section does not apply.

14(b) Compliance by Electronic Fund Transfer Service Provider

1. *Liability.* The service provider is liable for unauthorized EFTs that exceed limits on the consumer's liability under §205.6.

Paragraph 14(b)(1)—Disclosures and Documentation

1. *Periodic statements from electronic fund transfer service provider.* A service provider that meets the conditions set forth in this paragraph does not have to issue periodic statements. A service provider that does not meet the conditions need only include on periodic statements information about transfers initiated with the access device it has issued.

Paragraph 14(b)(2)—Error Resolution

1. *Error resolution.* When a consumer notifies the service provider of an error, the EFT service provider must investigate and resolve the error in compliance with §205.11 as modified by §205.14(b)(2). If an error occurred, any fees or charges imposed as a result of the error, either by the service provider or by the account-holding institution (for example, overdraft or dishonor fees) must be reimbursed to the consumer by the service provider.

14(c) Compliance by Account-Holding Institution

Paragraph 14(c)(1)

1. *Periodic statements from account-holding institution.* The periodic statement provided by the account-holding institution need only contain the information required by §205.9(b)(1).

SECTION 205.16—DISCLOSURES AT AUTOMATED TELLER MACHINES

16(b) General

Paragraph 16(b)(1)

1. *Specific notices.* An ATM operator that imposes a fee for a specific type of transaction such as a cash withdrawal, but not a balance inquiry, may provide a general statement that a fee will be imposed for providing EFT services or may specify the type of EFT for which a fee is imposed.

SECTION 205.17—REQUIREMENTS FOR ELECTRONIC COMMUNICATION

17(b) General Rule

1. *Relationship to the E-Sign Act.* The E-Sign Act authorizes the use of electronic disclosures. It does not affect any requirement imposed under this part other than a provision that requires disclosures to be in paper form, and it does not affect the content or timing of disclosures. Electronic disclosures are subject to the regulation's format, timing,

and retainability rules and the clear and readily understandable standard. For example, to satisfy the clear and readily understandable standard for disclosures, electronic disclosures must use visual text.

2. *Clear and readily understandable standard.* A financial institution must provide electronic disclosures using a clear and readily understandable format. Also, in accordance with the E-Sign Act:

i. The institution must disclose the requirements for accessing and retaining disclosures in that format;

ii. The consumer must demonstrate the ability to access the information electronically and affirmatively consent to electronic delivery; and

iii. The institution must provide the disclosures in accordance with the specified requirements.

3. *Timing and effective delivery when a consumer signs up for an EFT service on-line.* When a consumer contracts for an EFT service on the Internet and will be able immediately to initiate a fund transfer, a financial institution satisfies the timing requirements under this part if, at the time the consumer contracts for the service or before the first transfer is made, the disclosures automatically appear on the screen, even if multiple screens are required to view the entire disclosure. Or a financial institution may provide a link to electronic disclosures, as long as consumers cannot bypass the link and they are required to access the disclosures before initiating the first transfer. The institution is not required to confirm that the consumer has read the disclosures.

4. *Timing and effective delivery for disclosures provided periodically.* Disclosures provided by e-mail are timely based on when the disclosures are sent. Disclosures posted at an Internet web site, such as periodic statements or change-in-terms and other notices, are timely when the financial institution has both made the disclosures available and sent a notice alerting the consumer that the disclosures have been posted. For example, under § 205.8(a), institution offering accounts with EFT services must provide a change-in-terms notice to consumers at least 21 days in advance of certain changes. For a change-in-terms notice posted on the Internet, an institution must both post the notice and notify consumers of its availability at least 21 days in advance of the change.

5. *Retainability of disclosures.* Financial institutions satisfy the requirement that disclosures be in a form that the consumer may keep if electronic disclosures are delivered in a format that is capable of being retained (such as by printing or storing electronically). The format must also be consistent with the information required to be provided under section 101(c)(1)(C)(i) of the E-Sign Act (15 U.S.C. 7001(c)(1)(C)(i)) about the hardware and software requirements for accessing and retaining electronic disclosures.

6. *Disclosures provided on financial institution's equipment.* A financial institution that controls the equipment providing electronic disclosures to consumers (for example, an ATM or computer terminal in a financial institution's lobby) must ensure that the equipment satisfies the regulation's requirements to provide timely disclosures in a clear and readily understandable format and in a form that the consumer may keep. For example, if disclosures are required at the time of an on-line transaction, the disclosures must be sent to the consumer's e-mail address or must be made available at another location such as the financial institution's Internet web site, unless the financial institution provides a printer that automatically prints the disclosures.

17(c) Address or Location To Receive Electronic Communication

Paragraph 17(c)(1)

1. *Electronic address.* A consumer's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by the financial institution.

Paragraph 17(c)(2)

1. *Identifying account involved.* A financial institution may identify a specific account in a variety of ways and is not required to identify an account by reference to the account number. For example, where the consumer has only one checking account, and no confusion would result, the institution may refer to ''your checking account.'' If the consumer has two checking accounts, the institution may, for example, differentiate accounts based on names for different checking account programs or by using a truncated account number.

2. *90-day rule.* The actual disclosures provided to the consumer must be available for at least 90 days, but the financial institution has discretion to determine whether they should be available at the same location for the entire period.

17(d) Redelivery

1. *E-mail returned as undeliverable.* If an e-mail to the consumer (containing an alert notice or other disclosure) is returned as undeliverable, the redelivery requirement is satisfied if, for example, the institution sends the disclosure to a different e-mail address or postal address that the institution has on file for the consumer. Sending the disclosure a second time to the same electronic address is not sufficient if the institution has a different address for the consumer on file.

17(e) Persons Other Than Financial Institutions

1. *Electronic disclosures.* Entities other than financial institutions, such as merchants, are subject to certain provisions of Regulation E, including §§205.10(b) and (d). These entities too may use electronic communication to provide disclosures required to be in writing.

APPENDIX A—MODEL DISCLOSURE CLAUSES AND FORMS

1. *Review of forms.* The Board will not review or approve disclosure forms or statements for financial institutions. However, the Board has issued model clauses for institutions to use in designing their disclosures. If an institution uses these clauses accurately to reflect its service, the institution is protected from liability for failure to make disclosures in proper form.

2. *Use of the forms.* The appendix contains model disclosure clauses for optional use by financial institutions to facilitate compliance with the disclosure requirements of §§205.5(b)(2) and (b)(3), 205.6(a), 205.7, 205.8(b), 205.14(b)(1)(ii) and 205.15(d)(7) and (d)(2). The use of appropriate clauses in making disclosures will protect a financial institution from liability under sections 915 and 916 of the act provided the clauses accurately reflect the institution's EFT services.

3. *Altering the clauses.* Financial institutions may use clauses of their own design in conjunction with the Board's model clauses. The inapplicable words or portions of phrases in parentheses should be deleted. The catchlines are not part of the clauses and need not be used. Financial institutions may make alterations, substitutions, or additions in the clauses to reflect the services offered, such as technical changes (including the substitution of a trade name for the word ''card,'' deletion of inapplicable services, or substitution of lesser liability limits). Several of the model clauses include references to a telephone number and address. Where two or more of these clauses are used in a disclosure, the telephone number and address may be referenced and need not be repeated.

[Reg. E, 61 FR 19686, May 2, 1996, as amended at 66 FR 13412, Mar. 6, 2001; 66 FR 15192, Mar. 16, 2001; 66 FR 17794, Apr. 4, 2001]

PART 206—LIMITATIONS ON INTERBANK LIABILITIES (REGULATION F)

Sec.

206.1 Authority, purpose, and scope.
206.2 Definitions.
206.3 Prudential standards.
206.4 Credit exposure.
206.5 Capital levels of correspondents.
206.6 Waiver.
206.7 Transition provisions.

AUTHORITY: Section 308 of Public Law 102–242, 105 Stat. 2236, 12 U.S.C. 371b–2.

SOURCE: Reg. F, 57 FR 60106, Dec. 18, 1992, unless otherwise noted.

§206.1 Authority, purpose, and scope.

(a) *Authority and purpose.* This part (Regulation F, 12 CFR part 206) is issued by the Board of Governors of the Federal Reserve System (Board) to implement section 308 of the Federal Deposit Insurance Corporation Improvements Act of 1991 (Act), 12 U.S.C. 371b–2. The purpose of this part is to limit the risks that the failure of a depository institution would pose to insured depository institutions.

(b) *Scope.* This part applies to all depository institutions insured by the Federal Deposit Insurance Corporation.

§206.2 Definitions.

As used in this part, unless the context requires otherwise:

(a) *Bank* means an insured depository institution, as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), and includes an insured national bank, state bank, District bank, or savings association, and an insured branch of a foreign bank.

(b) *Commonly-controlled correspondent* means a correspondent that is commonly controlled with the bank and for which the bank is subject to liability under section 5(e) of the Federal Deposit Insurance Act. A correspondent is considered to be commonly controlled with the bank if:

(1) 25 percent or more of any class of voting securities of the bank and the correspondent are owned, directly or indirectly, by the same depository institution or company; or

(2) Either the bank or the correspondent owns 25 percent or more of any class of voting securities of the other.

(c) C*orrespondent* means a U.S. depository institution or a foreign bank, as defined in this part, to which a bank has exposure, but does not include a commonly controlled correspondent.

(d) *Exposure* means the potential that an obligation will not be paid in a timely manner or in full. ''Exposure'' includes credit and liquidity risks, including operational risks, related to intraday and interday transactions.

(e) *Foreign bank* means an institution that: (1) Is organized under the laws of a country other than the United States;

(2) Engages in the business of banking;

(3) Is recognized as a bank by the bank supervisory or monetary authorities of the country of the bank's organization;

(4) Receives deposits to a substantial extent in the regular course of business; and

(5) Has the power to accept demand deposits.

(f) *Primary federal supervisor* has the same meaning as the term ''appropriate Federal banking agency'' in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

(g) *Total capital* means the total of a bank's Tier 1 and Tier 2 capital under the risk-based capital guidelines provided by the bank's primary federal supervisor. For an insured branch of a foreign bank organized under the laws of a country that subscribes to the principles of the Basle Capital Accord, ''total capital'' means total Tier 1 and Tier 2 capital as calculated under the standards of that country. For an insured branch of a foreign bank organized under the laws of a country that does not subscribe to the principles of the Basle Capital Accord, ''total capital'' means total Tier 1 and Tier 2 capital as calculated under the provisions of the Accord.

(h) *U.S. depository institution* means a bank, as defined in § 206.2(a) of this part, other than an insured branch of a foreign bank.

§ 206.3 Prudential standards.

(a) *General.* A bank shall establish and maintain written policies and procedures to prevent excessive exposure to any individual correspondent in relation to the condition of the correspondent.

(b) *Standards for selecting correspondents.* (1) A bank shall establish policies and procedures that take into account credit and liquidity risks, including operational risks, in selecting correspondents and terminating those relationships.

(2) Where exposure to a correspondent is significant, the policies and procedures shall require periodic reviews of the financial condition of the correspondent and shall take into account any deterioration in the correspondent's financial condition. Factors bearing on the financial condition of the correspondent include the capital level of the correspondent, level of nonaccrual and past due loans and leases, level of earnings, and other factors affecting the financial condition of the correspondent. Where public information on the financial condition of the correspondent is available, a bank may base its review of the financial condition of a correspondent on such information, and is not required to obtain non-public information for its review. However, for those foreign banks for which there is no public source of financial information, a bank will be required to obtain information for its review.

(3) A bank may rely on another party, such as a bank rating agency or the bank's holding company, to assess the financial condition of or select a correspondent, provided that the bank's board of directors has reviewed and approved the general assessment or selection criteria used by that party.

(c) *Internal limits on exposure.* (1) Where the financial condition of the correspondent and the form of maturity of the exposure create a significant risk that payments will not be made in full or in a timely manner, a bank's policies and procedures shall limit the bank's exposure to the correspondent, either by the establishment of internal limits or by other means. Limits shall be consistent with the risk undertaken, considering the financial condition and the form and maturity of exposure to the correspondent. Limits may be fixed as to amount of flexible, based on such factors as the monitoring of exposure and the financial condition of the correspondent. Different limits may be set for different forms of exposure, different products, and different maturities.

(2) A bank shall structure transactions with a correspondent or monitor exposure to a correspondent, directly or through another party, to ensure that its exposure ordinarily does not exceed the bank's internal limits,

including limits established for credit exposure, except for occasional excesses resulting from unusual market disturbances, market movements favorable to the bank, increases in activity, operational problems, or other unusual circumstances. Generally, monitoring may be done on a retrospective basis. The level of monitoring required depends on:

(i) The extent to which exposure approaches the bank's internal limits;

(ii) The volatility of the exposure; and

(iii) The financial condition of the correspondent.

(3) A bank shall establish appropriate procedures to address excesses over its internal limits.

(d) *Review by board of directors.* The policies and procedures established under this section shall be reviewed and approved by the bank's board of directors at least annually.

§ 206.4 Credit exposure.

(a) *Limits on credit exposure.* (1) The policies and procedures on exposure established by a bank under § 206.3(c) of this part shall limit a bank's interday credit exposure to an individual correspondent to not more than 25 percent of the bank's total capital, unless the bank can demonstrate that its correspondent is at least adequately capitalized, as defined in § 206.5(a) of this part.

(2) Where a bank is no longer able to demonstrate that a correspondent is at least adequately capitalized for the purposes of § 206.4(a) of this part, including where the bank cannot obtain adequate information concerning the capital ratios of the correspondent, the bank shall reduce its credit exposure to comply with the requirements of § 206.4(a)(1) of this part within 120 days after the date when the current Report of Condition and Income or other relevant report normally would be available.

(b) *Calculation of credit exposure.* Except as provided in §§ 206.4 (c) and (d) of this part, the credit exposure of a bank to a correspondent shall consist of the bank's assets and off-balance sheet items that are subject to capital requirements under the capital adequacy guidelines of the bank's primary federal supervisor, and that involve claims on the correspondent or capital instruments issued by the correspondent. For this purpose, off-balance sheet items shall be valued on the basis of current exposure. The term ''credit exposure'' does not include exposure related to the settlement of transactions, intraday exposure, transactions in an agency or similar capacity where losses will be passed back to the principal of other party, or other sources of exposure that are not covered by the capital adequacy guidelines.

(c) *Netting.* Transactions covered by netting agreements that are valid and enforceable under all applicable laws may be netted in calculating credit exposure.

(d) *Exclusions.* A bank may exclude the following from the calculation of credit exposure to a correspondent:

(1) Transactions, including reverse repurchase agreements, to the extent that the transactions are secured by government securities or readily marketable collateral, as defined in paragraph (f) of this section, based on the current market value of the collateral;

(2) The proceeds of checks and other cash items deposited in an account at a correspondent that are not yet available for withdrawal;

(3) Quality assets, as defined in paragraph (f) of this section, on which the correspondent is secondarily liable, or obligations of the correspondent on which a creditworthy obligor in addition to the correspondent is available, including but not limited to:

(i) Loans to third parties secured by stock or debt obligations of the correspondent;

(ii) Loans to third parties purchased from the correspondent with recourse;

(iii) Loans or obligations of third parties backed by stand-by letters of credit issued by the correspondent; or

(iv) Obligations of the correspondent backed by stand-by letters of credit issued by a creditworthy third party;

(4) exposure that results from the merger with or acquisition of another bank for one year after that merger or acquisition is consummated; and

(5) The portion of the bank's exposure to the correspondent that is covered by federal deposit insurance.

(e) *Credit exposure of subsidiaries.* In calculating credit exposure to a correspondent under this part, a bank shall include credit exposure to the correspondent of any entity that the bank is required to consolidate on its Report of Condition and Income or Thrift Financial Report.

(f) *Definitions.* As used in this section:

(1) *Government securities* means obligations of, or obligations fully guaranteed as to principal and interest by, the United States government or any department, agency, bureau, board, commission, or establishment of the United States, or any corporation wholly owned, directly or indirectly, by the United States.

(2) *Readily marketable collateral* means financial instruments or bullion that may be sold in ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions on an auction or a similarly available daily bid- ask-price market.

(3)(i) *Quality asset* means an asset:

(A) That is not in a nonaccrual status;

(B) On which principal or interest is not more than thirty days past due; and

(C) Whose terms have not been renegotiated or compromised due to the deteriorating financial conditions of the additional obligor.

(ii) An asset is not considered a ''quality asset'' if any other loans to the primary obligor on the asset have been classified as ''substandard,'' ''doubtful,'' or ''loss,'' or treated as ''other loans specially mentioned'' in the most recent report of examination or inspection of the bank or an affiliate prepared by either a federal or a state supervisory agency.

§ 206.5 Capital levels of correspondents.

(a) *Adequately capitalized correspondents.*[1] For the purpose of this part, a correspondent is considered adequately capitalized if the correspondent has:

(1) A total risk-based capital ratio, as defined in paragraph (e)(1) of this section, of 8.0 percent or greater;

(2) A Tier 1 risk-based capital ratio, as defined in paragraph (e)(2) of this section, of 4.0 percent or greater; and

(3) A leverage ratio, as defined in paragraph (e)(3) of this section, of 4.0 percent or greater.

(b) *Frequency of monitoring capital levels.* A bank shall obtain information to demonstrate that a correspondent is at least adequately capitalized on a quarterly basis, either from the most recently available Report of Condition and Income, Thrift Financial Report, financial statement, or bank rating report for the correspondent. For a foreign bank correspondent for which quarterly financial statements or reports are not available, a bank shall obtain such information on as frequent a basis as such information is available. Information obtained directly from a correspondent for the purpose of this section should be based on the most recently available Report of Condition and Income, Thrift Financial Report, or financial statement of the correspondent.

(c) *Foreign banks.* A correspondent that is a foreign bank may be considered adequately capitalized under this section without regard to the minimum leverage ratio required under paragraph (a)(3) of this section.

(d) *Reliance on information.* A bank may rely on information as to the capital levels of a correspondent obtained from the correspondent, a bank rating agency, or other party that it reasonably believes to be accurate.

(e) *Definitions.* For the purposes of this section:

(1) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets.

(2) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets.

(3) *Leverage ratio* means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with the capital adequacy guidelines of the correspondent's primary federal supervisor.

[1] As used in this part, the term ''adequately capitalized'' is similar but not identical to the definition of that term as used for the purposes of the prompt corrective action standards. See, *e.g.* 12 CFR part 208, subpart B.

(f) *Calculation of capital ratios.* (i) For a correspondent that is a U.S. depository institution, the ratios shall be calculated in accordance with the capital adequacy guidelines of the correspondent's primary federal supervisor.

(ii) For a correspondent that is a foreign bank organized in a country that has adopted the risk-based framework of the Basle Capital Accord, the ratios shall be calculated in accordance with the capital adequacy guidelines of the appropriate supervisory authority of the country in which the correspondent is chartered.

(iii) For a correspondent that is a foreign bank organized in a country that has not adopted the risk-based framework of the Basle Capital Accord, the ratios shall be calculated in accordance with the provisions of the Basle Capital Accord.

§ 206.6 Waiver.

The Board may waive the application of § 206.4(a) of this part to a bank if the primary Federal supervisor of the bank advises the Board that the bank is not reasonably able to obtain necessary services, including payment-related services and placement of funds, without incurring exposure to a correspondent in excess of the otherwise applicable limit.

§ 206.7 Transition provisions.

(a) Beginning on June 19, 1993, a bank shall comply with the prudential standards prescribed under § 206.3 of this part.

(b) Beginning on June 19, 1994, a bank shall comply with the limit on credit exposure to an individual correspondent required under § 206.4(a) of this part, but for a period of one year after this date the limit shall be 50 percent of the bank's total capital.

PART 207—DISCLOSURE AND REPORTING OF CRA-RELATED AGREEMENTS (REGULATION G)

Sec.

207.1 Purpose and scope of this part.
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AUTHORITY: 12 U.S.C. 1831y.

SOURCE: Reg. G, 66 FR 2092, Jan. 10, 2001, unless otherwise noted.

§ 207.1 Purpose and scope of this part.

(a) *General.* This part implements section 711 of the Gramm-Leach-Bliley Act (12 U.S.C. 1831y). That section requires any nongovernmental entity or person, insured depository institution, or affiliate of an insured depository institution that enters into a covered agreement to—

(1) Make the covered agreement available to the public and the appropriate Federal banking agency; and

(2) File an annual report with the appropriate Federal banking agency concerning the covered agreement.

(b) *Scope of this part.* The provisions of this part apply to—

(1) State member banks and their subsidiaries;

(2) Bank holding companies;

(3) Affiliates of bank holding companies, other than banks, savings associations and subsidiaries of banks and savings associations; and

(4) Nongovernmental entities or persons that enter into covered agreements with any company listed in paragraph (b)(1) through (3) of this section.

(c) *Relation to Community Reinvestment Act.* This part does not affect in any way the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*), the Board's Regulation BB (12 CFR part 228), or the Board's interpretations or administration of that Act or regulation.

(d) *Examples.*—(1) The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

(2) Examples in a paragraph illustrate only the issue described in the paragraph and do not illustrate any other issues that may arise in this part.

§ 207.2 Definition of covered agreement.

(a) *General definition of covered agreement.* A covered agreement is any contract, arrangement, or understanding that meets all of the following criteria—

(1) The agreement is in writing.

(2) The parties to the agreement include—

(i) One or more insured depository institutions or affiliates of an insured depository institution; and

(ii) One or more nongovernmental entities or persons (referred to hereafter as NGEPs).

(3) The agreement provides for the insured depository institution or any affiliate to—

(i) Provide to one or more individuals or entities (whether or not parties to the agreement) cash payments, grants, or other consideration (except loans) that have an aggregate value of more than $10,000 in any calendar year; or

(ii) Make to one or more individuals or entities (whether or not parties to the agreement) loans that have an aggregate principal amount of more than $50,000 in any calendar year.

(4) The agreement is made pursuant to, or in connection with, the fulfillment of the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*) (CRA), as defined in § 207.4.

(5) The agreement is with a NGEP that has had a CRA communication as described in § 207.3 prior to entering into the agreement.

(b) *Examples concerning written arrangements or understandings*—(1) *Example 1.* A NGEP meets with an insured depository institution and states that the institution needs to make more community development investments in the NGEP's community. The NGEP and insured depository institution do not reach an agreement concerning the community development investments the institution should make in the community, and the parties do not reach any mutual arrangement or understanding. Two weeks later, the institution unilaterally issues a press release announcing that it has established a general goal of making $100 million of community development grants in low- and moderate-income neighborhoods served by the insured depository institution over the next 5 years. The NGEP is not identified in the press release. The press release is not a written arrangement or understanding.

(2) *Example 2.* A NGEP meets with an insured depository institution and states that the institution needs to offer new loan programs in the NGEP's community. The NGEP and the insured depository institution reach a mutual arrangement or understanding that the institution will provide additional loans in the NGEP's community. The institution tells the NGEP that it will issue a press release announcing the program. Later, the insured depository institution issues a press release announcing the loan program. The press release incorporates the key terms of the understanding reached between the NGEP and the insured depository institution. The written press release reflects the mutual arrangement or understanding of the NGEP and the insured depository institution and is, therefore, a written arrangement or understanding.

(3) *Example 3.* An NGEP sends a letter to an insured depository institution requesting that the institution provide a $15,000 grant to the NGEP. The insured depository institution responds in writing and agrees to provide the grant in connection with its annual grant program. The exchange of letters constitutes a written arrangement or understanding.

(c) *Loan agreements that are not covered agreements.* A covered agreement does not include—

(1) Any individual loan that is secured by real estate; or

(2) Any specific contract or commitment for a loan or extension of credit to an individual, business, farm, or other entity, or group of such individuals or entities, if—

(i) The funds are loaned at rates that are not substantially below market rates; and

(ii) The loan application or other loan documentation does not indicate that the borrower intends or is authorized to use the borrowed funds to make a loan or extension of credit to one or more third parties.

(d) *Examples concerning loan agreements*—(1) *Example 1.* An insured depository institution provides an organization with a $1 million loan that is documented in writing and is secured by real estate owned or to-be-acquired by the organization. The agreement is an individual mortgage loan and is exempt from coverage under paragraph (c)(1) of this section, regardless of the interest rate on the loan or whether the organization intends or is authorized to re-loan the funds to a third party.

(2) *Example 2.* An insured depository institution commits to provide a $500,000 line of credit to a small business that is documented by a written agreement. The loan is made at rates that are within the range of rates offered by the institution to similarly situated small businesses in the market and the loan documentation does not indicate that the small business intends or is authorized to re-lend the borrowed funds. The agreement is exempt from coverage under paragraph (c)(2) of this section.

(3) *Example 3.* An insured depository institution offers small business loans that are guaranteed by the Small Business Administration (SBA). A small business obtains a $75,000 loan, documented in writing, from the institution under the institution's SBA loan program. The loan documentation does not indicate that the borrower intends or is authorized to re-lend the funds. Although the rate charged on the loan is well below that charged by the institution on commercial loans, the rate is within the range of rates that the institution would charge a similarly situated small business for a similar loan under the SBA loan program. Accordingly, the loan is not made at substantially below market rates and is exempt from coverage under paragraph (c)(2) of this section.

(4) *Example 4.* A bank holding company enters into a written agreement with a community development organization that provides that insured depository institutions owned by the bank holding company will make $250 million in small business loans in the community over the next 5 years. The written agreement is not a specific contract or commitment for a loan or an extension of credit and, thus, is not exempt from coverage under paragraph (c)(2) of this section. Each small business loan made by the insured depository institution pursuant to this general commitment would, however, be exempt from coverage if the loan is made at rates that are not substantially below market rates and the loan documentation does not indicate that the borrower intended or was authorized to re-lend the funds.

(e) *Agreements that include exempt loan agreements.* If an agreement includes a loan, extension of credit or loan commitment that, if documented separately, would be exempt under paragraph (c) of this section, the exempt loan, extension of credit or loan commitment may be excluded for purposes of determining whether the agreement is a covered agreement.

(f) *Determining annual value of agreements that lack schedule of disbursements.* For purposes of paragraph (a)(3) of this section, a multi-year agreement that does not include a schedule for the disbursement of payments, grants, loans or other consideration by the insured depository institution or affiliate, is considered to have a value in the first year of the agreement equal to all payments, grants, loans and other consideration to be provided at any time under the agreement.

§ 207.3 CRA communications.

(a) *Definition of CRA communication.* A CRA communication is any of the following—

(1) Any written or oral comment or testimony provided to a Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate.

(2) Any written comment submitted to the insured depository institution that discusses the adequacy of the performance under the CRA of the institution and must be included in the institution's CRA public file.

(3) Any discussion or other contact with the insured depository institution or any affiliate about—

(i) Providing (or refraining from providing) written or oral comments or testimony to any Federal banking

agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate;

(ii) Providing (or refraining from providing) written comments to the insured depository institution that concern the adequacy of the institution's performance under the CRA and must be included in the institution's CRA public file; or

(iii) The adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate.

(b) *Discussions or contacts that are not CRA communications*—(1) *Timing of contacts with a Federal banking agency*. An oral or written communication with a Federal banking agency is not a CRA communication if it occurred more than 3 years before the parties entered into the agreement.

(2) *Timing of contacts with insured depository institutions and affiliates*. A communication with an insured depository institution or affiliate is not a CRA communication if the communication occurred—

(i) More than 3 years before the parties entered into the agreement, in the case of any written communication;

(ii) More than 3 years before the parties entered into the agreement, in the case of any oral communication in which the NGEP discusses providing (or refraining from providing) comments or testimony to a Federal banking agency or written comments that must be included in the institution's CRA public file in connection with a request to, or agreement by, the institution or affiliate to take (or refrain from taking) any action that is in fulfillment of the CRA; or

(iii) More than 1 year before the parties entered into the agreement, in the case of any other oral communication not described in paragraph (b)(2)(ii) of this section.

(3) *Knowledge of communication by insured depository institution or affiliate*. (i) A communication is only a CRA communication under paragraph (a) of this section if the insured depository institution or its affiliate has knowledge of the communication under this paragraph (b)(3)(ii) or (b)(3)(iii) of this section.

(ii) *Communication with insured depository institution or affiliate*. An insured depository institution or affiliate has knowledge of a communication by the NGEP to the institution or its affiliate under this paragraph only if one of the following representatives of the insured depository institution or any affiliate has knowledge of the communication.

(A) An employee who approves, directs, authorizes, or negotiates the agreement with the NGEP; or

(B) An employee designated with responsibility for compliance with the CRA or executive officer if the employee or executive officer knows that the institution or affiliate is negotiating, intends to negotiate, or has been informed by the NGEP that it expects to request that the institution or affiliate negotiate an agreement with the NGEP.

(iii) *Other communications*. An insured depository institution or affiliate is deemed to have knowledge of—

(A) Any testimony provided to a Federal banking agency at a public meeting or hearing;

(B) Any comment submitted to a Federal banking agency that is conveyed in writing by the agency to the insured depository institution or affiliate; and

(C) Any written comment submitted to the insured depository institution that must be and is included in the institution's CRA public file.

(4) *Communication where NGEP has knowledge*. A NGEP has a CRA communication with an insured depository institution or affiliate only if any of the following individuals has knowledge of the communication—

(i) A director, employee, or member of the NGEP who approves, directs, authorizes, or negotiates the agreement with the insured depository institution or affiliate;

(ii) A person who functions as an executive officer of the NGEP and who knows that the NGEP is negotiating or intends to negotiate an agreement with the insured depository institution or affiliate; or

(iii) Where the NGEP is an individual, the NGEP.

(c) *Examples of CRA communications*—(1) *Examples of actions that are CRA communications.* The following are examples of CRA communications. These examples are not exclusive and assume that the communication occurs within the relevant time period as described in paragraph (b)(1) or (b)(2) of this section and the appropriate representatives have knowledge of the communication as specified in paragraphs (b)(3) and (b)(4) of this section.

(i) *Example 1.* A NGEP files a written comment with a Federal banking agency that states than an insured depository institution successfully addresses the credit needs of its community. The written comment is in response to a general request from the agency for comments on an application of the insured depository institution to open a new branch and a copy of the comment is provided to the institution.

(ii) *Example 2.* A NGEP meets with an executive officer of an insured depository institution and states that the institution must improve its CRA performance.

(iii) *Example 3.* A NGEP meets with an executive officer of an insured depository institution and states that the institution needs to make more mortgage loans in low- and moderate-income neighborhoods in its community.

(iv) *Example 4.* A bank holding company files an application with a Federal banking agency to acquire an insured depository institution. Two weeks later, the NGEP meets with an executive officer of the bank holding company to discuss the adequacy of the performance under the CRA of the target insured depository institution. The insured depository institution was an affiliate of the bank holding company at the time the NGEP met with the target institution. (See § 207.11(a).) Accordingly, the NGEP had a CRA communication with an affiliate of the bank holding company.

(2) *Examples of actions that are not CRA communications.* The following are examples of actions that are not by themselves CRA communications. These examples are not exclusive.

(i) *Example 1.* A NGEP provides to a Federal banking agency comments or testimony concerning an insured depository institution or affiliate in response to a direct request by the agency for comments or testimony from that NGEP. Direct requests for comments or testimony do not include a general invitation by a Federal banking agency for comments or testimony from the public in connection with a CRA performance evaluation of, or application for a deposit facility (as defined in section 803 of the CRA (12 U.S.C. 2902(3)) by, an insured depository institution or an application by a company to acquire an insured depository institution.

(ii) *Example 2.* A NGEP makes a statement concerning an insured depository institution or affiliate at a widely attended conference or seminar regarding a general topic. A public or private meeting, public hearing, or other meeting regarding one or more specific institutions, affiliates or transactions involving an application for a deposit facility is not considered a widely attended conference or seminar.

(iii) *Example 3.* A NGEP, such as a civil rights group, community group providing housing and other services in low- and moderate-income neighborhoods, veterans organization, community theater group, or youth organization, sends a fundraising letter to insured depository institutions and to other businesses in its community. The letter encourages all businesses in the community to meet their obligation to assist in making the local community a better place to live and work by supporting the fundraising efforts of the NGEP.

(iv) *Example 4.* A NGEP discusses with an insured depository institution or affiliate whether particular loans, services, investments, community development activities, or other activities are generally eligible for consideration by a Federal banking agency under the CRA. The NGEP and insured depository institution or affiliate do not discuss the adequacy of the CRA performance of the insured depository institution or affiliate.

(v) *Example 5.* A NGEP engaged in the sale or purchase of loans in the secondary market sends a general offering circular to financial institutions offering to sell or purchase a portfolio of

loans. An insured depository institution that receives the offering circular discusses with the NGEP the types of loans included in the loan pool, whether such loans are generally eligible for consideration under the CRA, and which loans are made to borrowers in the institution's local community. The NGEP and insured depository institution do not discuss the adequacy of the institution's CRA performance.

(d) *Multiparty covered agreements.* (1) A NGEP that is a party to a covered agreement that involves multiple NGEPs is not required to comply with the requirements of this part if—

(i) The NGEP has not had a CRA communication; and

(ii) No representative of the NGEP identified in paragraph (b)(4) of this section has knowledge at the time of the agreement that another NGEP that is a party to the agreement has had a CRA communication.

(2) An insured depository institution or affiliate that is a party to a covered agreement that involves multiple insured depository institutions or affiliates is not required to comply with the disclosure and annual reporting requirements in §§ 207.6 and 207.7 if—

(i) No NGEP that is a party to the agreement has had a CRA communication concerning the insured depository institution or any affiliate; and

(ii) No representative of the insured depository institution or any affiliate identified in paragraph (b)(3) of this section has knowledge at the time of the agreement that an NGEP that is a party to the agreement has had a CRA communication concerning any other insured depository institution or affiliate that is a party to the agreement.

§ 207.4 Fulfillment of the CRA.

(a) *List of factors that are in fulfillment of the CRA.* Fulfillment of the CRA, for purposes of this part, means the following list of factors—

(1) *Comments to a Federal banking agency or included in CRA public file.* Providing or refraining from providing written or oral comments or testimony to any Federal banking agency concerning the performance under the CRA of an insured depository institution or CRA affiliate that is a party to the agreement or an affiliate of a party to the agreement or written comments that are required to be included in the CRA public file of any such insured depository institution; or

(2) *Activities given favorable CRA consideration.* Performing any of the following activities if the activity is of the type that is likely to receive favorable consideration by a Federal banking agency in evaluating the performance under the CRA of the insured depository institution that is a party to the agreement or an affiliate of a party to the agreement—

(i) Home-purchase, home-improvement, small business, small farm, community development, and consumer lending, as described in § 228.22 of Regulation BB (12 CFR 228.22), including loan purchases, loan commitments, and letters of credit;

(ii) Making investments, deposits, or grants, or acquiring membership shares, that have as their primary purpose community development, as described in § 228.23 of Regulation BB (12 CFR 228.23);

(iii) Delivering retail banking services, as described in § 228.24(d) of Regulation BB (12 CFR 228.24(d));

(iv) Providing community development services, as described in § 228.24(e) of Regulation BB (12 CFR 228.24(e));

(v) In the case of a wholesale or limited-purpose insured depository institution, community development lending, including originating and purchasing loans and making loan commitments and letters of credit, making qualified investments, or providing community development services, as described in § 228.25(c) of Regulation BB (12 CFR 228.25(c));

(vi) In the case of a small insured depository institution, any lending or other activity described in § 228.26(a) of Regulation BB (12 CFR 228.26(a)); or

(vii) In the case of an insured depository institution that is evaluated on the basis of a strategic plan, any element of the strategic plan, as described in § 228.27(f) of Regulation BB (12 CFR 228.27(f)).

(b) *Agreements relating to activities of CRA affiliates.* An insured depository institution or affiliate that is a party to a covered agreement that concerns any activity described in paragraph (a) of this section of a CRA affiliate must,

prior to the time the agreement is entered into, notify each NGEP that is a party to the agreement that the agreement concerns a CRA affiliate.

§ 207.5 Related agreements considered a single agreement.

The following rules must be applied in determining whether an agreement is a covered agreement under § 207.2.

(a) *Agreements entered into by same parties.* All written agreements to which an insured depository institution or an affiliate of the insured depository institution is a party shall be considered to be a single agreement if the agreements—

(1) Are entered into with the same NGEP;

(2) Were entered into within the same 12-month period; and

(3) Are each in fulfillment of the CRA.

(b) *Substantively related contracts.* All written contracts to which an insured depository institution or an affiliate of the insured depository institution is a party shall be considered to be a single agreement, without regard to whether the other parties to the contracts are the same or whether each such contract is in fulfillment of the CRA, if the contracts were negotiated in a coordinated fashion and a NGEP is a party to each contract.

§ 207.6 Disclosure of covered agreements.

(a) *Applicability date.* This section applies only to covered agreements entered into after November 12, 1999.

(b) *Disclosure of covered agreements to the public*—(1) *Disclosure required.* Each NGEP and each insured depository institution or affiliate that enters into a covered agreement must promptly make a copy of the covered agreement available to any individual or entity upon request.

(2) *Nondisclosure of confidential and proprietary information permitted.* In responding to a request for a covered agreement from any individual or entity under paragraph (b)(1) of this section, a NGEP, insured depository institution, or affiliate may withhold from public disclosure confidential or proprietary information that the party believes the relevant supervisory agency could withhold from disclosure under the Freedom of Information Act (5 U.S.C. 552 *et seq.*) (FOIA).

(3) *Information that must be disclosed.* Notwithstanding paragraph (b)(2) of this section, a party must disclose any of the following information that is contained in a covered agreement—

(i) The names and addresses of the parties to the agreement;

(ii) The amount of any payments, fees, loans, or other consideration to be made or provided by any party to the agreement;

(iii) Any description of how the funds or other resources provided under the agreement are to be used;

(iv) The term of the agreement (if the agreement establishes a term); and

(v) Any other information that the relevant supervisory agency determines is not properly exempt from public disclosure.

(4) *Request for review of withheld information.* Any individual or entity may request that the relevant supervisory agency review whether any information in a covered agreement withheld by a party must be disclosed. Any requests for agency review of withheld information must be filed, and will be processed in accordance with, the relevant supervisory agency's rules concerning the availability of information (*see* § 261.12 of the Board's Rules Regarding the Availability of Information (12 CFR 261.12)).

(5) *Duration of obligation.* The obligation to disclose a covered agreement to the public terminates 12 months after the end of the term of the agreement.

(6) *Reasonable copy and mailing fees.* Each NGEP and each insured depository institution or affiliate may charge an individual or entity that requests a copy of a covered agreement a reasonable fee not to exceed the cost of copying and mailing the agreement.

(7) *Use of CRA public file by insured depository institution or affiliate.* An insured depository institution and any affiliate of an insured depository institution may fulfill its obligation under this paragraph (b) by placing a copy of the covered agreement in the insured depository institution's CRA public file if the institution makes the agreement

available in accordance with the procedures set forth in § 228.43 of Regulation BB (12 CFR 228.43).

(c) *Disclosure by NGEPs of covered agreements to the relevant supervisory agency*. (1) Each NGEP that is a party to a covered agreement must provide the following within 30 days of receiving a request from the relevant supervisory agency—

(i) A complete copy of the agreement; and

(ii) In the event the NGEP proposes the withholding of any information contained in the agreement in accordance with paragraph (b)(2) of this section, a public version of the agreement that excludes such information and an explanation justifying the exclusions. Any public version must include the information described in paragraph (b)(3) of this section.

(2) The obligation of a NGEP to provide a covered agreement to the relevant supervisory agency terminates 12 months after the end of the term of the covered agreement.

(d) *Disclosure by insured depository institution or affiliate of covered agreements to the relevant supervisory agency*—(1) *In general*. Within 60 days of the end of each calendar quarter, each insured depository institution and affiliate must provide each relevant supervisory agency with—

(i)(A) A complete copy of each covered agreement entered into by the insured depository institution or affiliate during the calendar quarter; and

(B) In the event the institution or affiliate proposes the withholding of any information contained in the agreement in accordance with paragraph (b)(2) of this section, a public version of the agreement that excludes such information (other than any information described in paragraph (b)(3) of this section) and an explanation justifying the exclusions; or

(ii) A list of all covered agreements entered into by the insured depository institution or affiliate during the calendar quarter that contains—

(A) The name and address of each insured depository institution or affiliate that is a party to the agreement;

(B) The name and address of each NGEP that is a party to the agreement;

(C) The date the agreement was entered into;

(D) The estimated total value of all payments, fees, loans and other consideration to be provided by the institution or any affiliate of the institution under the agreement; and

(E) The date the agreement terminates.

(2) *Prompt filing of covered agreements contained in list required*. (i) If an insured depository institution or affiliate files a list of the covered agreements entered into by the institution or affiliate pursuant to paragraph (d)(1)(ii) of this section, the institution or affiliate must provide any relevant supervisory agency a complete copy and public version of any covered agreement referenced in the list within 7 calendar days of receiving a request from the agency for a copy of the agreement.

(ii) The obligation of an insured depository institution or affiliate to provide a covered agreement to the relevant supervisory agency under this paragraph (d)(2) terminates 36 months after the end of the term of the agreement.

(3) *Joint filings*. In the event that 2 or more insured depository institutions or affiliates are parties to a covered agreement, the insured depository institution(s) and affiliate(s) may jointly file the documents required by this paragraph (d). Any joint filing must identify the insured depository institution(s) and affiliate(s) for whom the filings are being made.

§ 207.7 Annual reports.

(a) *Applicability date*. This section applies only to covered agreements entered into on or after May 12, 2000.

(b) *Annual report required*. Each NGEP and each insured depository institution or affiliate that is a party to a covered agreement must file an annual report with each relevant supervisory agency concerning the disbursement, receipt, and uses of funds or other resources under the covered agreement.

(c) *Duration of reporting requirement*—(1) *NGEPs*. A NGEP must file an annual report for a covered agreement for any fiscal year in which the NGEP receives or uses funds or other resources under the agreement.

(2) *Insured depository institutions and affiliates.* An insured depository institution or affiliate must file an annual report for a covered agreement for any fiscal year in which the institution or affiliate—

(i) provides or receives any payments, fees, or loans under the covered agreement that must be reported under paragraphs (e)(1)(iii) and (iv) of this section; or

(ii) has data to report on loans, investments, and services provided by a party to the covered agreement under the covered agreement under paragraph (e)(1)(vi) of this section.

(d) *Annual reports filed by NGEP*—(1) *Contents of report.* The annual report filed by a NGEP under this section must include the following—

(i) The name and mailing address of the NGEP filing the report;

(ii) Information sufficient to identify the covered agreement for which the annual report is being filed, such as by providing the names of the parties to the agreement and the date the agreement was entered into or by providing a copy of the agreement;

(iii) The amount of funds or resources received under the covered agreement during the fiscal year; and

(iv) A detailed, itemized list of how any funds or resources received by the NGEP under the covered agreement were used during the fiscal year, including the total amount used for—

(A) Compensation of officers, directors, and employees;

(B) Administrative expenses;

(C) Travel expenses;

(D) Entertainment expenses;

(E) Payment of consulting and professional fees; and

(F) Other expenses and uses (specify expense or use).

(2) *More detailed reporting of uses of funds or resources permitted*—(i) *In general.* If a NGEP allocated and used funds received under a covered agreement for a specific purpose, the NGEP may fulfill the requirements of paragraph (d)(1)(iv) of this section with respect to such funds by providing—

(A) A brief description of each specific purpose for which the funds or other resources were used; and

(B) The amount of funds or resources used during the fiscal year for each specific purpose.

(ii) *Specific purpose defined.* A NGEP allocates and uses funds for a specific purpose if the NGEP receives and uses the funds for a purpose that is more specific and limited than the categories listed in paragraph (d)(1)(iv) of this section.

(3) *Use of other reports.* The annual report filed by a NGEP may consist of or incorporate a report prepared for any other purpose, such as the Internal Revenue Service Return of Organization Exempt From Income Tax on Form 990, or any other Internal Revenue Service form, state tax form, report to members or shareholders, audited or unaudited financial statements, audit report, or other report, so long as the annual report filed by the NGEP contains all of the information required by this paragraph (d).

(4) *Consolidated reports permitted.* A NGEP that is a party to 2 or more covered agreements may file with each relevant supervisory agency a single consolidated annual report covering all the covered agreements. Any consolidated report must contain all the information required by this paragraph (d). The information reported under paragraphs (d)(1)(iv) and (d)(2) of this section may be reported on an aggregate basis for all covered agreements.

(5) *Examples of annual report requirements for NGEPs*—(i) *Example 1.* A NGEP receives an unrestricted grant of $15,000 under a covered agreement, includes the funds in its general operating budget and uses the funds during its fiscal year. The NGEP's annual report for the fiscal year must provide the name and mailing address of the NGEP, information sufficient to identify the covered agreement, and state that the NGEP received $15,000 during the fiscal year. The report must also indicate the total expenditures made by the NGEP during the fiscal year for compensation, administrative expenses, travel expenses, entertainment expenses, consulting and professional fees, and other expenses and uses. The NGEP's annual report may provide this information by submitting an Internal Revenue Service Form 990 that includes the required information. If the Internal Revenue

Service Form does not include information for all of the required categories listed in this part, the NGEP must report the total expenditures in the remaining categories either by providing that information directly or by providing another form or report that includes the required information.

(ii) *Example 2.* An organization receives $15,000 from an insured depository institution under a covered agreement and allocates and uses the $15,000 during the fiscal year to purchase computer equipment to support its functions. The organization's annual report must include the name and address of the organization, information sufficient to identify the agreement, and a statement that the organization received $15,000 during the year. In addition, since the organization allocated and used the funds for a specific purpose that is more narrow and limited than the categories of expenses included in the detailed, itemized list of expenses, the organization would have the option of providing either the total amount it used during the year for each category of expenses included in paragraph (d)(1)(iv) of this section, or a statement that it used the $15,000 to purchase computer equipment and a brief description of the equipment purchased.

(iii) *Example 3.* A community group receives $50,000 from an insured depository institution under a covered agreement. During its fiscal year, the community group specifically allocates and uses $5,000 of the funds to pay for a particular business trip and uses the remaining $45,000 for general operating expenses. The group's annual report for the fiscal year must include the name and address of the group, information sufficient to identify the agreement, and a statement that the group received $50,000. Because the group did not allocate and use all of the funds for a specific purpose, the group's annual report must provide the total amount of funds it used during the year for each category of expenses included in paragraph (d)(1)(iv) of this section. The group's annual report also could state that it used $5,000 for a particular business trip and include a brief description of the trip.

(iv) *Example 4.* A community development organization is a party to two separate covered agreements with two unaffiliated insured depository institutions. Under each agreement, the organization receives $15,000 during its fiscal year and uses the funds to support its activities during that year. If the organization elects to file a consolidated annual report, the consolidated report must identify the organization and the two covered agreements, state that the organization received $15,000 during the fiscal year under each agreement, and provide the total amount that the organization used during the year for each category of expenses included in paragraph (d)(1)(iv) of this section.

(e) *Annual report filed by insured depository institution or affiliate*—(1) *General.* The annual report filed by an insured depository institution or affiliate must include the following—

(i) The name and principal place of business of the insured depository institution or affiliate filing the report;

(ii) Information sufficient to identify the covered agreement for which the annual report is being filed, such as by providing the names of the parties to the agreement and the date the agreement was entered into or by providing a copy of the agreement;

(iii) The aggregate amount of payments, aggregate amount of fees, and aggregate amount of loans provided by the insured depository institution or affiliate under the covered agreement to any other party to the agreement during the fiscal year;

(iv) The aggregate amount of payments, aggregate amount of fees, and aggregate amount of loans received by the insured depository institution or affiliate under the covered agreement from any other party to the agreement during the fiscal year;

(v) A general description of the terms and conditions of any payments, fees, or loans reported under paragraphs (e)(1)(iii) and (iv) of this section, or, in the event such terms and conditions are set forth—

(A) In the covered agreement, a statement identifying the covered agreement and the date the agreement (or a list identifying the agreement)

was filed with the relevant supervisory agency; or

(B) In a previous annual report filed by the insured depository institution or affiliate, a statement identifying the date the report was filed with the relevant supervisory agency; and

(vi) The aggregate amount and number of loans, aggregate amount and number of investments, and aggregate amount of services provided under the covered agreement to any individual or entity not a party to the agreement—

(A) By the insured depository institution or affiliate during its fiscal year; and

(B) By any other party to the agreement, unless such information is not known to the insured depository institution or affiliate filing the report or such information is or will be contained in the annual report filed by another party under this section.

(2) *Consolidated reports permitted*—(i) *Party to multiple agreements.* An insured depository institution or affiliate that is a party to 2 or more covered agreements may file a single consolidated annual report with each relevant supervisory agency concerning all the covered agreements.

(ii) *Affiliated entities party to the same agreement.* An insured depository institution and its affiliates that are parties to the same covered agreement may file a single consolidated annual report relating to the agreement with each relevant supervisory agency for the covered agreement.

(iii) *Content of report.* Any consolidated annual report must contain all the information required by this paragraph (e). The amounts and data required to be reported under paragraphs (e)(1)(iv) and (vi) of this section may be reported on an aggregate basis for all covered agreements.

(f) *Time and place of filing*—(1) *General.* Each party must file its annual report with each relevant supervisory agency for the covered agreement no later than six months following the end of the fiscal year covered by the report.

(2) *Alternative method of fulfilling annual reporting requirement for a NGEP*—(i) A NGEP may fulfill the filing requirements of this section by providing the following materials to an insured depository institution or affiliate that is a party to the agreement no later than six months following the end of the NGEP's fiscal year—

(A) A copy of the NGEP's annual report required under paragraph (d) of this section for the fiscal year; and

(B) Written instructions that the insured depository institution or affiliate promptly forward the annual report to the relevant supervisory agency or agencies on behalf of the NGEP.

(ii) An insured depository institution or affiliate that receives an annual report from a NGEP pursuant to paragraph (f)(2)(i) of this section must file the report with the relevant supervisory agency or agencies on behalf of the NGEP within 30 days.

§ 207.8 Release of information under FOIA.

The Board will make covered agreements and annual reports available to the public in accordance with the Freedom of Information Act (5 U.S.C. 552 *et seq.*) and the Board's Rules Regarding the Availability of Information (12 CFR part 261). A party to a covered agreement may request confidential treatment of proprietary and confidential information in a covered agreement or an annual report under those procedures.

§ 207.9 Compliance provisions.

(a) *Willful failure to comply with disclosure and reporting obligations*—(1) If the Board determines that a NGEP has willfully failed to comply in a material way with §§ 207.6 or 207.7, the Board will notify the NGEP in writing of that determination and provide the NGEP a period of 90 days (or such longer period as the Board finds to be reasonable under the circumstances) to comply.

(2) If the NGEP does not comply within the time period established by the Board, the agreement shall thereafter be unenforceable by that NGEP by operation of section 48 of the Federal Deposit Insurance Act (12 U.S.C. 1831y).

(3) The Board may assist any insured depository institution or affiliate that is a party to a covered agreement that is unenforceable by a NGEP by operation of section 48 of the Federal Deposit Insurance Act (12 U.S.C. 1831y) in identifying a successor to assume the

NGEP's responsibilities under the agreement.

(b) *Diversion of funds.* If a court or other body of competent jurisdiction determines that funds or resources received under a covered agreement have been diverted contrary to the purposes of the covered agreement for an individual's personal financial gain, the Board may take either or both of the following actions—

(1) Order the individual to disgorge the diverted funds or resources received under the agreement;

(2) Prohibit the individual from being a party to any covered agreement for a period not to exceed 10 years.

(c) *Notice and opportunity to respond.* Before making a determination under paragraph (a)(1) of this section, or taking any action under paragraph (b) of this section, the Board will provide written notice and an opportunity to present information to the Board concerning any relevant facts or circumstances relating to the matter.

(d) *Inadvertent or de minimis errors.* Inadvertent or de minimis errors in annual reports or other documents filed with the Board under §§ 207.6 or 207.7 will not subject the reporting party to any penalty.

(e) *Enforcement of provisions in covered agreements.* No provision of this part shall be construed as authorizing the Board to enforce the provisions of any covered agreement.

§ 207.10 Transition provisions.

(a) *Disclosure of covered agreements entered into before the effective date of this part.* The following disclosure requirements apply to covered agreements that were entered into after November 12, 1999, and that terminated before April 1, 2001.

(1) *Disclosure to the public.* Each NGEP and each insured depository institution or affiliate that was a party to the agreement must make the agreement available to the public under § 207.6 until at least April 1, 2002.

(2) *Disclosure to the relevant supervisory agency*—(i) Each NGEP that was a party to the agreement must make the agreement available to the relevant supervisory agency under § 207.6 until at least April 1, 2002.

(ii) Each insured depository institution or affiliate that was a party to the agreement must, by June 30, 2001, provide each relevant supervisory agency either—

(A) A copy of the agreement under § 207.6(d)(1)(i); or

(B) The information described in § 207.6(d)(1)(ii) for each agreement.

(b) *Filing of annual reports that relate to fiscal years ending on or before December 31, 2000.* In the event that a NGEP, insured depository institution or affiliate has any information to report under § 207.7 for a fiscal year that ends on or before December 31, 2000, and that concerns a covered agreement entered into between May 12, 2000, and December 31, 2000, the annual report for that fiscal year must be provided no later than June 30, 2001, to—

(1) Each relevant supervisory agency; or

(2) In the case of a NGEP, to an insured depository institution or affiliate that is a party to the agreement in accordance with § 207.7(f)(2).

§ 207.11 Other definitions and rules of construction used in this part.

(a) *Affiliate.* ''Affiliate'' means—

(1) Any company that controls, is controlled by, or is under common control with another company; and

(2) For the purpose of determining whether an agreement is a covered agreement under § 207.2, an ''affiliate'' includes any company that would be under common control or merged with another company on consummation of any transaction pending before a Federal banking agency at the time—

(i) The parties enter into the agreement; and

(ii) The NGEP that is a party to the agreement makes a CRA communication, as described in § 207.3.

(b) *Control.* ''Control'' is defined in section 2(a) of the Bank Holding Company Act (12 U.S.C. 1841(a)).

(c) *CRA affiliate.* A ''CRA affiliate'' of an insured depository institution is any company that is an affiliate of an insured depository institution to the extent, and only to the extent, that the activities of the affiliate were considered by the appropriate Federal banking agency when evaluating the CRA performance of the institution at its

most recent CRA examination prior to the agreement. An insured depository institution or affiliate also may designate any company as a CRA affiliate at any time prior to the time a covered agreement is entered into by informing the NGEP that is a party to the agreement of such designation.

(d) *CRA public file.* ''CRA public file'' means the public file maintained by an insured depository institution and described in § 228.43 of Regulation BB (12 CFR 228.43).

(e) *Executive officer.* The term ''executive officer'' has the same meaning as in § 215.2(e)(1) of the Board's Regulation O (12 CFR 215.2(e)(1)).

(f) *Federal banking agency; appropriate Federal banking agency.* The terms ''Federal banking agency'' and ''appropriate Federal banking agency'' have the same meanings as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(g) *Fiscal year.* (1) The fiscal year for a NGEP that does not have a fiscal year shall be the calendar year.

(2) Any NGEP, insured depository institution, or affiliate that has a fiscal year may elect to have the calendar year be its fiscal year for purposes of this part.

(h) *Insured depository institution.* ''Insured depository institution'' has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(i) *NGEP.* ''NGEP'' means a nongovernmental entity or person.

(j) *Nongovernmental entity or person*—(1) *General.* A ''nongovernmental entity or person'' is any partnership, association, trust, joint venture, joint stock company, corporation, limited liability corporation, company, firm, society, other organization, or individual.

(2) *Exclusions.* A nongovernmental entity or person does not include—

(i) The United States government, a state government, a unit of local government (including a county, city, town, township, parish, village, or other general-purpose subdivision of a state) or an Indian tribe or tribal organization established under Federal, state or Indian tribal law (including the Department of Hawaiian Home Lands), or a department, agency, or instrumentality of any such entity;

(ii) A federally-chartered public corporation that receives Federal funds appropriated specifically for that corporation;

(iii) An insured depository institution or affiliate of an insured depository institution; or

(iv) An officer, director, employee, or representative (acting in his or her capacity as an officer, director, employee, or representative) of an entity listed in paragraphs (i)(2)(i) through (iii) of this section.

(k) *Party.* The term ''party'' with respect to a covered agreement means each NGEP and each insured depository institution or affiliate that entered into the agreement.

(l) *Relevant supervisory agency.* The ''relevant supervisory agency'' for a covered agreement means the appropriate Federal banking agency for—

(1) Each insured depository institution (or subsidiary thereof) that is a party to the covered agreement;

(2) Each insured depository institution (or subsidiary thereof) or CRA affiliate that makes payments or loans or provides services that are subject to the covered agreement; and

(3) Any company (other than an insured depository institution or subsidiary thereof) that is a party to the covered agreement.

(m) *Term of agreement.* An agreement that does not have a fixed termination date is considered to terminate on the last date on which any party to the agreement makes any payment or provides any loan or other resources under the agreement, unless the relevant supervisory agency for the agreement otherwise notifies each party in writing.

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

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AUTHORITY: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831,

1831o, 1831p–1, 1831r–1, 1831w, 1831x, 1835a, 1882, 2901–2907, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318, 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

SOURCE: Reg. H, 17 FR 8006, Sept. 4, 1952, unless otherwise noted.

Subpart A—General Membership and Branching Requirements

SOURCE: 63 FR 37637, July 13, 1998, unless otherwise noted.

§ 208.1 Authority, purpose, and scope.

(a) *Authority*. Subpart A of Regulation H (12 CFR part 208, Subpart A) is issued by the Board of Governors of the Federal Reserve System (Board) under 12 U.S.C. 24, 36; sections 9, 11, 21, 25 and 25A of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), 481–486, 601 and 611); sections 1814, 1816, 1818, 1831o, 1831p–1, 1831r–1 and 1835a of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1814, 1816, 1818, 1831o, 1831p–1, 1831r–1, and 1835); and 12 U.S.C. 3906–3909.

(b) *Purpose and scope of Part 208*. The requirements of this part 208 govern State member banks and state banks applying for admission to membership in the Federal Reserve System (System) under section 9 of the Federal Reserve Act (Act), except for § 208.7, which also applies to certain foreign banks licensed by a State. This part 208 does not govern banks eligible for membership under section 2 or 19 of the Act.[1] Any bank desiring to be admitted to the System under the provisions of section 2 or 19 should communicate with the Federal Reserve Bank with which it would like to become a member.

[1] Under section 2 of the Federal Reserve Act, every national bank in any state shall, upon commencing business, or within 90 days after admission into the Union of the State in which it is located, become a member of the System. Under section 19 of the Federal Reserve Act, national banks and banks organized under local laws, located in a dependency or insular possession or any part of the United States outside of the States of the United States and the District of Columbia, are not required to become members of the System but may, with the consent of the board, become members of the System.

(c) *Purpose and scope of Subpart A*. This Subpart A describes the eligibility requirements for membership of state-chartered banking institutions in the System, the general conditions imposed upon members, including capital and dividend requirements, as well as the requirements for establishing and maintaining branches.

§ 208.2 Definitions.

For the purposes of this part:

(a) *Board of Directors* means the governing board of any institution performing the usual functions of a board of directors.

(b) *Board* means the Board of Governors of the Federal Reserve System.

(c) *Branch*. (1) Branch means any branch bank, branch office, branch agency, additional office, or any branch place of business that receives deposits, pays checks, or lends money. A branch may include a temporary, seasonal, or mobile facility that meets these criteria.

(2) *Branch* does not include:

(i) A loan origination facility where the proceeds of loans are not disbursed;

(ii) An office of an affiliated or unaffiliated institution that provides services to customers of the member bank on behalf of the member bank so long as the institution is not established or operated by the bank;

(iii) An automated teller machine;

(iv) A remote service unit;

(v) A facility to which the bank does not permit members of the public to have physical access for purposes of making deposits, paying checks, or borrowing money (such as an office established by the bank that receives deposits only through the mail); or

(vi) A facility that is located at the site of, or is an extension of, an approved main office or branch. The Board determines whether a facility is an extension of an existing main or branch office on a case-by-case basis.

(d) *Capital stock and surplus* means, unless otherwise provided in this part, or by statute, Tier 1 and Tier 2 capital included in a member bank's risk-based capital (under the guidelines in appendix A of this part) and the balance of a member bank's allowance for loan and lease losses not included in its Tier 2 capital for calculation of risk-based

capital, based on the bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 324.

(e) *Eligible bank* means a member bank that:

(1) Is well capitalized as defined in subpart D of this part;

(2) Has a composite Uniform Financial Institutions Rating System (CAMELS) rating of 1 or 2;

(3) Has a Community Reinvestment Act (CRA) (12 U.S.C. 2906) rating of ''Outstanding'' or ''Satisfactory;''

(4) Has a compliance rating of 1 or 2; and

(5) Has no major unresolved supervisory issues outstanding (as determined by the Board or appropriate Federal Reserve Bank in its discretion).

(f) *State bank* means any bank incorporated by special law of any State, or organized under the general laws of any State, or of the United States, including a Morris Plan bank, or other incorporated banking institution engaged in a similar business.

(g) *State member bank or member bank* means a state bank that is a member of the Federal Reserve System.

§ 208.3 Application and conditions for membership in the Federal Reserve System.

(a) *Applications for membership and stock.* (1) State banks applying for membership in the Federal Reserve System shall file with the appropriate Federal Reserve Bank an application for membership in the Federal Reserve System and for stock in the Reserve Bank,[2] in accordance with this part and § 262.3 of the Rules of Procedure, located at 12 CFR 262.3.

(2) *Board approval.* If an applying bank conforms to all the requirements of the Federal Reserve Act and this section, and is otherwise qualified for membership, the Board may approve its application subject to such conditions as the Board may prescribe.

(3) *Effective date of membership.* A State bank becomes a member of the Federal Reserve System on the date its Federal Reserve Bank stock is credited to its account (or its deposit is accepted, if it is a mutual savings bank not authorized to purchase Reserve Bank stock) in accordance with the Board's Regulation I (12 CFR part 209).

(b) *Factors considered in approving applications for membership.* Factors given special consideration by the Board in passing upon an application are:

(1) *Financial condition and management.* The financial history and condition of the applying bank and the general character of its management.

(2) *Capital.* The adequacy of the bank's capital in accordance with § 208.4, and its future earnings prospects.

(3) *Convenience and needs.* The convenience and needs of the community.

(4) *Corporate powers.* Whether the bank's corporate powers are consistent with the purposes of the Federal Reserve Act.

(c) *Expedited approval for eligible banks and bank holding companies.* (1) *Availability of expedited treatment.* The expedited membership procedures described in paragraph (c)(2) of this section are available to:

(i) An eligible bank; and

(ii) A bank that cannot be determined to be an eligible bank because it has not received CAMELS compliance or CRA ratings from a bank regulatory authority, if it is controlled by a bank holding company that meets the criteria for expedited processing under § 225.14(c) of Regulation Y (12 CFR 225.14(c)).

(2) *Expedited procedures.* A completed membership application filed with the appropriate Reserve Bank will be deemed approved on the fifteenth day after receipt of the complete application by the Board or appropriate Reserve Bank, unless the Board or the appropriate Reserve Bank notifies the bank that the application is approved prior to that date or the Board or the appropriate Federal Reserve Bank notifies the bank that the application is not eligible for expedited review for

[2] A mutual savings bank not authorized to purchase Federal Reserve Bank stock may apply for membership evidenced initially by a deposit, but if the laws under which the bank is organized are not amended at the first session of the legislature after its admission to authorize the purchase, or if the bank fails to purchase the stock within six months of the amendment, its membership shall be terminated.

any reason, including, without limitation, that:

(i) The bank will offer banking services that are materially different from those currently offered by the bank, or by the affiliates of the proposed bank;

(ii) The bank or bank holding company does not meet the criteria under § 208.3(c)(1);

(iii) The application contains a material error or is otherwise deficient; or

(iv) The application raises significant supervisory, compliance, policy or legal issues that have not been resolved, or a timely substantive adverse comment is submitted. A comment will be considered substantive unless it involves individual complaints, or raises frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues.

(d) *Conditions of membership.* (1) *Safety and soundness.* Each member bank shall at all times conduct its business and exercise its powers with due regard to safety and soundness. Each member bank shall comply with the Interagency Guidelines Establishing Standards for Safety and Soundness prescribed pursuant to section 39 of the FDI Act (12 U.S.C. 1831p–1), set forth in appendix D–1 to this part, and the Interagency Guidelines Establishing Standards for Safeguarding Customer Information prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805), set forth in appendix D–2 to this part.

(2) *General character of bank's business.* A member bank may not, without the permission of the Board, cause or permit any change in the general character of its business or in the scope of the corporate powers it exercises at the time of admission to membership.

(3) *Compliance with conditions of membership.* Each member bank shall comply at all times with this Regulation H (12 CFR part 208) and any other conditions of membership prescribed by the Board.

(e) *Waivers.* (1) *Conditions of membership.* A member bank may petition the Board to waive a condition of membership. The Board may grant a waiver of a condition of membership upon a showing of good cause and, in its discretion, may limit, among other items, the scope, duration, and timing of the waiver.

(2) *Reports of affiliates.* Pursuant to section 21 of the Federal Reserve Act (12 U.S.C. 486), the Board waives the requirement for the submission of reports of affiliates of member banks, unless such reports are specifically requested by the Board.

(f) *Voluntary withdrawal from membership.* Voluntary withdrawal from membership becomes effective upon cancellation of the Federal Reserve Bank stock held by the member bank, and after the bank has made due provision to pay any indebtedness due or to become due to the Federal Reserve Bank in accordance with the Board's Regulation I (12 CFR part 209).

[Reg. H, 63 FR 37637, July 13, 1998, as amended at 63 FR 58620, Nov. 2, 1998; 66 FR 8634, Feb. 1, 2001]

§ 208.4 Capital adequacy.

(a) *Adequacy.* A member bank's capital, as defined in appendix A to this part, shall be at all times adequate in relation to the character and condition of its assets and to its existing and prospective liabilities and other corporate responsibilities. If at any time, in light of all the circumstances, the bank's capital appears inadequate in relation to its assets, liabilities, and responsibilities, the bank shall increase the amount of its capital, within such period as the Board deems reasonable, to an amount which, in the judgment of the Board, shall be adequate.

(b) *Standards for evaluating capital adequacy.* Standards and guidelines by which the Board evaluates the capital adequacy of member banks include those in appendices A and E to this part for risk-based capital purposes and appendix B to this part for leverage measurement purposes.

§ 208.5 Dividends and other distributions.

(a) *Definitions.* For the purposes of this section:

(1) *Capital surplus* means the total of surplus as reportable in the bank's Reports of Condition and Income and surplus on perpetual preferred stock.

(2) *Permanent capital* means the total of the bank's perpetual preferred stock and related surplus, common stock and

surplus, and minority interest in consolidated subsidiaries, as reportable in the Reports of Condition and Income.

(b) *Limitations.* The limitations in this section on the payment of dividends and withdrawal of capital apply to all cash and property dividends or distributions on common or preferred stock. The limitations do not apply to dividends paid in the form of common stock.

(c) *Earnings limitations on payment of dividends.* (1) A member bank may not declare or pay a dividend if the total of all dividends declared during the calendar year, including the proposed dividend, exceeds the sum of the bank's net income (as reportable in its Reports of Condition and Income) during the current calendar year and the retained net income of the prior two calendar years, unless the dividend has been approved by the Board.

(2) ''Retained net income'' in a calendar year is equal to the bank's net income (as reported in its Report of Condition and Income for such year), less any dividends declared during such year.[3] The bank's net income during the current year and its retained net income from the prior two calendar years is reduced by any net losses incurred in the current or prior two years and any required transfers to surplus or to a fund for the retirement of preferred stock.[4]

(d) *Limitation on withdrawal of capital by dividend or otherwise.* (1) A member bank may not declare or pay a dividend if the dividend would exceed the bank's undivided profits as reportable on its Reports of Condition and Income, unless the bank has received the prior approval of the Board and of at least two-thirds of the shareholders of each class of stock outstanding.

(2) A member bank may not permit any portion of its permanent capital to be withdrawn unless the withdrawal has been approved by the Board and by at least two-thirds of the shareholders of each class of stock outstanding.

(3) If a member bank has capital surplus in excess of that required by law, the excess amount may be transferred to the bank's undivided profits account and be available for the payment of dividends if:

(i) The amount transferred came from the earnings of prior periods, excluding earnings transferred as a result of stock dividends;

(ii) The bank's board of directors approves the transfer of funds; and

(iii) The transfer has been approved by the Board.

(e) *Payment of capital distributions.* All member banks also are subject to the restrictions on payment of capital distributions contained in § 208.45 of subpart D of this part implementing section 38 of the FDI Act (12 U.S.C. 1831o).

(f) *Compliance.* A member bank shall use the date a dividend is declared to determine compliance with this section.

§ 208.6 Establishment and maintenance of branches.

(a) *Branching.* (1) To the extent authorized by state law, a member bank may establish and maintain branches (including interstate branches) subject to the same limitations and restrictions that apply to the establishment and maintenance of national bank branches (12 U.S.C. 36 and 1831u), except that approval of such branches

[3] In the case of dividends in excess of net income for the year, a bank generally is not required to carry forward negative amounts resulting from such excess. Instead, the bank may attribute the excess to the prior two years, attributing the excess first to the earlier year and then to the immediately preceding year. If the excess is greater than the bank's previously undistributed net income for the preceding two years, prior Board approval of the dividend is required and a negative amount would be carried forward in future dividend calculations. However, in determining any such request for approval, the Board could consider any request for different treatment of such negative amount, including advance waivers for future periods. This applies only to earnings deficits that result from dividends declared in excess of net income for the year and does not apply to other types of current earnings deficits.

[4] State member banks are required to comply with state law provisions concerning the maintenance of surplus funds in addition to common capital. Where the surplus of a State member bank is less than what applicable state law requires the bank to maintain relative to its capital stock account, the bank may be required to transfer amounts from its undivided profits account to surplus.

shall be obtained from the Board rather than from the Comptroller of the Currency.

(2) *Branch applications.* A State member bank wishing to establish a branch in the United States or its territories must file an application in accordance with the Board's Rules of Procedure, located at 12 CFR 262.3, and must comply with the public notice and comment rules contained in paragraphs (a)(3) and (a)(4) of this section. Branches of member banks located in foreign nations, in the overseas territories, dependencies, and insular possessions of those nations and of the United States, and in the Commonwealth of Puerto Rico, are subject to the Board's Regulation K (12 CFR part 211).

(3) *Public notice of branch applications.* (i) *Location of publication.* A State member bank wishing to establish a branch in the United States or its territories must publish notice in a newspaper of general circulation in the form and at the locations specified in § 262.3 of the Rules of Procedure (12 CFR 262.3).

(ii) *Contents of notice.* The newspaper notice referred to in paragraph (a)(3) of this section shall provide an opportunity for interested persons to comment on the application for a period of at least 15 days.

(iii) *Timing of publication.* Each newspaper notice shall be published no more than 7 calendar days before and no later than the calendar day on which an application is filed with the appropriate Reserve Bank.

(4) *Public comment.* (i) *Timely comments.* Interested persons may submit information and comments regarding a branch application under § 208.6. A comment shall be considered timely for purposes of this subpart if the comment, together with all supplemental information, is submitted in writing in accordance with the Board's Rules of Procedure (12 CFR 262.3) and received by the Board or the appropriate Reserve Bank prior to the expiration of the public comment period provided in paragraph (a)(3)(ii) of this section.

(ii) *Extension of comment period.* The Board may, in its discretion, extend the public comment period regarding any application under § 208.6. In the event that an interested person requests a copy of an application submitted under § 208.6, the Board may, in its discretion and based on the facts and circumstances, grant such person an extension of the comment period for up to 15 calendar days.

(b) *Factors considered in approving domestic branch applications.* Factors given special consideration by the Board in passing upon a branch application are:

(1) *Financial condition and management.* The financial history and condition of the applying bank and the general character of its management;

(2) *Capital.* The adequacy of the bank's capital in accordance with § 208.4, and its future earnings prospects;

(3) *Convenience and needs.* The convenience and needs of the community to be served by the branch;

(4) *CRA performance.* In the case of branches with deposit-taking capability, the bank's performance under the Community Reinvestment Act (12 U.S.C. 2901 *et seq.*) and Regulation BB (12 CFR part 228); and

(5) *Investment in bank premises.* Whether the bank's investment in bank premises in establishing the branch is consistent with § 208.21.

(c) *Expedited approval for eligible banks and bank holding companies.* (1) *Availability of expedited treatment.* The expedited branch application procedures described in paragraph (c)(2) of this section are available to:

(i) An eligible bank; and

(ii) A bank that cannot be determined to be an eligible bank because it has not received CAMELS compliance or CRA ratings from a bank regulatory authority, if it is controlled by a bank holding company that meets the criteria for expedited processing under § 225.14(c) of Regulation Y (12 CFR 225.14(c)).

(2) *Expedited procedures.* A completed domestic branch application filed with the appropriate Reserve Bank will be deemed approved on the fifth day after the close of the comment period, unless the Board or the appropriate Reserve Bank notifies the bank that the application is approved prior to that date (but in no case will an application be approved before the third day after the

close of the public comment period) or the Board or the appropriate Federal Reserve Bank notifies the bank that the application is not eligible for expedited review for any reason, including, without limitation, that:

(i) The bank or bank holding company does not meet the criteria under § 208.6(c)(1);

(ii) The application contains a material error or is otherwise deficient; or

(iii) The application or the notice required under paragraph (a)(3) of this section, raises significant supervisory, Community Reinvestment Act, compliance, policy or legal issues that have not been resolved, or a timely substantive adverse comment is submitted. A comment will be considered substantive unless it involves individual complaints, or raises frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues.

(d) *Consolidated Applications.* (1) *Proposed branches; notice of branch opening.* A member bank may seek approval in a single application or notice for any branches that it proposes to establish within one year after the approval date. The bank shall, unless notification is waived, notify the appropriate Reserve Bank not later than 30 days after opening any branch approved under a consolidated application. A bank is not required to open a branch approved under either a consolidated or single branch application.

(2) *Duration of branch approval.* Branch approvals remain valid for one year unless the Board or the appropriate Reserve Bank notifies the bank that in its judgment, based on reports of condition, examinations, or other information, there has been a change in the bank's condition, financial or otherwise, that warrants reconsideration of the approval.

(e) *Branch closings.* A member bank shall comply with section 42 of the FDI Act (FDI Act), 12 U.S.C. 1831r–1, with regard to branch closings.

(f) *Branch relocations.* A relocation of an existing branch does not require filing a branch application. A relocation of an existing branch, for purposes of determining whether to file a branch application, is a movement that does not substantially affect the nature of the branch's business or customers served.

[63 FR 37639, July 13, 1998, as amended at 63 FR 58621, Nov. 2, 1998]

§ 208.7 Prohibition against use of interstate branches primarily for deposit production.

(a) *Purpose and scope*—(1) *Purpose.* The purpose of this section is to implement section 109 (12 U.S.C. 1835a) of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act).

(2) *Scope.* (i) This section applies to any State member bank that has operated a covered interstate branch for a period of at least one year, and any foreign bank that has operated a covered interstate branch licensed by a State for a period of at least one year.

(ii) This section describes the requirements imposed under 12 U.S.C. 1835a, which requires the appropriate Federal banking agencies (the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) to prescribe uniform rules that prohibit a bank from using any authority to engage in interstate branching pursuant to the Interstate Act, or any amendment made by the Interstate Act to any other provision of law, primarily for the purpose of deposit production.

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

(1) *Bank* means, unless the context indicates otherwise:

(i) A State member bank as that term is defined in 12 U.S.C. 1813(d)(2); and

(ii) A foreign bank as that term is defined in 12 U.S.C. 3101(7) and 12 CFR 211.21.

(2) *Covered interstate branch* means any branch of a State member bank, and any uninsured branch of a foreign bank licensed by a State, that:

(i) Is established or acquired outside the bank's home state pursuant to the interstate branching authority granted by the Interstate Act or by any amendment made by the Interstate Act to any other provision of law; or

(ii) Could not have been established or acquired outside of the bank's home

state but for the establishment or acquisition of a branch described in paragraph (b)(2)(i) of this section.

(3) *Home state* means:

(i) With respect to a state bank, the state that chartered the bank;

(ii) With respect to a national bank, the state in which the main office of the bank is located; and

(iii) With respect to a foreign bank, the home state of the foreign bank as determined in accordance with 12 U.S.C. 3103(c) and 12 CFR 211.22.

(4) *Host state* means a state in which a bank establishes or acquires a covered interstate branch.

(5) *Host state loan-to-deposit ratio* generally means, with respect to a particular host state, the ratio of total loans in the host state relative to total deposits from the host state for all banks (including institutions covered under the definition of ''bank'' in 12 U.S.C. 1813(a)(1)) that have that state as their home state, as determined and updated periodically by the appropriate Federal banking agencies and made available to the public.

(6) *State* means state as that term is defined in 12 U.S.C. 1813(a)(3).

(7) *Statewide loan-to-deposit ratio* means, with respect to a bank, the ratio of the bank's loans to its deposits in a state in which the bank has one or more covered interstate branches, as determined by the Board.

(c) *Loan-to-deposit ratio screen*—(1) *Application of screen.* Beginning no earlier than one year after a bank establishes or acquires a covered interstate branch, the Board will consider whether the bank's statewide loan-to-deposit ratio is less than 50 percent of the relevant host state loan-to-deposit ratio.

(2) *Results of screen.* (i) If the Board determines that the bank's statewide loan-to-deposit ratio is 50 percent or more of the host state loan-to-deposit ratio, no further consideration under this section is required.

(ii) If the Board determines that the bank's statewide loan-to-deposit ratio is less than 50 percent of the host state loan-to-deposit ratio, or if reasonably available data are insufficient to calculate the bank's statewide loan-to-deposit ratio, the Board will make a credit needs determination for the bank as provided in paragraph (d) of this section.

(d) *Credit needs determination*—(1) *In general.* The Board will review the loan portfolio of the bank and determine whether the bank is reasonably helping to meet the credit needs of the communities in the host state that are served by the bank.

(2) *Guidelines.* The Board will use the following considerations as guidelines when making the determination pursuant to paragraph (d)(1) of this section:

(i) Whether covered interstate branches were formerly part of a failed or failing depository institution;

(ii) Whether covered interstate branches were acquired under circumstances where there was a low loan-to-deposit ratio because of the nature of the acquired institution's business or loan portfolio;

(iii) Whether covered interstate branches have a high concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state;

(iv) The Community Reinvestment Act ratings received by the bank, if any, under 12 U.S.C. 2901 *et seq.*;

(v) Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches;

(vi) The safe and sound operation and condition of the bank; and

(vii) The Board's Regulation BB—Community Reinvestment (12 CFR part 228) and interpretations of that regulation.

(e) *Sanctions*—(1) *In general.* If the Board determines that a bank is not reasonably helping to meet the credit needs of the communities served by the bank in the host state, and that the bank's statewide loan-to-deposit ratio is less than 50 percent of the host state loan-to-deposit ratio, the Board:

(i) May order that a bank's covered interstate branch or branches be closed unless the bank provides reasonable assurances to the satisfaction of the Board, after an opportunity for public comment, that the bank has an acceptable plan under which the bank will reasonably help to meet the credit

needs of the communities served by the bank in the host state; and

(ii) Will not permit the bank to open a new branch in the host state that would be considered to be a covered interstate branch unless the bank provides reasonable assurances to the satisfaction of the Board, after an opportunity for public comment, that the bank will reasonably help to meet the credit needs of the community that the new branch will serve.

(2) *Notice prior to closure of a covered interstate branch.* Before exercising the Board's authority to order the bank to close a covered interstate branch, the Board will issue to the bank a notice of the Board's intent to order the closure and will schedule a hearing within 60 days of issuing the notice.

(3) *Hearing.* The Board will conduct a hearing scheduled under paragraph (e)(2) of this section in accordance with the provisions of 12 U.S.C. 1818(h) and 12 CFR part 263.

Subpart B—Investments and Loans

SOURCE: 63 FR 37641, July 13, 1998, unless otherwise noted.

§ 208.20 Authority, purpose, and scope.

(a) *Authority.* Subpart B of Regulation H (12 CFR part 208, subpart B) is issued by the Board of Governors of the Federal Reserve System under 12 U.S.C. 24; sections 9, 11 and 21 of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), and 481–486); sections 1814, 1816, 1818, 1823(j), 1831o, 1831p–1 and 1831r–1 of the FDI Act (12 U.S.C. 1814, 1816, 1818, 1823(j), 1831o, 1831p–1 and 1831r–1); and the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(b) *Purpose and scope.* This subpart B describes certain investment limitations on member banks, statutory requirements for amortizing losses on agricultural loans and extending credit in areas having special flood hazards, as well as the requirements for issuing letters of credit and acceptances.

§ 208.21 Investments in premises and securities.

(a) *Investment in bank premises.* No state member bank shall invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank, or make loans to or upon the security of any such corporation unless:

(1) The bank notifies the appropriate Reserve Bank at least fifteen days prior to such investment and has not received notice that the investment is subject to further review by the end of the fifteen day notice period;

(2) The aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation that is an affiliate of the bank (as defined in section 2 of the Banking Act of 1933, as amended, 12 U.S.C. 221a), is less than or equal to the bank's perpetual preferred stock and related surplus plus common stock plus surplus, as those terms are defined in the FFIEC Consolidated Reports of Condition and Income; or

(3)(i) The aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation that is an affiliate of the bank, is less than or equal to 150 percent of the bank's perpetual preferred stock and related surplus plus common stock plus surplus, as those terms are defined in the FFIEC Consolidated Reports of Condition and Income; and

(ii) The bank:

(A) Has a CAMELS composite rating of 1 or 2 under the Uniform Interagency Bank Rating System[5] (or an equivalent rating under a comparable rating system) as of the most recent examination of the bank; and

(B) Is well capitalized and will continue to be well capitalized, in accordance with subpart D of this part, after the investment or loan.

(b) *Investments in securities.* Member banks are subject to the same limitations and conditions with respect to purchasing, selling, underwriting, and holding investment securities and stocks as are national banks under 12 U.S.C. 24, ¶7th. To determine whether an obligation qualifies as an investment security for the purposes of 12

[5] *See* FRRS 3–1575 for an explanation of the Uniform Interagency Bank Rating System. (For availability, see 12 CFR 261.10(f).)

U.S.C. 24, ¶7th, and to calculate the limits with respect to the purchase of such obligations, a state member bank may look to part 1 of the rules of the Comptroller of the Currency (12 CFR part 1) and interpretations thereunder. A state member bank may consult the Board for a determination with respect to the application of 12 U.S.C. 24, ¶7th, with respect to issues not addressed in 12 CFR part 1. The provisions of 12 CFR part 1 do not provide authority for a state member bank to purchase securities of a type or amount that the bank is not authorized to purchase under applicable state law.

§ 208.22 Community development and public welfare investments.

(a) *Definitions.* For purposes of this section:

(1) *Low- or moderate-income area* means:

(i) One or more census tracts in a Metropolitan Statistical Area where the median family income adjusted for family size in each census tract is less than 80 percent of the median family income adjusted for family size of the Metropolitan Statistical Area; or

(ii) If not in a Metropolitan Statistical Area, one or more census tracts or block-numbered areas where the median family income adjusted for family size in each census tract or block-numbered area is less than 80 percent of the median family income adjusted for family size of the State.

(2) *Low- and moderate-income persons* has the same meaning as low- and moderate-income persons as defined in 42 U.S.C. 5302(a)(20)(A).

(3) *Small business* means a business that meets the size-eligibility standards of 13 CFR 121.802(a)(2).

(b) *Investments not requiring prior Board approval.* Notwithstanding the provisions of section 5136 of the Revised Statutes (12 U.S.C. 24, ¶7th) made applicable to member banks by paragraph 20 of section 9 of the Federal Reserve Act (12 U.S.C. 335), a member bank may make an investment, without prior Board approval, if the following conditions are met:

(1) The investment is in a corporation, limited partnership, or other entity, and:

(i) The Board has determined that an investment in that entity or class of entities is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), or a community development investment under Regulation Y (12 CFR 225.25(b)(6)); or

(ii) The Comptroller of the Currency has determined, by order or regulation, that an investment in that entity by a national bank is a public welfare investment under section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh)); or

(iii) The entity is a community development financial institution as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5)); or

(iv) The entity, directly or indirectly, engages solely in or makes loans solely for the purposes of one or more of the following community development activities:

(A) Investing in, developing, rehabilitating, managing, selling, or renting residential property if a majority of the units will be occupied by low- and moderate-income persons, or if the property is a ''qualified low-income building'' as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));

(B) Investing in, developing, rehabilitating, managing, selling, or renting nonresidential real property or other assets located in a low- or moderate-income area and targeted towards low- and moderate-income persons;

(C) Investing in one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(D) Investing in, developing, or otherwise assisting job training or placement facilities or programs that will be targeted towards low- and moderate-income persons;

(E) Investing in an entity located in a low- or moderate-income area if the entity creates long-term employment opportunities, a majority of which (based on full-time equivalent positions) will be held by low- and moderate-income persons; and

(F) Providing technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development;

(2) The investment is permitted by state law;

(3) The investment will not expose the member bank to liability beyond the amount of the investment;

(4) The aggregate of all such investments of the member bank does not exceed the sum of five percent of its capital stock and surplus;

(5) The member bank is well capitalized or adequately capitalized under §§ 208.43(b) (1) and (2);

(6) The member bank received a composite CAMELS rating of ''1'' or ''2'' under the Uniform Financial Institutions Rating System as of its most recent examination and an overall rating of ''1'' or ''2'' as of its most recent consumer compliance examination; and

(7) The member bank is not subject to any written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, or memorandum of understanding issued by the Board or a Federal Reserve Bank.

(c) *Notice to Federal Reserve Bank*. Not more than 30 days after making an investment under paragraph (b) of this section, the member bank shall advise its Federal Reserve Bank of the investment, including the amount of the investment and the identity of the entity in which the investment is made.

(d) *Investments requiring Board approval*. (1) With prior Board approval, a member bank may make public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), other than those specified in paragraph (b) of this section.

(2) Requests for Board approval under this paragraph (d) shall include, at a minimum:

(i) The amount of the proposed investment;

(ii) A description of the entity in which the investment is to be made;

(iii) An explanation of why the investment is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a);

(iv) A description of the member bank's potential liability under the proposed investment;

(v) The amount of the member bank's aggregate outstanding public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act;

(vi) The amount of the member bank's capital stock and surplus; and

(vii) If the bank investment is not eligible under paragraph (b) of this section, explain the reason or reasons why it is ineligible.

(3) The Board shall act on a request under this paragraph (d) within 60 calendar days of receipt of a request that meets the requirements of paragraph (d)(2) of this section, unless the Board notifies the requesting member bank that a longer time period will be required.

(e) *Divestiture of investments*. A member bank shall divest itself of an investment made under paragraph (b) or (d) of this section to the extent that the investment exceeds the scope of, or ceases to meet, the requirements of paragraphs (b)(1) through (b)(4) or paragraph (d) of this section. The divestiture shall be made in the manner specified in 12 CFR 225.140, Regulation Y, for interests acquired by a lending subsidiary of a bank holding company or the bank holding company itself in satisfaction of a debt previously contracted.

§ 208.23 Agricultural loan loss amortization.

(a) *Definitions*. For purposes of this section:

(1) *Accepting official* means:

(i) The Reserve Bank in whose district the bank is located; or

(ii) The Director of the Division of Banking Supervision and Regulation in cases in which the Reserve Bank cannot determine that the bank qualifies.

(2) *Agriculturally related other property* means any property, real or personal, that the bank owned on January 1, 1983, and any additional property that it acquired prior to January 1, 1992, in connection with a qualified agricultural loan. For the purposes of paragraph (d) of this section, the value of such property shall include the amount previously charged off as a loss.

(3) *Participating bank* means an agricultural bank (as defined in 12 U.S.C. 1823(j)(4)(A)) that, as of January 1, 1992, had a proposal for a capital restoration plan accepted by an accepting official and received permission from the accepting official, subject to paragraphs (d) and (e) of this section, to amortize losses in accordance with paragraphs (b) and (c) of this section.

(4) *Qualified agricultural loan* means:

(i) Loans that finance agricultural production or are secured by farm land for purposes of Schedule RC–C of the FFIEC Consolidated Report of Condition or such other comparable schedule;

(ii) Loans secured by farm machinery;

(iii) Other loans that a bank proves to be sufficiently related to agriculture for classification as an agricultural loan by the Board; and

(iv) The remaining unpaid balance of any loans described in paragraphs (a)(4)(i), (ii) and (iii) of this section that have been charged off since January 1, 1984, and that qualify for deferral under this section.

(b)(1) Provided there is no evidence that the loss resulted from fraud or criminal abuse on the part of the bank, the officers, directors, or principal shareholders, a participating bank may amortize in its Reports of Condition and Income:

(i) Any loss on a qualified agricultural loan that the bank would be required to reflect in its financial statements for any period between and including 1984 and 1991; or

(ii) Any loss that the bank would be required to reflect in its financial statements for any period between and including 1983 and 1991 resulting from a reappraisal or sale of agriculturally-related other property.

(2) Amortization under this section shall be computed over a period not to exceed seven years on a quarterly straight-line basis commencing in the first quarter after the loan was or is charged off so as to be fully amortized not later than December 31, 1998.

(c) *Accounting for amortization.* Any bank that is permitted to amortize losses in accordance with paragraph (b) of this section may restate its capital and other relevant accounts and account for future authorized deferrals and authorizations in accordance with the instructions to the FFIEC Consolidated Reports of Condition and Income. Any resulting increase in the capital account shall be included in qualifying capital pursuant to appendix A of this part.

(d) *Conditions of participation.* In order for a bank to maintain its status as a participating bank, it shall:

(1) Adhere to the approved capital plan and obtain the prior approval of the accepting official before making any modifications to the plan;

(2) Maintain accounting records for each asset subject to loss deferral under the program that document the amount and timing of the deferrals, repayments, and authorizations;

(3) Maintain the financial condition of the bank so that it does not deteriorate to the point where it is no longer a viable, fundamentally sound institution;

(4) Make a reasonable effort, consistent with safe and sound banking practices, to maintain in its loan portfolio a percentage of agricultural loans, including agriculturally-related other property, not less than the percentage of such loans in its loan portfolio on January 1, 1986; and

(5) Provide the accepting official, upon request, with any information the accepting official deems necessary to monitor the bank's amortization, its compliance with the conditions of participation, and its continued eligibility.

(e) *Revocation of eligibility for loss amortization.* The failure to comply with any condition in an acceptance, with the capital restoration plan, or with the conditions stated in paragraph (d) of this section, is grounds for revocation of acceptance for loss amortization and for an administrative action against the bank under 12 U.S.C. 1818(b). In addition, acceptance of a bank for loss amortization shall not foreclose any administrative action against the bank that the Board may deem appropriate.

(f) *Expiration date.* The terms of this section will no longer be in effect as of January 1, 1999.

§ 208.24 Letters of credit and acceptances.

(a) *Standby letters of credit.* For the purpose of this section, standby letters of credit include every letter of credit (or similar arrangement however named or designated) that represents an obligation to the beneficiary on the part of the issuer:

(1) To repay money borrowed by or advanced to or for the account of the account party; or

(2) To make payment on account of any evidence of indebtedness undertaken by the account party; or

(3) To make payment on account of any default by the party procuring the issuance of the letter of credit in the performance of an obligation.[6]

(b) *Ineligible acceptance.* An ineligible acceptance is a time draft accepted by a bank, which does not meet the requirements for discount with a Federal Reserve Bank.

(c) *Bank's lending limits.* Standby letters of credit and ineligible acceptances count toward member banks' lending limits imposed by state law.

(d) *Exceptions.* A standby letter of credit or ineligible acceptance is not subject to the restrictions set forth in paragraph (c) of this section if prior to or at the time of issuance of the credit:

(1) The issuing bank is paid an amount equal to the bank's maximum liability under the standby letter of credit; or

(2) The party procuring the issuance of a letter of credit or ineligible acceptance has set aside sufficient funds in a segregated, clearly earmarked deposit account to cover the bank's maximum liability under the standby letter of credit or ineligible acceptance.

§ 208.25 Loans in areas having special flood hazards.

(a) *Purpose and scope.* (1) *Purpose.* The purpose of this section is to implement the requirements of the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(2) *Scope.* This section, except for paragraphs (f) and (h) of this section, applies to loans secured by buildings or mobile homes located or to be located in areas determined by the Director of the Federal Emergency Management Agency to have special flood hazards. Paragraphs (f) and (h) of this section apply to loans secured by buildings or mobile homes, regardless of location.

(b) *Definitions.* For purposes of this section:

(1) *Act* means the National Flood Insurance Act of 1968, as amended (42 U.S.C. 4001–4129).

(2) *Building* means a walled and roofed structure, other than a gas or liquid storage tank, that is principally above ground and affixed to a permanent site, and a walled and roofed structure while in the course of construction, alteration, or repair.

(3) *Community* means a State or a political subdivision of a State that has zoning and building code jurisdiction over a particular area having special flood hazards.

(4) *Designated loan* means a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in which flood insurance is available under the Act.

(5) *Director of FEMA* means the Director of the Federal Emergency Management Agency.

(6) *Mobile home* means a structure, transportable in one or more sections, that is built on a permanent chassis and designed for use with or without a permanent foundation when attached to the required utilities. The term *mobile home* does not include a recreational vehicle. For purposes of this section, the term *mobile home* means a mobile home on a permanent foundation. The term *mobile home* includes a manufactured home as that term is used in the National Flood Insurance Program.

(7) *NFIP* means the National Flood Insurance Program authorized under the Act.

(8) *Residential improved real estate* means real estate upon which a home or other residential building is located or to be located.

[6] A standby letter of credit does not include: (1) Commercial letters of credit and similar instruments, where the issuing bank expects the beneficiary to draw upon the issuer, and which do not guaranty payment of a money obligation; or (2) a guaranty or similar obligation issued by a foreign branch in accordance with and subject to the limitations of 12 CFR part 211 (Regulation K).

(9) *Servicer* means the person responsible for:

(i) Receiving any scheduled, periodic payments from a borrower under the terms of a loan, including amounts for taxes, insurance premiums, and other charges with respect to the property securing the loan; and

(ii) Making payments of principal and interest and any other payments from the amounts received from the borrower as may be required under the terms of the loan.

(10) *Special flood hazard area* means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Director of FEMA.

(11) *Table funding* means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.

(c) *Requirement to purchase flood insurance where available.* (1) *In general.* A member bank shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located.

(2) *Table funded loans.* A member bank that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purposes of this section.

(d) *Exemptions.* The flood insurance requirement prescribed by paragraph (c) of this section does not apply with respect to:

(1) Any State-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA, who publishes and periodically revises the list of States falling within this exemption; or

(2) Property securing any loan with an original principal balance of $5,000 or less and a repayment term of one year or less.

(e) *Escrow requirement.* If a member bank requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by *residential* improved real estate or a mobile home that is made, increased, extended, or renewed after October 1, 1996, the member bank shall also require the escrow of all premiums and fees for any flood insurance required under paragraph (c) of this section. The member bank, or a servicer acting on its behalf, shall deposit the flood insurance premiums on behalf of the borrower in an escrow account. This escrow account will be subject to escrow requirements adopted pursuant to section 10 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2609) (RESPA), which generally limits the amount that may be maintained in escrow accounts for certain types of loans and requires escrow account statements for those accounts, only if the loan is otherwise subject to RESPA. Following receipt of a notice from the Director of FEMA or other provider of flood insurance that premiums are due, the member bank, or a servicer acting on its behalf, shall pay the amount owed to the insurance provider from the escrow account by the date when such premiums are due.

(f) *Required use of standard flood hazard determination form.* (1) *Use of form.* A member bank shall use the standard flood hazard determination form developed by the Director of FEMA when determining whether the building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area in which flood insurance is available under the Act. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner. A member bank may obtain the standard flood hazard determination form by written request to FEMA, P.O. Box 2012, Jessup, MD 20794–2012.

(2) *Retention of form.* A member bank shall retain a copy of the completed standard flood hazard determination form, in either hard copy or electronic form, for the period of time the bank owns the loan.

(g) *Forced placement of flood insurance.* If a member bank, or a servicer acting on behalf of the bank, determines at any time during the term of a designated loan that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered by flood insurance in an amount less than the amount required under paragraph (c) of this section, then the bank or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required under paragraph (c) of this section, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the member bank or its servicer shall purchase insurance on the borrower's behalf. The member bank or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance.

(h) *Determination fees.* (1) *General.* Notwithstanding any Federal or State law other than the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129), any member bank, or a servicer acting on behalf of the bank, may charge a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a special flood hazard area. A determination fee may also include, but is not limited to, a fee for life-of-loan monitoring.

(2) *Borrower fee.* The determination fee authorized by paragraph (h)(1) of this section may be charged to the borrower if the determination:

(i) Is made in connection with a making, increasing, extending, or renewing of the loan that is initiated by the borrower;

(ii) Reflects the Director of FEMA's revision or updating of flood plain areas or flood-risk zones;

(iii) Reflects the Director of FEMA's publication of a notice or compendium that:

(A) Affects the area in which the building or mobile home securing the loan is located; or

(B) By determination of the Director of FEMA, may reasonably require a determination whether the building or mobile home securing the loan is located in a special flood hazard area;

(iv) Results in the purchase of flood insurance coverage by the lender or its servicer on behalf of the borrower under paragraph (g) of this section.

(3) *Purchaser or transferee fee.* The determination fee authorized by paragraph (h)(1) of this section may be charged to the purchaser or transferee of a loan in the case of the sale or transfer of the loan.

(i) *Notice of special flood hazards and availability of Federal disaster relief assistance.* When a member bank makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area, the bank shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

(1) *Contents of notice.* The written notice must include the following information:

(i) A warning, in a form approved by the Director of FEMA, that the building or the mobile home is or will be located in a special flood hazard area;

(ii) A description of the flood insurance purchase requirements set forth in section 102(b) of the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4012a(b));

(iii) A statement, where applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers; and

(iv) A statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally declared disaster.

(2) *Timing of notice.* The member bank shall provide the notice required by paragraph (i)(1) of this section to the borrower within a reasonable time before the completion of the transaction, and to the servicer as promptly as practicable after the bank provides notice to the borrower and in any event no later than the time the bank provides other similar notices to the servicer concerning hazard insurance and taxes. Notice to the servicer may be made electronically or may take the

form of a copy of the notice to the borrower.

(3) *Record of receipt.* The member bank shall retain a record of the receipt of the notices by the borrower and the servicer for the period of time the bank owns the loan.

(4) *Alternate method of notice.* Instead of providing the notice to the borrower required by paragraph (i)(1) of this section, a member bank may obtain satisfactory written assurance from a seller or lessor that, within a reasonable time before the completion of the sale or lease transaction, the seller or lessor has provided such notice to the purchaser or lessee. The member bank shall retain a record of the written assurance from the seller or lessor for the period of time the bank owns the loan.

(5) *Use of prescribed form of notice.* A member bank will be considered to be in compliance with the requirement for notice to the borrower of this paragraph (i) by providing written notice to the borrower containing the language presented in appendix A of this section within a reasonable time before the completion of the transaction. The notice presented in appendix A of this section satisfies the borrower notice requirements of the Act.

(j) *Notice of servicer's identity.* (1) *Notice requirement.* When a member bank makes, increases, extends, renews, sells, or transfers a loan secured by a building or mobile home located or to be located in a special flood hazard area, the bank shall notify the Director of FEMA (or the Director's designee) in writing of the identity of the servicer of the loan. The Director of FEMA has designated the insurance provider to receive the member bank's notice of the servicer's identity. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee.

(2) *Transfer of servicing rights.* The member bank shall notify the Director of FEMA (or the Director's designee) of any change in the servicer of a loan described in paragraph (j)(1) of this section within 60 days after the effective date of the change. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee. Upon any change in the servicing of a loan described in paragraph (j)(1) of this section, the duty to provide notice under this paragraph (j)(2) shall transfer to the transferee servicer.

APPENDIX A TO § 208.25 SAMPLE FORM OF NOTICE

NOTICE OF SPECIAL FLOOD HAZARDS AND AVAILABILITY OF FEDERAL DISASTER RELIEF ASSISTANCE

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's *Flood Insurance Rate Map* or the *Flood Hazard Boundary Map* for the following community: _____. This area has a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

_____ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

• Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance also may be available from private insurers that do not participate in the NFIP.

• At a minimum, flood insurance purchased must cover *the lesser of*:

(1) the outstanding principal balance of the loan; *or*

(2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

• Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

_____Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the nonparticipating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally declared flood disaster.

[Reg. H, 63 FR 37641, July 13, 1998, as amended at 64 FR 71274, Dec. 21, 1999]

Subpart C—Bank Securities and Securities-Related Activities

SOURCE: 63 FR 37646, July 13, 1998, unless otherwise noted.

§ 208.30 Authority, purpose, and scope.

(a) *Authority*. Subpart C of Regulation H (12 CFR part 208, subpart C) is issued by the Board of Governors of the Federal Reserve System under 12 U.S.C. 24, 92a, 93a; sections 1818 and 1831p–1(a)(2) of the FDI Act (12 U.S.C. 1818, 1831p–1(a)(2)); and sections 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78o–5, 78q, 78q–1, and 78w of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78o–5, 78q, 78q–1, 78w).

(b) *Purpose and scope*. This subpart C describes the requirements imposed upon member banks acting as transfer agents, registered clearing agencies, or sellers of securities under the Securities Exchange Act of 1934. This subpart C also describes the reporting requirements imposed on member banks whose securities are subject to registration under the Securities Exchange Act of 1934.

§ 208.31 State member banks as transfer agents.

(a) The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1) prescribing procedures for registration of transfer agents for which the SEC is the appropriate regulatory agency (17 CFR 240.17Ac2–1) apply to member bank transfer agents. References to the ''Commission'' are deemed to refer to the Board.

(b) The rules adopted by the SEC pursuant to section 17A prescribing operational and reporting requirements for transfer agents (17 CFR 240.17Ac2–2 and 240.17Ad–1 through 240.17Ad–16) apply to member bank transfer agents.

§ 208.32 Notice of disciplinary sanctions imposed by registered clearing agency.

(a) *Notice requirement*. Any member bank or any of its subsidiaries that is a registered clearing agency pursuant to section 17A(b) of the Securities Exchange Act of 1934 (the Act), and that:

(1) Imposes any final disciplinary sanction on any participant therein;

(2) Denies participation to any applicant; or

(3) Prohibits or limits any person in respect to access to services offered by the clearing agency, shall file with the Board (and the appropriate regulatory agency, if other than the Board, for a participant or applicant) notice thereof in the manner prescribed in this section.

(b) *Notice of final disciplinary actions*. (1) Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final disciplinary action with respect to any participant shall promptly file a notice thereof with the Board in accordance with paragraph (c) of this section. For the purposes of this paragraph (b), *final disciplinary action* means the imposition of any disciplinary sanction pursuant to section 17A(b)(3)(G) of the Act, or other action of a registered clearing agency which, after notice and opportunity for hearing, results in final disposition of charges of:

(i) One or more violations of the rules of the registered clearing agency; or

(ii) Acts or practices constituting a statutory disqualification of a type defined in paragraph (iv) or (v) (except prior convictions) of section 3(a)(39) of the Act.

(2) However, if a registered clearing agency fee schedule specifies certain charges for errors made by its participants in giving instructions to the registered clearing agency which are *de*

minimis on a per error basis, and whose purpose is, in part, to provide revenues to the clearing agency to compensate it for effort expended in beginning to process an erroneous instruction, such error charges shall not be considered a final disciplinary action for purposes of this paragraph (b).

(c) *Contents of final disciplinary action notice.* Any notice filed pursuant to paragraph (b) of this section shall consist of the following, as appropriate:

(1) The name of the respondent and the respondent's last known address, as reflected on the records of the clearing agency, and the name of the person, committee, or other organizational unit that brought the charges. However, identifying information as to any respondent found not to have violated a provision covered by a charge may be deleted insofar as the notice reports the disposition of that charge and, prior to the filing of the notice, the respondent does not request that identifying information be included in the notice;

(2) A statement describing the investigative or other origin of the action;

(3) As charged in the proceeding, the specific provision or provisions of the rules of the clearing agency violated by the respondent, or the statutory disqualification referred to in paragraph (b)(2) of this section, and a statement describing the answer of the respondent to the charges;

(4) A statement setting forth findings of fact with respect to any act or practice in which the respondent was charged with having engaged in or omitted; the conclusion of the clearing agency as to whether the respondent violated any rule or was subject to a statutory disqualification as charged; and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceedings;

(5) A statement describing any sanction imposed, the reasons therefor, and the date upon which the sanction became or will become effective; and

(6) Such other matters as the clearing agency may deem relevant.

(d) *Notice of final denial, prohibition, termination or limitation based on qualification or administrative rules.* (1) Any registered clearing agency, for which the Board is the appropriate regulatory agency, that takes any final action that denies or conditions the participation of any person, or prohibits or limits access, to services offered by the clearing agency, shall promptly file notice thereof with the Board (and the appropriate regulatory agency, if other than the Board, for the affected person) in accordance with paragraph (e) of this section; but such action shall not be considered a final disciplinary action for purposes of paragraph (b) of this section where the action is based on an alleged failure of such person to:

(i) Comply with the qualification standards prescribed by the rules of the registered clearing agency pursuant to section 17A(b)(4)(B) of the Act; or

(ii) Comply with any administrative requirements of the registered clearing agency (including failure to pay entry or other dues or fees, or to file prescribed forms or reports) not involving charges of violations that may lead to a disciplinary sanction.

(2) However, no such action shall be considered final pursuant to this paragraph (d) that results merely from a notice of such failure to comply to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted the administrative remedies within the registered clearing agency with respect to such a matter.

(e) *Contents of notice required by paragraph (d) of this section.* Any notice filed pursuant to paragraph (d) of this section shall consist of the following, as appropriate:

(1) The name of each person concerned and each person's last known address, as reflected in the records of the clearing agency;

(2) The specific grounds upon which the action of the clearing agency was based, and a statement describing the answer of the person concerned;

(3) A statement setting forth findings of fact and conclusions as to each alleged failure of the person to comply with qualification standards or administrative obligations, and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceeding;

(4) The date upon which such action became or will become effective; and

(5) Such other matters as the clearing agency deems relevant.

(f) *Notice of final action based on prior adjudicated statutory disqualifications.* Any registered clearing agency for which the Board is the appropriate regulatory agency that takes any final action shall promptly file notice thereof with the Board (and the appropriate regulatory agency, if other than the Board, for the affected person) in accordance with paragraph (g) of this section, where the final action:

(1) Denies or conditions participation to any person, or prohibits or limits access to services offered by the clearing agency; and

(2) Is based upon a statutory disqualification of a type defined in paragraph (A), (B) or (C) of section 3(a)(39) of the Act, consisting of a prior conviction, as described in subparagraph (E) of section 3(a)(39) of the Act. However, no such action shall be considered final pursuant to this paragraph (f) that results merely from a notice of such disqualification to the person affected, if such person has not sought an adjudication of the matter, including a hearing, or otherwise exhausted the administrative remedies within the clearing agency with respect to such a matter.

(g) *Contents of notice required by paragraph (f) of this section.* Any notice filed pursuant to paragraph (f) of this section shall consist of the following, as appropriate:

(1) The name of each person concerned and each person's last known address, as reflected in the records of the clearing agency;

(2) A statement setting forth the principal issues raised, the answer of any person concerned, and a statement of the clearing agency in support of its resolution of the principal issues raised in the proceeding;

(3) Any description furnished by or on behalf of the person concerned of the activities engaged in by the person since the adjudication upon which the disqualification is based;

(4) A copy of the order or decision of the court, appropriate regulatory agency, or self-regulatory organization that adjudicated the matter giving rise to the statutory disqualification;

(5) The nature of the action taken and the date upon which such action is to be made effective; and

(6) Such other matters as the clearing agency deems relevant.

(h) *Notice of summary suspension of participation.* Any registered clearing agency for which the Board is the appropriate regulatory agency that summarily suspends or closes the accounts of a participant pursuant to the provisions of section 17A(b)(5)(C) of the Act shall, within one business day after such action becomes effective, file notice thereof with the Board and the appropriate regulatory agency for the participant, if other than the Board, of such action in accordance with paragraph (i) of this section.

(i) *Contents of notice of summary suspension.* Any notice pursuant to paragraph (h) of this section shall contain at least the following information, as appropriate:

(1) The name of the participant concerned and the participant's last known address, as reflected in the records of the clearing agency;

(2) The date upon which the summary action became or will become effective;

(3) If the summary action is based upon the provisions of section 17A(b)(5)(C)(i) of the Act, a copy of the relevant order or decision of the self-regulatory organization, if available to the clearing agency;

(4) If the summary action is based upon the provisions of section 17A(b)(5)(C)(ii) of the Act, a statement describing the default of any delivery of funds or securities to the clearing agency;

(5) If the summary action is based upon the provisions of section 17A(b)(5)(C)(iii) of the Act, a statement describing the financial or operating difficulty of the participant based upon which the clearing agency determined that the suspension and closing of accounts was necessary for the protection of the clearing agency, its participants, creditors, or investors;

(6) The nature and effective date of the suspension; and

(7) Such other matters as the clearing agency deems relevant.

§ 208.33 Application for stay or review of disciplinary sanctions imposed by registered clearing agency.

(a) *Stays.* The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for stays of disciplinary sanctions or summary suspensions imposed by registered clearing agencies (17 CFR 240.19d–2) apply to applications by member banks. References to the ''Commission'' are deemed to refer to the Board.

(b) *Reviews.* The regulations adopted by the Securities and Exchange Commission pursuant to section 19 of the Securities and Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for reviews of final disciplinary sanctions, denials of participation, or prohibitions or limitations of access to services imposed by registered clearing agencies (17 CFR 240.19d–3(a)–(f)) apply to applications by member banks. References to the ''Commission'' are deemed to refer to the Board. The Board's Uniform Rules of Practice and Procedure (12 CFR part 263) apply to review proceedings under this § 208.33 to the extent not inconsistent with this § 208.33.

§ 208.34 Recordkeeping and confirmation of certain securities transactions effected by State member banks.

(a) *Exceptions and safe and sound operations.* (1) A State member bank may be excepted from one or more of the requirements of this section if it meets one of the following conditions of paragraphs (a)(1)(i) through (a)(1)(iv) of this section:

(i) *De minimis transactions.* The requirements of paragraphs (c)(2) through (c)(4) and paragraphs (e)(1) through (e)(3) of this section shall not apply to banks having an average of less than 200 securities transactions per year for customers over the prior three calendar year period, exclusive of transactions in government securities;

(ii) *Government securities.* The recordkeeping requirements of paragraph (c) of this section shall not apply to banks effecting fewer than 500 government securities brokerage transactions per year; provided that this exception shall not apply to government securities transactions by a State member bank that has filed a written notice, or is required to file notice, with the Federal Reserve Board that it acts as a government securities broker or a government securities dealer;

(iii) *Municipal securities.* The municipal securities activities of a State member bank that are subject to regulations promulgated by the Municipal Securities Rulemaking Board shall not be subject to the requirements of this section; and

(iv) *Foreign branches.* The requirements of this section shall not apply to the activities of foreign branches of a State member bank.

(2) Every State member bank qualifying for an exemption under paragraph (a)(1) of this section that conducts securities transactions for customers shall, to ensure safe and sound operations, maintain effective systems of records and controls regarding its customer securities transactions that clearly and accurately reflect appropriate information and provide an adequate basis for an audit of the information.

(b) *Definitions.* For purposes of this section:

(1) *Asset-backed security* shall mean a security that is serviced primarily by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.

(2) *Collective investment fund* shall mean funds held by a State member bank as fiduciary and, consistent with local law, invested collectively as follows:

(i) In a common trust fund maintained by such bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as trustee, executor, administrator, guardian, or custodian under the Uniform Gifts to Minors Act; or

(ii) In a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or similar trusts which are exempt from Federal income taxation under the Internal Revenue Code (26 U.S.C.).

(3) *Completion of the transaction* effected by or through a state member bank shall mean:

(i) For purchase transactions, the time when the customer pays the bank any part of the purchase price (or the time when the bank makes the bookentry for any part of the purchase price if applicable); however, if the customer pays for the security prior to the time payment is requested or becomes due, then the transaction shall be completed when the bank transfers the security into the account of the customer; and

(ii) For sale transactions, the time when the bank transfers the security out of the account of the customer or, if the security is not in the bank's custody, then the time when the security is delivered to the bank; however, if the customer delivers the security to the bank prior to the time delivery is requested or becomes due then the transaction shall be completed when the banks makes payment into the account of the customer.

(4) *Crossing of buy and sell orders* shall mean a security transaction in which the same bank acts as agent for both the buyer and the seller.

(5) *Customer* shall mean any person or account, including any agency, trust, estate, guardianship, or other fiduciary account, for which a State member bank effects or participates in effecting the purchase or sale of securities, but shall not include a broker, dealer, bank acting as a broker or dealer, municipal securities broker or dealer, or issuer of the securities which are the subject of the transactions.

(6) *Debt security* as used in paragraph (c) of this section shall mean any security, such as a bond, debenture, note or any other similar instrument which evidences a liability of the issuer (including any security of this type that is convertible into stock or similar security) and fractional or participation interests in one or more of any of the foregoing; provided, however, that securities issued by an investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a–1 *et seq.*, shall not be included in this definition.

(7) *Government security* shall mean:

(i) A security that is a direct obligation of, or obligation guaranteed as to principal and interest by, the United States;

(ii) A security that is issued or guaranteed by a corporation in which the United States has a direct or indirect interest and which is designated by the Secretary of the Treasury for exemption as necessary or appropriate in the public interest or for the protection of investors;

(iii) A security issued or guaranteed as to principal and interest by any corporation whose securities are designated, by statute specifically naming the corporation, to constitute exempt securities within the meaning of the laws administered by the Securities and Exchange Commission; or

(iv) Any put, call, straddle, option, or privilege on a security as described in paragraphs (b)(7) (i), (ii), or (iii) of this section other than a put, call, straddle, option, or privilege that is traded on one or more national securities exchanges, or for which quotations are disseminated though an automated quotation system operated by a registered securities association.

(8) *Investment discretion* with respect to an account shall mean if the State member bank, directly or indirectly, is authorized to determine what securities or other property shall be purchased or sold by or for the account, or makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions.

(9) *Municipal security* shall mean a security which is a direct obligation of, or obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in 26 U.S.C. 103(c)(2) the interest on which is excludable from gross income under 26 U.S.C.

103(a)(1), by reason of the application of paragraph (4) or (6) of 26 U.S.C. 103(c) (determined as if paragraphs (4)(A), (5) and (7) were not included in 26 U.S.C. 103(c)), paragraph (1) of 26 U.S.C. 103(c) does not apply to such security.

(10) *Periodic plan* shall mean:

(i) A written authorization for a State member bank to act as agent to purchase or sell for a customer a specific security or securities, in a specific amount (calculated in security units or dollars) or to the extent of dividends and funds available, at specific time intervals, and setting forth the commission or charges to be paid by the customer or the manner of calculating them (including dividend reinvestment plans, automatic investment plans, and employee stock purchase plans); or

(ii) Any prearranged, automatic transfer or sweep of funds from a deposit account to purchase a security, or any prearranged, automatic redemption or sale of a security with the funds being transferred into a deposit account (including cash management sweep services).

(11) *Security* shall mean:

(i) Any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, for a security, any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), any instrument commonly known as a ''security''; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.

(ii) But does not include a deposit or share account in a federally or state insured depository institution, a loan participation, a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, currency, any note, draft, bill of exchange, or bankers acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, units of a collective investment fund, interests in a variable amount (master) note of a borrower of prime credit, or U.S. Savings Bonds.

(c) *Recordkeeping*. Except as provided in paragraph (a) of this section, every State member bank effecting securities transactions for customers, including transactions in government securities, and municipal securities transactions by banks not subject to registration as municipal securities dealers, shall maintain the following records with respect to such transactions for at least three years. Nothing contained in this section shall require a bank to maintain the records required by this paragraph in any given manner, provided that the information required to be shown is clearly and accurately reflected and provides an adequate basis for the audit of such information. Records may be maintained in hard copy, automated, or electronic form provided the records are easily retrievable, readily available for inspection, and capable of being reproduced in a hard copy. A bank may contract with third party service providers, including broker/dealers, to maintain records required under this part.

(1) Chronological records of original entry containing an itemized daily record of all purchases and sales of securities. The records of original entry shall show the account or customer for which each such transaction was effected, the description of the securities, the unit and aggregate purchase or sale price (if any), the trade date and the name or other designation of the broker/dealer or other person from whom purchased or to whom sold;

(2) Account records for each customer which shall reflect all purchases and sales of securities, all receipts and deliveries of securities, and all receipts and disbursements of cash with respect to transactions in securities for such account and all other debits and credits pertaining to transactions in securities;

(3) A separate memorandum (order ticket) of each order to purchase or sell securities (whether executed or canceled), which shall include:

(i) The account(s) for which the transaction was effected;

(ii) Whether the transaction was a market order, limit order, or subject to special instructions;

(iii) The time the order was received by the trader or other bank employee responsible for effecting the transaction;

(iv) The time the order was placed with the broker/dealer, or if there was no broker/dealer, the time the order was executed or canceled;

(v) The price at which the order was executed; and

(vi) The broker/dealer utilized;

(4) A record of all broker/dealers selected by the bank to effect securities transactions and the amount of commissions paid or allocated to each such broker during the calendar year; and

(5) A copy of the written notification required by paragraphs (d) and (e) of this section.

(d) *Content and time of notification.* Every State member bank effecting a securities transaction for a customer shall give or send to such customer either of the following types of notifications at or before completion of the transaction or; if the bank uses a broker/dealer's confirmation, within one business day from the bank's receipt of the broker/dealer's confirmation:

(1) A copy of the confirmation of a broker/dealer relating to the securities transaction; and if the bank is to receive remuneration from the customer or any other source in connection with the transaction, and the remuneration is not determined pursuant to a prior written agreement between the bank and the customer, a statement of the source and the amount of any remuneration to be received; or

(2) A written notification disclosing:

(i) The name of the bank;

(ii) The name of the customer;

(iii) Whether the bank is acting as agent for such customer, as agent for both such customer and some other person, as principal for its own account, or in any other capacity;

(iv) The date of execution and a statement that the time of execution will be furnished within a reasonable time upon written request of such customer specifying the identity, price and number of shares or units (or principal amount in the case of debt securities) of such security purchased or sold by such customer;

(v) The amount of any remuneration received or to be received, directly or indirectly, by any broker/dealer from such customer in connection with the transaction;

(vi) The amount of any remuneration received or to be received by the bank from the customer and the source and amount of any other remuneration to be received by the bank in connection with the transaction, unless remuneration is determined pursuant to a written agreement between the bank and the customer, provided, however, in the case of Government securities and municipal securities, this paragraph (d)(2)(vi) shall apply only with respect to remuneration received by the bank in an agency transaction. If the bank elects not to disclose the source and amount of remuneration it has or will receive from a party other than the customer pursuant to this paragraph (d)(2)(vi), the written notification must disclose whether the bank has received or will receive remuneration from a party other than the customer, and that the bank will furnish within a reasonable time the source and amount of this remuneration upon written request of the customer. This election is not available, however, if, with respect to a purchase, the bank was participating in a distribution of that security; or with respect to a sale, the bank was participating in a tender offer for that security;

(vii) The name of the broker/dealer utilized; or, where there is no broker/dealer, the name of the person from whom the security was purchased or to whom it was sold, or the fact that such information will be furnished within a reasonable time upon written request;

(viii) In the case of a transaction in a debt security subject to redemption before maturity, a statement to the effect that the debt security may be redeemed in whole or in part before maturity, that the redemption could affect the yield represented and that additional information is available on request;

(ix) In the case of a transaction in a debt security effected exclusively on the basis of a dollar price:

(A) The dollar price at which the transaction was effected;

(B) The yield to maturity calculated from the dollar price; provided, however, that this paragraph (c)(2)(ix)(B) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(x) In the case of a transaction in a debt security effected on the basis of yield:

(A) The yield at which the transaction was effected, including the percentage amount and its characterization (e.g., current yield, yield to maturity, or yield to call) and if effected at yield to call, the type of call, the call date, and the call price; and

(B) The dollar price calculated from the yield at which the transaction was effected; and

(C) If effected on a basis other than yield to maturity and the yield to maturity is lower than the represented yield, the yield to maturity as well as the represented yield; provided, however, that this paragraph (c)(2)(x)(C) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest rate payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(xi) In the case of a transaction in a debt security that is an asset-backed security which represents an interest in or is secured by a pool of receivables or other financial assets that are subject continuously to prepayment, a statement indicating that the actual yield of such asset-backed security may vary according to the rate at which the underlying receivables or other financial assets are prepaid and a statement of the fact that information concerning the factors that affect yield (including at a minimum, the estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon written request of such customer; and

(xii) In the case of a transaction in a debt security, other than a government security, that the security is unrated by a nationally recognized statistical rating organization, if that is the case.

(e) *Notification by agreement; alternative forms and times of notification.* A State member bank may elect to use the following alternative procedures if a transaction is effected for:

(1) Accounts (except periodic plans) where the bank does not exercise investment discretion and the bank and the customer agree in writing to a different arrangement as to the time and content of the notification; provided, however, that such agreement makes clear the customer's right to receive the written notification pursuant to paragraph (c) of this section at no additional cost to the customer;

(2) Accounts (except collective investment funds) where the bank exercises investment discretion in other than an agency capacity, in which instance the bank shall, upon request of the person having the power to terminate the account or, if there is no such person, upon the request of any person holding a vested beneficial interest in such account, give or send to such person the written notification within a reasonable time. The bank may charge such person a reasonable fee for providing this information;

(3) Accounts, where the bank exercises investment discretion in an agency capacity, in which instance:

(i) The bank shall give or send to each customer not less frequently than once every three months an itemized statement which shall specify the funds and securities in the custody or possession of the bank at the end of such period and all debits, credits and transactions in the customer's accounts during such period; and

(ii) If requested by the customer, the bank shall give or send to each customer within a reasonable time the written notification described in paragraph (c) of this section. The bank may charge a reasonable fee for providing the information described in paragraph (c) of this section;

(4) A collective investment fund, in which instance the bank shall at least

annually furnish a copy of a financial report of the fund, or provide notice that a copy of such report is available and will be furnished upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. This report shall be based upon an audit made by independent public accountants or internal auditors responsible only to the board of directors of the bank;

(5) A periodic plan, in which instance the bank:

(i) Shall (except for a cash management sweep service) give or send to the customer a written statement not less than every three months if there are no securities transactions in the account, showing the customer's funds and securities in the custody or possession of the bank; all service charges and commissions paid by the customer in connection with the transaction; and all other debits and credits of the customer's account involved in the transaction; or

(ii) Shall for a cash management sweep service or similar periodic plan as defined in §208.34(b)(10)(ii) give or send its customer a written statement in the same form as prescribed in paragraph (e)(3) above for each month in which a purchase or sale of a security takes place in a deposit account and not less than once every three months if there are no securities transactions in the account subject to any other applicable laws or regulations;

(6) Upon the written request of the customer the bank shall furnish the information described in paragraph (d) of this section, except that any such information relating to remuneration paid in connection with the transaction need not be provided to the customer when paid by a source other than the customer. The bank may charge a reasonable fee for providing the information described in paragraph (d) of this section.

(f) *Settlement of securities transactions*. All contracts for the purchase or sale of a security shall provide for completion of the transaction within the number of business days in the standard settlement cycle for the security followed by registered broker dealers in the United States unless otherwise agreed to by the parties at the time of the transaction.

(g) *Securities trading policies and procedures*. Every State member bank effecting securities transactions for customers shall establish written policies and procedures providing:

(1) Assignment of responsibility for supervision of all officers or employees who:

(i) Transmit orders to or place orders with broker/dealers;

(ii) Execute transactions in securities for customers; or

(iii) Process orders for notification and/or settlement purposes, or perform other back office functions with respect to securities transactions effected for customers; provided that procedures established under this paragraph (g)(1)(iii) should provide for supervision and reporting lines that are separate from supervision of personnel under paragraphs (g)(1)(i) and (g)(1)(ii) of this section;

(2) For the fair and equitable allocation of securities and prices to accounts when orders for the same security are received at approximately the same time and are placed for execution either individually or in combination;

(3) Where applicable and where permissible under local law, for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction; and

(4) That bank officers and employees who make investment recommendations or decisions for the accounts of customers, who participate in the determination of such recommendations or decisions, or who, in connection with their duties, obtain information concerning which securities are being purchased or sold or recommended for such action, must report to the bank, within ten days after the end of the calendar quarter, all transactions in securities made by them or on their behalf, either at the bank or elsewhere in which they have a beneficial interest. The report shall identify the securities purchased or sold and indicate the dates of the transactions and whether the transactions were purchases or sales. Excluded from this requirement are transactions for the benefit of the

officer or employee over which the officer or employee has no direct or indirect influence or control, transactions in mutual fund shares, and all transactions involving in the aggregate $10,000 or less during the calendar quarter. For purposes of this paragraph (g)(4), the term securities does not include government securities.

§ 208.35 Qualification requirements for transactions in certain securities. [Reserved]

§ 208.36 Reporting requirements for State member banks subject to the Securities Exchange Act of 1934.

(a) *Filing requirements.* Except as otherwise provided in this section, a member bank whose securities are subject to registration pursuant to section 12(b) or section 12(g) of the Securities Exchange Act of 1934 (the 1934 Act) (15 U.S.C. 78l (b) and (g)) shall comply with the rules, regulations, and forms adopted by the Securities and Exchange Commission (Commission) pursuant to sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act (15 U.S.C. 78l, 78m, 78n(a), (c), (d), (f) and 78p). The term ''Commission'' as used in those rules and regulations shall with respect to securities issued by member banks be deemed to refer to the Board unless the context otherwise requires.

(b) *Elections permitted for member banks with total assets of $150 million or less.* (1) Notwithstanding paragraph (a) of this section or the rules and regulations promulgated by the Commission pursuant to the 1934 Act a member bank that has total assets of $150 million or less as of the end of its most recent fiscal year, and no foreign offices, may elect to substitute for the financial statements required by the Commission's Form 10–Q, the balance sheet and income statement from the quarterly report of condition required to be filed by the bank with the Board under section 9 of the Federal Reserve Act (12 U.S.C. 324) (Federal Financial Institutions Examination Council Form 033 or 034).

(2) A member bank qualifying for and electing to file financial statements from its quarterly report of condition pursuant to paragraph (b)(1) of this section in its form 10–Q shall include earnings per share or net loss per share data prepared in accordance with GAAP and disclose any material contingencies, as required by Article 10 of the Commission's Regulation S–X (17 CFR 210.10–01), in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of Form 10–Q.

(c) *Required filings.* (1) *Place and timing of filing.* All papers required to be filed with the Board, pursuant to the 1934 Act or regulations thereunder, shall be submitted to the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Material may be filed by delivery to the Board, through the mails, or otherwise. The date on which papers are actually received by the Board shall be the date of filing thereof if all of the requirements with respect to the filing have been complied with.

(2) *Filing fees.* No filing fees specified by the Commission's rules shall be paid to the Board.

(3) *Public inspection.* Copies of the registration statement, definitive proxy solicitation materials, reports, and annual reports to shareholders required by this section (exclusive of exhibits) shall be available for public inspection at the Board's offices in Washington, DC, as well as at the Federal Reserve Banks of New York, Chicago, and San Francisco and at the Reserve Bank in the district in which the reporting bank is located.

(d) *Confidentiality of filing.* Any person filing any statement, report, or document under the 1934 Act may make written objection to the public disclosure of any information contained therein in accordance with the following procedure:

(1) The person shall omit from the statement, report, or document, when it is filed, the portion thereof that the person desires to keep undisclosed (hereinafter called the confidential portion). The person shall indicate at the appropriate place in the statement, report, or document that the confidential portion has been omitted and filed separately with the Board.

(2) The person shall file the following with the copies of the statement, report, or document filed with the Board:

(i) As many copies of the confidential portion, each clearly marked ''CONFIDENTIAL TREATMENT,'' as there are copies of the statement, report, or document filed with the Board. Each copy of the confidential portion shall contain the complete text of the item and, notwithstanding that the confidential portion does not constitute the whole of the answer, the entire answer thereto; except that in case the confidential portion is part of a financial statement or schedule, only the particular financial statement or schedule need be included. All copies of the confidential portion shall be in the same form as the remainder of the statement, report, or document; and

(ii) An application making objection to the disclosure of the confidential portion. The application shall be on a sheet or sheets separate from the confidential portion, and shall:

(A) Identify the portion of the statement, report, or document that has been omitted;

(B) Include a statement of the grounds of objection; and

(C) Include the name of each exchange, if any, with which the statement, report, or document is filed.

(3) The copies of the confidential portion and the application filed in accordance with this paragraph shall be enclosed in a separate envelope marked ''CONFIDENTIAL TREATMENT,'' and addressed to Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551.

(4) Pending determination by the Board on the objection filed in accordance with this paragraph, the confidential portion shall not be disclosed by the Board.

(5) If the Board determines to sustain the objection, a notation to that effect shall be made at the appropriate place in the statement, report, or document.

(6) If the Board determines not to sustain the objection because disclosure of the confidential portion is in the public interest, a finding and determination to that effect shall be entered and notice of the finding and determination sent by registered or certified mail to the person.

(7) If the Board determines not to sustain the objection, pursuant to paragraph (d)(6) of this section, the confidential portion shall be made available to the public:

(i) 15 days after notice of the Board's determination not to sustain the objection has been given, as required by paragraph (d)(6) of this section, provided that the person filing the objection has not previously filed with the Board a written statement that he intends, in good faith, to seek judicial review of the finding and determination; or

(ii) 60 days after notice of the Board's determination not to sustain the objection has been given as required by paragraph (d)(6) of this section and the person filing the objection has filed with the Board a written statement of intent to seek judicial review of the finding and determination, but has failed to file a petition for judicial review of the Board's determination; or

(iii) Upon final judicial determination, if adverse to the party filing the objection.

(8) If the confidential portion is made available to the public, a copy thereof shall be attached to each copy of the statement, report, or document filed with the Board.

§ 208.37 Government securities sales practices.

(a) *Scope.* This subpart is applicable to state member banks that have filed notice as, or are required to file notice as, government securities brokers or dealers pursuant to section 15C of the Securities Exchange Act (15 U.S.C. 78o-5) and Department of the Treasury rules under section 15C (17 CFR 400.1(d) and part 401).

(b) *Definitions.* For purposes of this section:

(1) *Bank that is a government securities broker or dealer* means a state member bank that has filed notice, or is required to file notice, as a government securities broker or dealer pursuant to section 15C of the Securities Exchange Act (15 U.S.C. 78o-5) and Department of the Treasury rules under section 15C (17 CFR 400.1(d) and Part 401).

(2) *Customer* does not include a broker or dealer or a government securities broker or dealer.

(3) *Government security* has the same meaning as this term has in section

3(a)(42) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(42)).

(4) *Non-institutional customer* means any customer other than:

(i) A bank, savings association, insurance company, or registered investment company;

(ii) An investment adviser registered under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3); or

(iii) Any entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

(c) *Business conduct.* A bank that is a government securities broker or dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business as a government securities broker or dealer.

(d) *Recommendations to customers.* In recommending to a customer the purchase, sale or exchange of a government security, a bank that is a government securities broker or dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to the customer's other security holdings and as to the customer'ancial situation and needs.

(e) *Customer information.* Prior to the execution of a transaction recommended to a non-institutional customer, a bank that is a government securities broker or dealer shall make reasonable efforts to obtain information concerning:

(1) The customer's financial status;

(2) The customer's tax status;

(3) The customer's investment objectives; and

(4) Such other information used or considered to be reasonable by the bank in making recommendations to the customer.

Subpart D—Prompt Corrective Action

SOURCE: 63 FR 37652, July 13, 1998, unless otherwise noted.

§ 208.40 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.

(a) *Authority.* Subpart D of Regulation H (12 CFR part 208, Subpart D) is issued by the Board of Governors of the Federal Reserve System (Board) under section 38 (section 38) of the FDI Act as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose and scope.* This subpart D defines the capital measures and capital levels that are used for determining the supervisory actions authorized under section 38 of the FDI Act. (Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized.) This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38. Certain of the provisions of this subpart apply to officers, directors, and employees of state member banks. Other provisions apply to any company that controls a member bank and to the affiliates of the member bank.

(c) *Other supervisory authority.* Neither section 38 nor this subpart in any way limits the authority of the Board under any other provision of law to take supervisory actions to address unsafe or unsound practices or conditions, deficient capital levels, violations of law, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the Board, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(d) *Disclosure of capital categories.* The assignment of a bank under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the Board or otherwise required by law, no bank

may state in any advertisement or promotional material its capital category under this subpart or that the Board or any other Federal banking agency has assigned the bank to a particular capital category.

§ 208.41 Definitions for purposes of this subpart.

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used have the same meanings as set forth in section 38 and section 3 of the FDI Act.

(a) *Control*—(1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term *controlled* shall be construed consistently with the term *control*.

(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect to the shares.

(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate Federal banking agency for up to three one-year periods.

(b) *Controlling person* means any person having control of an insured depository institution and any company controlled by that person.

(c) *Leverage ratio* means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure (Appendix B to this part).

(d) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(e) *Risk-weighted assets* means total weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(f) *Tangible equity* means the amount of core capital elements as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage servicing assets to the extent that the Board determines that mortgage servicing assets may be included in calculating the bank's Tier 1 capital.

(g) *Tier 1 capital* means the amount of Tier 1 capital as defined in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(h) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

(i) *Total assets* means quarterly average total assets as reported in a bank's Report of Condition and Income (Call Report), minus intangible assets as provided in the definition of tangible equity. At its discretion the Federal Reserve may calculate total assets using a bank's period-end assets rather than quarterly average assets.

(j) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part).

[63 FR 37652, July 13, 1998, as amended at 63 FR 42674, Aug. 10, 1998]

§ 208.42 Notice of capital category.

(a) *Effective date of determination of capital category*. A member bank shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) *Notice of capital category*. A member bank shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Report of Condition and Income (Call Report) is required to be filed with the Board;

(2) A final report of examination is delivered to the bank; or

(3) Written notice is provided by the Board to the bank of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's capital category has changed as provided in paragraph (c) of this section or § 208.43(c).

(c) *Adjustments to reported capital levels and capital category*—(1) *Notice of adjustment by bank*. A member bank shall provide the Board with written notice that an adjustment to the bank's capital category may have occurred no later than 15 calendar days following the date that any material event occurred that would cause the bank to be placed in a lower capital category from the category assigned to the bank for purposes of section 38 and this subpart on the basis of the bank's most recent Call Report or report of examination.

(2) *Determination by Board to change capital category*. After receiving notice pursuant to paragraph (c)(1) of this section, the Board shall determine whether to change the capital category of the bank and shall notify the bank of the Board's determination.

§ 208.43 Capital measures and capital category definitions.

(a) Capital measures. For purposes of section 38 and this subpart, the relevant capital measures are:

(1) The total risk-based capital ratio;

(2) The Tier 1 risk-based capital ratio; and

(3) The leverage ratio.

(b) *Capital categories*. For purposes of section 38 and this subpart, a member bank is deemed to be:

(1) ''Well capitalized'' if the bank:

(i) Has a total risk-based capital ratio of 10.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and

(iii) Has a leverage ratio of 5.0 percent or greater; and

(iv) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if the bank:

(i) Has a total risk-based capital ratio of 8.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 4.0 percent or greater; and

(iii) Has:

(A) A leverage ratio of 4.0 percent or greater; or

(B) A leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth; and

(iv) Does not meet the definition of a ''well capitalized'' bank.

(3) ''Undercapitalized'' if the bank has:

(i) A total risk-based capital ratio that is less than 8.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(iii) Except as provided in paragraph (b)(2)(iii)(B) of this section, has a leverage ratio that is less than 4.0 percent; or

(iv) A leverage ratio that is less than 3.0 percent, if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth.

(4) ''Significantly undercapitalized'' if the bank has:

(i) A total risk-based capital ratio that is less than 6.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 3.0 percent; or

(iii) A leverage ratio that is less than 3.0 percent.

(5) ''Critically undercapitalized'' if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Reclassification based on supervisory criteria other than capital.* The Board may reclassify a well capitalized member bank as adequately capitalized and may require an adequately-capitalized or an undercapitalized member bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower capital category (except that the Board may not reclassify a significantly undercapitalized bank as critically undercapitalized) (each of these actions are hereinafter referred to generally as ''reclassifications'') in the following circumstances:

(1) *Unsafe or unsound condition.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that the bank is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The Board has determined, after notice and opportunity for hearing pursuant to 12 CFR 263.203, that, in the most recent examination of the bank, the bank received and has not corrected, a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, liquidity, or sensitivity to market risk.

§ 208.44 Capital restoration plans.

(a) *Schedule for filing plan.* (1) *In general.* A member bank shall file a written capital restoration plan with the appropriate Reserve Bank within 45 days of the date that the bank receives notice or is deemed to have notice that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the Board notifies the bank in writing that the plan is to be filed within a different period. An adequately capitalized bank that has been required, pursuant to § 208.43(c), to comply with supervisory actions as if the bank were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 208.43(c), unless the Board notifies the bank that it must submit a new or revised capital plan. A bank that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate Reserve Bank within 45 days of receiving such notice, unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the Board instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A bank that is required to submit a capital restoration plan as the result of a reclassification of the bank pursuant to § 208.43(c) shall include a description of the steps the bank will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that Act by each company that controls the bank.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the Board shall provide written notice to the bank of whether the plan has been approved. The Board may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If the Board does not approve a capital restoration plan, the bank shall submit a revised capital restoration plan within the time specified by the Board. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized member bank (as defined in § 208.43(b)(3)) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

These provisions shall be applicable until such time as the Board approves a new or revised capital restoration plan submitted by the bank.

(e) *Failure to submit capital restoration plan.* A member bank that is undercapitalized (as defined in § 208.43(b)(3)) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement capital restoration plan.* Any undercapitalized member bank that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital plan.* A bank that has filed an approved capital restoration plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* Within 45 days of the effective date of Board approval of a capital restoration plan, or any amendment to a capital restoration plan, the Board shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank.* (1) *Limitation on Liability.* (i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific member bank that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank's total assets at the time the bank was notified or deemed to have notice that the bank was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank to the levels required for the bank to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the Board notifies the bank that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a bank shall be jointly and severally liable for the guarantee for such bank as required under section 38 and this subpart, and the Board may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank that is controlled by a company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks that have not submitted an acceptable capital restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a bank to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank shall be subject to the provisions of section 38 and this subpart that are applicable to banks that have failed in a material respect to implement a capital restoration plan.

§ 208.45 Mandatory and discretionary supervisory actions under section 38.

(a) *Mandatory supervisory actions.* (1) *Provisions applicable to all banks.* All member banks are subject to the restrictions contained in section 38(d) of

the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks.* Immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the Board monitor the condition of the bank (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the bank's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 3(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.42 or § 208.44, that the bank is significantly undercapitalized, or critically undercapitalized, or that the bank is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank failed to submit or implement in any material respect an acceptable capital restoration plan, the bank shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized banks.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (a)(3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 208.32, that the bank is critically undercapitalized, the bank shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting the activities of the bank (section 38(h)(1)); and

(ii) Restricting payments on subordinated debt of the bank (section 38(h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the Board's discretion to take in connection with: A member bank that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; an officer or director of such bank; or a company that controls such bank, the Board shall follow the procedures for issuing directives under 12 CFR 263.202 and 263.204, unless otherwise provided in section 38 or this subpart.

Subpart E—Real Estate Lending and Appraisal Standards

SOURCE: 63 FR 37655, July 13, 1998, unless otherwise noted.

§ 208.50 Authority, purpose, and scope.

(a) *Authority.* Subpart E of Regulation H (12 CFR part 208, subpart E) is issued by the Board of Governors of the Federal Reserve System under section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o) and Title 11 of the Financial Institutions Reform, Recovery, and Enforcement Act (12 U.S.C. 3331–3351).

(b) *Purpose and scope.* This subpart E prescribes standards for real estate lending to be used by member banks in adopting internal real estate lending policies. The standards applicable to appraisals rendered in connection with federally related transactions entered into by member banks are set forth in 12 CFR part 225, subpart G (Regulation Y).

§ 208.51 Real estate lending standards.

(a) *Adoption of written policies.* Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real

estate, or that are made for the purpose of financing permanent improvements to real estate.

(b) *Requirements of lending policies.* (1) Real estate lending policies adopted pursuant to this section shall be:

(i) Consistent with safe and sound banking practices;

(ii) Appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies shall establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the bank's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) *Monitoring conditions.* Each member bank shall monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) *Interagency guidelines.* The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies (contained in appendix C of this part) established by the Federal bank and thrift supervisory agencies.

Subpart F—Miscellaneous Requirements

SOURCE: 63 FR 37655, July 13, 1998, unless otherwise noted.

§ 208.60 Authority, purpose, and scope.

(a) *Authority.* Subpart F of Regulation H (12 CFR part 208, subpart F) is issued by the Board of Governors of the Federal Reserve System under sections 9, 11, 21, 25 and 25A of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), 481–486, 601 and 611), section 7 of the International Banking Act (12 U.S.C. 3105), section 3 of the Bank Protection Act of 1968 (12 U.S.C. 1882), sections 1814, 1816, 1818, 1831o, 1831p–1 and 1831r–1 of the FDI Act (12 U.S.C. 1814, 1816, 1818, 1831o, 1831p–1 and 1831r–1), and the Bank Secrecy Act (31 U.S.C. 5318).

(b) *Purpose and scope.* This subpart F describes a member bank's obligation to implement security procedures to discourage certain crimes, to file suspicious activity reports, and to comply with the Bank Secrecy Act's requirements for reporting and recordkeeping of currency and foreign transactions. It also describes the examination schedule for certain small insured member banks.

§ 208.61 Bank security procedures.

(a) *Authority, purpose, and scope.* Pursuant to section 3 of the Bank Protection Act of 1968 (12 U.S.C. 1882), member banks are required to adopt appropriate security procedures to discourage robberies, burglaries, and larcenies, and to assist in the identification and prosecution of persons who commit such acts. It is the responsibility of the member bank's board of directors to comply with the provisions of this section and ensure that a written security program for the bank's main office and branches is developed and implemented.

(b) *Designation of security officer.* Upon becoming a member of the Federal Reserve System, a member bank's board of directors shall designate a security officer who shall have the authority, subject to the approval of the board of directors, to develop, within a reasonable time, but no later than 180 days, and to administer a written security program for each banking office.

(c) *Security program.* (1) The security program shall:

(i) Establish procedures for opening and closing for business and for the safekeeping of all currency, negotiable securities, and similar valuables at all times;

(ii) Establish procedures that will assist in identifying persons committing crimes against the institution and that will preserve evidence that may aid in their identification and prosecution. Such procedures may include, but are not limited to: maintaining a camera that records activity in the banking office; using identification devices, such

as prerecorded serial-numbered bills, or chemical and electronic devices; and retaining a record of any robbery, burglary, or larceny committed against the bank;

(iii) Provide for initial and periodic training of officers and employees in their responsibilities under the security program and in proper employee conduct during and after a burglary, robbery, or larceny; and

(iv) Provide for selecting, testing, operating, and maintaining appropriate security devices, as specified in paragraph (c)(2) of this section.

(2) *Security devices.* Each member bank shall have, at a minimum, the following security devices:

(i) A means of protecting cash and other liquid assets, such as a vault, safe, or other secure space;

(ii) A lighting system for illuminating, during the hours of darkness, the area around the vault, if the vault is visible from outside the banking office;

(iii) Tamper-resistant locks on exterior doors and exterior windows that may be opened;

(iv) An alarm system or other appropriate device for promptly notifying the nearest responsible law enforcement officers of an attempted or perpetrated robbery or burglary; and

(v) Such other devices as the security officer determines to be appropriate, taking into consideration: the incidence of crimes against financial institutions in the area; the amount of currency and other valuables exposed to robbery, burglary, or larceny; the distance of the banking office from the nearest responsible law enforcement officers; the cost of the security devices; other security measures in effect at the banking office; and the physical characteristics of the structure of the banking office and its surroundings.

(d) *Annual reports.* The security officer for each member bank shall report at least annually to the bank's board of directors on the implementation, administration, and effectiveness of the security program.

(e) *Reserve Banks.* Each Reserve Bank shall develop and maintain a written security program for its main office and branches subject to review and approval of the Board.

§ 208.62 Suspicious activity reports.

(a) *Purpose.* This section ensures that a member bank files a Suspicious Activity Report when it detects a known or suspected violation of Federal law, or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act. This section applies to all member banks.

(b) *Definitions.* For the purposes of this section:

(1) *FinCEN* means the Financial Crimes Enforcement Network of the Department of the Treasury.

(2) *Institution-affiliated* party means any institution-affiliated party as that term is defined in 12 U.S.C. 1786(r), or 1813(u) and 1818(b) (3), (4) or (5).

(3) *SAR* means a Suspicious Activity Report on the form prescribed by the Board.

(c) *SARs required.* A member bank shall file a SAR with the appropriate Federal law enforcement agencies and the Department of the Treasury in accordance with the form's instructions by sending a completed SAR to FinCEN in the following circumstances:

(1) *Insider abuse involving any amount.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, and the bank has a substantial basis for identifying one of its directors, officers, employees, agents or other institution-affiliated parties as having committed or aided in the commission of a criminal act regardless of the amount involved in the violation.

(2) *Violations aggregating $5,000 or more where a suspect can be identified.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank and involving or aggregating $5,000 or more in funds or other assets,

where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, and the bank has a substantial basis for identifying a possible suspect or group of suspects. If it is determined prior to filing this report that the identified suspect or group of suspects has used an ''alias,'' then information regarding the true identity of the suspect or group of suspects, as well as alias identifiers, such as drivers' licenses or social security numbers, addresses and telephone numbers, must be reported.

(3) *Violations aggregating $25,000 or more regardless of a potential suspect.* Whenever the member bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank and involving or aggregating $25,000 or more in funds or other assets, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, even though there is no substantial basis for identifying a possible suspect or group of suspects.

(4) *Transactions aggregating $5,000 or more that involve potential money laundering or violations of the Bank Secrecy Act.* Any transaction (which for purposes of this paragraph (c)(4) means a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument or investment security, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected) conducted or attempted by, at or through the member bank and involving or aggregating $5,000 or more in funds or other assets, if the bank knows, suspects, or has reason to suspect that:

(i) The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any law or regulation or to avoid any transaction reporting requirement under federal law;

(ii) The transaction is designed to evade any regulations promulgated under the Bank Secrecy Act; or

(iii) The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

(d) *Time for reporting.* A member bank is required to file a SAR no later than 30 calendar days after the date of initial detection of facts that may constitute a basis for filing a SAR. If no suspect was identified on the date of detection of the incident requiring the filing, a member bank may delay filing a SAR for an additional 30 calendar days to identify a suspect. In no case shall reporting be delayed more than 60 calendar days after the date of initial detection of a reportable transaction. In situations involving violations requiring immediate attention, such as when a reportable violation is ongoing, the financial institution shall immediately notify, by telephone, an appropriate law enforcement authority and the Board in addition to filing a timely SAR.

(e) *Reports to state and local authorities.* Member banks are encouraged to file a copy of the SAR with state and local law enforcement agencies where appropriate.

(f) *Exceptions.* (1) A member bank need not file a SAR for a robbery or burglary committed or attempted that is reported to appropriate law enforcement authorities.

(2) A member bank need not file a SAR for lost, missing, counterfeit, or stolen securities if it files a report pursuant to the reporting requirements of 17 CFR 240.17f–1.

(g) *Retention of records.* A member bank shall maintain a copy of any SAR filed and the original or business record equivalent of any supporting documentation for a period of five years from the date of the filing of the

SAR. Supporting documentation shall be identified and maintained by the bank as such, and shall be deemed to have been filed with the SAR. A member bank must make all supporting documentation available to appropriate law enforcement agencies upon request.

(h) *Notification to board of directors.* The management of a member bank shall promptly notify its board of directors, or a committee thereof, of any report filed pursuant to this section.

(i) *Compliance.* Failure to file a SAR in accordance with this section and the instructions may subject the member bank, its directors, officers, employees, agents, or other institution affiliated parties to supervisory action.

(j) *Confidentiality of SARs.* SARs are confidential. Any member bank subpoenaed or otherwise requested to disclose a SAR or the information contained in a SAR shall decline to produce the SAR or to provide any information that would disclose that a SAR has been prepared or filed citing this section, applicable law (e.g., 31 U.S.C. 5318(g)), or both, and notify the Board.

(k) *Safe harbor.* The safe harbor provisions of 31 U.S.C. 5318(g), which exempts any member bank that makes a disclosure of any possible violation of law or regulation from liability under any law or regulation of the United States, or any constitution, law or regulation of any state or political subdivision, covers all reports of suspected or known criminal violations and suspicious activities to law enforcement and financial institution supervisory authorities, including supporting documentation, regardless of whether such reports are filed pursuant to this section or are filed on a voluntary basis.

§ 208.63 Procedures for monitoring Bank Secrecy Act compliance.

(a) *Purpose.* This section is issued to assure that all state member banks establish and maintain procedures reasonably designed to assure and monitor their compliance with the provisions of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*) and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103, requiring recordkeeping and reporting of currency transactions.

(b) *Establishment of compliance program.* On or before April 27, 1987, each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*) and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103. The compliance program shall be reduced to writing, approved by the board of directors, and noted in the minutes.

(c) *Contents of compliance program.* The compliance program shall, at a minimum:

(1) Provide for a system of internal controls to assure ongoing compliance;

(2) Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;

(3) Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide training for appropriate personnel.

§ 208.64 Frequency of examination.

(a) *General.* The Federal Reserve examines insured member banks pursuant to authority conferred by 12 U.S.C. 325 and the requirements of 12 U.S.C. 1820(d). The Federal Reserve is required to conduct a full-scope, on-site examination of every insured member bank at least once during each 12-month period.

(b) *18-month rule for certain small institutions.* The Federal Reserve may conduct a full-scope, on-site examination of an insured member bank at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The bank has total assets of $250 million or less;

(2) The bank is well capitalized as defined in subpart D of this part (§ 208.43);

(3) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve found the bank to be well managed;

(4) At the most recent examination conducted by either the Federal Reserve or applicable State banking agency, the Federal Reserve assigned the bank a CAMELS rating of 1 or 2;

(5) The bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve System; and

(6) No person acquired control of the bank during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(c) *Authority to conduct more frequent examinations.* This section does not limit the authority of the Federal Reserve to examine any member bank as frequently as the agency deems necessary.

Subpart G—Financial Subsidiaries of State Member Banks

SOURCE: Reg. H, 66 FR 42933, Aug. 16, 2001, unless otherwise noted.

§ 208.71 What are the requirements to invest in or control a financial subsidiary?

(a) *In general.* A state member bank may control, or hold an interest in, a financial subsidiary only if:

(1) The state member bank and each depository institution affiliate of the state member bank are well capitalized and well managed;

(2) The aggregate consolidated total assets of all financial subsidiaries of the state member bank do not exceed the lesser of:

(i) 45 percent of the consolidated total assets of the parent bank; or

(ii) $50 billion, which dollar amount shall be adjusted according to an indexing mechanism jointly established by the Board and the Secretary of the Treasury;

(3) The state member bank, if it is one of the largest 100 insured banks (based on consolidated total assets as of the end of the previous calendar year), meets the debt rating or alternative requirement of paragraph (b) of this section, if applicable; and

(4) The Board or the appropriate Reserve Bank has approved the bank to acquire the interest in or control the financial subsidiary under § 208.76.

(b) *Debt rating or alternative requirement for 100 largest insured banks*—(1) *General.* A state member bank meets the debt rating or alternative requirement of this paragraph (b) if:

(i) The bank has at least one issue of eligible debt outstanding that is currently rated in one of the three highest investment grade rating categories by a nationally recognized statistical rating organization; or

(ii) If the bank is one of the second 50 largest insured banks (based on consolidated total assets as of the end of the previous calendar year), the bank has a current long-term issuer credit rating from at least one nationally recognized statistical rating organization that is within the three highest investment grade rating categories used by the organization.

(2) *Financial subsidiaries engaged in financial activities only as agent.* This paragraph (b) does not apply to a state member bank if the financial subsidiaries of the bank engage in financial activities described in § 208.72(a)(1) and (2) only in an agency capacity and not directly or indirectly as principal.

§ 208.72 What activities may a financial subsidiary conduct?

(a) *Authorized activities.* A financial subsidiary of a state member bank may engage in only the following activities:

(1) Any financial activity listed in § 225.86(a), (b), or (c) of the Board's Regulation Y (12 CFR 225.86(a), (b), or (c));

(2) Any activity that the Secretary of the Treasury, in consultation with the Board, has determined to be financial in nature or incidental to a financial activity and permissible for financial subsidiaries pursuant to Section 5136A(b) of the Revised Statutes of the United States (12 U.S.C. 24a(b)); and

(3) Any activity that the state member bank is permitted to engage in directly (subject to the same terms and conditions that govern the conduct of the activity by the state member bank).

(b) *Impermissible activities.* Notwithstanding paragraph (a) of this section, a financial subsidiary may not engage as principal in the following activities:

(1) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability or death (except to the extent permitted under applicable state law and section 302 or 303(c) of the Gramm-Leach-Bliley Act (15 U.S.C. 6712 or 6713(c));

(2) Providing or issuing annuities the income of which is subject to tax treatment under section 72 of the Internal Revenue Code of 1986 (26 U.S.C. 72);

(3) Real estate development or real estate investment, unless otherwise expressly authorized by applicable state and Federal law; and

(4) Any merchant banking or insurance company investment activity permitted for financial holding companies by section 4(k)(4)(H) or (I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H) and (I)).

§ 208.73 What additional provisions are applicable to state member banks with financial subsidiaries?

(a) *Capital deduction required.* A state member bank that controls or holds an interest in a financial subsidiary must comply with the following rules in determining its compliance with applicable regulatory capital standards (including the well capitalized standard of § 208.71(a)(1)):

(1) The bank must not consolidate the assets and liabilities of any financial subsidiary with those of the bank.

(2) For purposes of determining the bank's risk-based capital ratios under Appendix A of this part, the bank must—

(i) Deduct 50 percent of the aggregate amount of its outstanding equity investment (including retained earnings) in all financial subsidiaries from both the bank's Tier 1 capital and Tier 2 capital; and

(ii) Deduct the entire amount of the bank's outstanding equity investment (including retained earnings) in all financial subsidiaries from the bank's risk-weighted assets.

(3) For purposes of determining the bank's leverage capital ratio under Appendix B of this part, the bank must—

(i) Deduct 50 percent of the aggregate amount of its outstanding equity investment (including retained earnings) in all financial subsidiaries from the bank's Tier 1 capital; and

(ii) Deduct the entire amount of the bank's outstanding equity investment (including retained earnings) in all financial subsidiaries from the bank's average total assets.

(4) For purposes of determining the bank's ratio of tangible equity to total assets under § 208.43(b)(5), the bank must deduct the entire amount of the bank's outstanding equity investment (including retained earnings) in all financial subsidiaries from the bank's tangible equity and total assets.

(5) If the deduction from Tier 2 capital required by paragraph (a)(2)(i) of this section exceeds the bank's Tier 2 capital, any excess must be deducted from the bank's Tier 1 capital.

(b) *Financial statement disclosure of capital deduction.* Any published financial statement of a state member bank that controls or holds an interest in a financial subsidiary must, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for the bank reflecting the capital deduction and adjustments required by paragraph (a) of this section.

(c) *Safeguards for the bank.* A state member bank that establishes, controls or holds an interest in a financial subsidiary must:

(1) Establish and maintain procedures for identifying and managing financial and operational risks within the state member bank and the financial subsidiary that adequately protect the state member bank from such risks; and

(2) Establish and maintain reasonable policies and procedures to preserve the separate corporate identity and limited liability of the state member bank and the financial subsidiary.

(d) *Application of Sections 23A and 23B of the Federal Reserve Act.* For purposes of sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c–1):

(1) A financial subsidiary of a state member bank shall be deemed an affiliate, and not a subsidiary, of the bank;

(2) The restrictions contained in section 23A(a)(1)(A) of the Federal Reserve Act (12 U.S.C. 371c(a)(1)(A)) shall not apply with respect to covered transactions between the bank and any individual financial subsidiary of the bank;

(3) The bank's investment in a financial subsidiary shall not include retained earnings of the financial subsidiary;

(4) Any purchase of, or investment in, the securities of a financial subsidiary by an affiliate of the bank will be considered to be a purchase of, or investment in, such securities by the bank; and

(5) Any extension of credit by an affiliate of the bank to a financial subsidiary of the bank will be considered to be an extension of credit by the bank to the financial subsidiary if the Board determines that such treatment is necessary or appropriate to prevent evasions of the Federal Reserve Act and the Gramm-Leach-Bliley Act.

(e) *Application of anti-tying prohibitions.* A financial subsidiary of a state member bank shall be deemed a subsidiary of a bank holding company and not a subsidiary of the bank for purposes of the anti-tying prohibitions of section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971 *et seq.*).

§ 208.74 What happens if the state member bank or a depository institution affiliate fails to continue to meet certain requirements?

(a) *Qualifications and safeguards.* The following procedures apply to a state member bank that controls or holds an interest in a financial subsidiary.

(1) *Notice by Board.* If the Board finds that a state member bank or any of its depository institution affiliates fails to continue to be well capitalized and well managed, or the state member bank is not in compliance with the asset limitation set forth in § 208.71(a)(2) or the safeguards set forth in § 208.73(c), the Board will notify the state member bank in writing and identify the areas of noncompliance. The Board may provide this notice at any time before or after receiving notice from the state member bank under paragraph (a)(2) of this section.

(2) *Notification by state member bank.* A state member bank must notify the appropriate Reserve Bank in writing within 15 calendar days of becoming aware that any depository institution affiliate of the bank has ceased to be well capitalized or well managed. The notification must identify the depository institution affiliate and the area(s) of noncompliance.

(3) *Execution of agreement.* Within 45 days after receiving a notice from the Board under paragraph (a)(1) of this section, or such additional period of time as the Board may permit, the:

(i) State member bank must execute an agreement acceptable to the Board to comply with all applicable capital, management, asset and safeguard requirements; and

(ii) Any relevant depository institution affiliate of the state member bank must execute an agreement acceptable to its appropriate Federal banking agency to comply with all applicable capital and management requirements.

(4) *Agreement requirements.* Any agreement required by paragraph (a)(3)(i) of this section must:

(i) Explain the specific actions that the state member bank will take to correct all areas of noncompliance;

(ii) Provide a schedule within which each action will be taken; and

(iii) Provide any other information the Board may require.

(5) *Imposition of limits.* Until the Board determines that the conditions described in the notice under paragraph (a)(1) of this section are corrected:

(i) The Board may impose any limitations on the conduct or activities of the state member bank or any subsidiary of the bank as the Board determines to be appropriate under the circumstances and consistent with the purposes of section 121 of the Gramm-Leach-Bliley Act, including requiring the Board's prior approval for any financial subsidiary of the bank to acquire any company or engage in any additional activity; and

(ii) The appropriate Federal banking agency for any relevant depository institution affiliate may impose any limitations on the conduct or activities of

the depository institution or any subsidiary of that institution as the agency determines to be appropriate under the circumstances and consistent with the purposes of section 121 of the Gramm-Leach-Bliley Act.

(6) *Divestiture*. The Board may require a state member bank to divest control of any financial subsidiary if the conditions described in a notice under paragraph (a)(1) of this section are not corrected within 180 days of receipt of the notice or such additional period of time as the Board may permit. Any divestiture must be completed in accordance with any terms and conditions established by the Board.

(7) *Consultation*. The Board will consult with all relevant Federal and state regulatory authorities in taking any action under this paragraph (a).

(b) *Debt rating or alternative requirement*. If a state member bank does not continue to meet any applicable debt rating or alternative requirement of § 208.71(b), the bank may not, directly or through a subsidiary, purchase or acquire any additional equity capital of any financial subsidiary until the bank restores its compliance with the requirements of that section. For purposes of this paragraph (b), the term ''equity capital'' includes, in addition to any equity instrument, any debt instrument issued by the financial subsidiary if the debt instrument qualifies as capital of the subsidiary under any Federal or state law, regulation or interpretation applicable to the subsidiary.

§ 208.75 What happens if the state member bank or any of its insured depository institution affiliates receives less than a "satisfactory" CRA rating?

(a) *Limits on establishment of financial subsidiaries and expansion of existing financial subsidiaries*. If a state member bank, or any insured depository institution affiliate of the bank, has received less than a ''satisfactory'' rating in meeting community credit needs in its most recent examination under the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*):

(1) The state member bank may not, directly or indirectly, acquire control of any financial subsidiary; and

(2) Any financial subsidiary controlled by the state member bank may not commence any additional activity or acquire control, including all or substantially all of the assets, of any company.

(b) *Exception for certain activities*. The prohibition in paragraph (a)(2) of this section does not apply to any activity, or to the acquisition of control of any company that is engaged only in activities, that the state member bank is permitted to conduct directly and that are conducted on the same terms and conditions that govern the conduct of the activity by the state member bank.

(c) *Duration of prohibitions*. The prohibitions described in paragraph (a) of this section shall continue in effect until such time as the state member bank and each insured depository institution affiliate of the state member bank has achieved at least a ''satisfactory'' rating in meeting community credit needs in its most recent examination under the Community Reinvestment Act.

§ 208.76 What Federal Reserve approvals are necessary for financial subsidiaries?

(a) *Notice requirements*. (1) A state member bank may not acquire control of, or an interest in, a financial subsidiary unless it files a notice (in letter form, with enclosures) with the appropriate Reserve Bank.

(2) A state member bank may not engage in any additional activity pursuant to § 208.72(a)(1) or (2) through an existing financial subsidiary unless the state member bank files a notice (in letter form, with enclosures) with the appropriate Reserve Bank.

(b) *Contents of Notice*. Any notice required by paragraph (a) of this section must:

(1) In the case of a notice filed under paragraph (a)(1) of this section, describe the transaction(s) through which the bank proposes to acquire control of, or an interest in, the financial subsidiary;

(2) Provide the name and head office address of the financial subsidiary;

(3) Provide a description of the current and proposed activities of the financial subsidiary and the specific authority permitting each activity;

(4) Provide the capital ratios as of the close of the previous calendar quarter for all relevant capital measures, as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o), for the bank and each of its depository institution affiliates;

(5) Certify that the bank and each of its depository institution affiliates was well capitalized at the close of the previous calendar quarter and is well capitalized as of the date the bank files its notice;

(6) Certify that the bank and each of its depository institution affiliates is well managed as of the date the bank files its notice;

(7) Certify that the bank meets the debt rating or alternative requirement of § 208.71(b), if applicable; and

(8) Certify that the bank and its financial subsidiaries are in compliance with the asset limit set forth in § 208.71(a)(2) both before the proposal and on a pro forma basis.

(c) *Insurance activities.* (1) If a notice filed under paragraph (a) of this section relates to the initial affiliation of the bank with a company engaged in insurance activities, the notice must describe the type of insurance activity that the company is engaged in or plans to conduct and identify each state where the company holds an insurance license and the state insurance regulatory authority that issued the license.

(2) The appropriate Reserve Bank will send a copy of any notice described in paragraph (c)(1) of this section to the appropriate state insurance regulatory authorities and provide such authorities with an opportunity to comment on the proposal.

(d) *Approval procedures.* A notice filed with the appropriate Reserve Bank under paragraph (a) of this section will be deemed approved on the fifteenth day after receipt of a complete notice by the appropriate Reserve Bank, unless prior to that date the Board or the appropriate Reserve Bank notifies the bank that the notice is approved, that the notice will require additional review, or that the bank does not meet the requirements of this subpart. Any notification of early approval of a notice must be in writing.

§ 208.77 Definitions.

The following definitions shall apply for purposes of this subpart:

(a) *Affiliate, Company, Control, and Subsidiary.* The terms ''affiliate'', ''company'', ''control'', and ''subsidiary'' have the meanings given those terms in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(b) *Appropriate Federal Banking Agency, Depository Institution, Insured Bank and Insured Depository Institution.* The terms ''appropriate Federal banking agency'', ''depository institution'', ''insured bank'' and ''insured depository institution'' have the meanings given those terms in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(c) *Capital-related definitions.*

(1) The terms ''Tier 1 capital'', ''tangible equity'', ''risk-weighted assets'' and ''total assets'' have the meanings given those terms in § 208.41 of this part.

(2) The terms ''Tier 2 capital'' and ''average total assets'' have the meanings given those terms in Appendix A and Appendix B of this part, respectively.

(d) *Eligible Debt.* The term ''eligible debt'' means unsecured debt with an initial maturity of more than 360 days that:

(1) Is not supported by any form of credit enhancement, including a guarantee or standby letter of credit; and

(2) Is not held in whole or in any significant part by any affiliate, officer, director, principal shareholder, or employee of the bank or any other person acting on behalf of or with funds from the bank or an affiliate of the bank.

(e) *Financial Subsidiary*—(1) *In general.* The term ''financial subsidiary'' means any company that is controlled by one or more insured depository institutions *other than:*

(i) A subsidiary that engages only in activities that the state member bank is permitted to engage in directly and that are conducted on the same terms and conditions that govern the conduct of the activities by the state member bank; or

(ii) A subsidiary that the state member bank is specifically authorized by the express terms of a Federal statute (other than section 9 of the Federal Reserve Act (12 U.S.C. 335)), and not by

implication or interpretation, to control, such as by section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601–604a, 611–631) or the Bank Service Company Act (12 U.S.C. 1861 *et seq.*).

(2) *Subsidiaries of financial subsidiaries.* A financial subsidiary includes any company that is directly or indirectly controlled by the financial subsidiary.

(f) *Long-term Issuer Credit Rating.* The term ''long-term issuer credit rating'' means a written opinion issued by a nationally recognized statistical rating organization of the bank's overall capacity and willingness to pay on a timely basis its unsecured, dollar-denominated financial obligations maturing in not less than one year.

(g) *Well Capitalized*—(1) *Insured depository institutions.* An insured depository institution is ''well capitalized'' if it has and maintains at least the capital levels required to be well capitalized under the capital adequacy regulations or guidelines adopted by the institution's appropriate Federal banking agency under section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

(2) *Uninsured depository institutions.* A depository institution the deposits of which are not insured by the Federal Deposit Insurance Corporation is ''well capitalized'' if the institution has and maintains at least the capital levels required for an insured depository institution to be well capitalized.

(h) *Well Managed*—(1) *In general.* The term ''well managed'' means:

(i) Unless otherwise determined in writing by the appropriate Federal banking agency, the institution has received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (or an equivalent rating under an equivalent rating system) and at least a rating of 2 for management (if such rating is given) in connection with its most recent examination or subsequent review by the institution's appropriate Federal banking agency (or the appropriate state banking agency in an examination described in section 10(d) of the Federal Deposit Insurance Act (12 U.S.C. 1820(d)); or

(ii) In the case of any depository institution that has not been examined by its appropriate Federal banking agency or been subject to an examination by its appropriate state banking agency that meets the requirements of section 10(d) of the Federal Deposit Insurance Act (18 U.S.C. 1820(d)), the existence and use of managerial resources that the appropriate Federal banking agency determines are satisfactory.

(2) *Merged depository institutions*—(i) *Merger involving well managed institutions.* A depository institution that results from the merger of two or more depository institutions that are well managed will be considered to be well managed unless the appropriate Federal banking agency for the resulting depository institution determines otherwise.

(ii) *Merger involving a poorly rated institution.* A depository institution that results from the merger of a well managed depository institution with one or more depository institutions that are not well managed or that have not been examined shall be considered to be well managed if the appropriate Federal banking agency for the resulting depository institution determines that the institution is well managed.

Subpart H—Consumer Protection in Sales of Insurance

SOURCE: 65 FR 75841, Dec. 4, 2000, unless otherwise noted.

§ 208.81 Purpose and scope.

This subpart establishes consumer protections in connection with retail sales practices, solicitations, advertising, or offers of any insurance product or annuity to a consumer by:

(a) Any state member bank; or

(b) Any other person that is engaged in such activities at an office of the bank or on behalf of the bank.

§ 208.82 Definitions for purposes of this subpart.

As used in this subpart:

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

(b) *Bank* means a state member bank.

(c) *Company* means any corporation, partnership, business trust, association or similar organization, or any other trust (unless by its terms the trust

must terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust). It does not include any corporation the majority of the shares of which are owned by the United States or by any State, or a qualified family partnership, as defined in section 2(o)(10) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(o)(10)).

(d) *Consumer* means an individual who purchases, applies to purchase, or is solicited to purchase from you insurance products or annuities primarily for personal, family, or household purposes.

(e) *Control* of a company has the same meaning as in section 3(w)(5) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(5)).

(f) *Domestic violence* means the occurrence of one or more of the following acts by a current or former family member, household member, intimate partner, or caretaker:

(1) Attempting to cause or causing or threatening another person physical harm, severe emotional distress, psychological trauma, rape, or sexual assault;

(2) Engaging in a course of conduct or repeatedly committing acts toward another person, including following the person without proper authority, under circumstances that place the person in reasonable fear of bodily injury or physical harm;

(3) Subjecting another person to false imprisonment; or

(4) Attempting to cause or causing damage to property so as to intimidate or attempt to control the behavior of another person.

(g) *Electronic media* includes any means for transmitting messages electronically between you and a consumer in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor.

(h) *Office* means the premises of a bank where retail deposits are accepted from the public.

(i) *Subsidiary* has the same meaning as in section 3(w)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(4)).

(j)(1) *You* means:

(i) A bank; or

(ii) Any other person only when the person sells, solicits, advertises, or offers an insurance product or annuity to a consumer at an office of the bank or on behalf of a bank.

(2) For purposes of this definition, activities on behalf of a bank include activities where a person, whether at an office of the bank or at another location sells, solicits, advertises, or offers an insurance product or annuity and at least one of the following applies:

(i) The person represents to a consumer that the sale, solicitation, advertisement, or offer of any insurance product or annuity is by or on behalf of the bank;

(ii) If the bank refers a consumer to a seller of insurance products or annuities and the bank has a contractual arrangement to receive commissions or fees derived from the sale of an insurance product or annuity resulting from that referral; or

(iii) Documents evidencing the sale, solicitation, advertising, or offer of an insurance product or annuity identify or refer to the bank.

§ 208.83 Prohibited practices.

(a) *Anticoercion and antitying rules.* You may not engage in any practice that would lead a consumer to believe that an extension of credit, in violation of section 106(b) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972), is conditional upon either:

(1) The purchase of an insurance product or annuity from the bank or any of its affiliates; or

(2) An agreement by the consumer not to obtain, or a prohibition on the consumer from obtaining, an insurance product or annuity from an unaffiliated entity.

(b) *Prohibition on misrepresentations generally.* You may not engage in any practice or use any advertisement at any office of, or on behalf of, the bank or a subsidiary of the bank that could mislead any person or otherwise cause a reasonable person to reach an erroneous belief with respect to:

(1) The fact that an insurance product or annuity sold or offered for sale by you or any subsidiary of the bank is not backed by the Federal government

or the bank or the fact that the insurance product or annuity is not insured by the Federal Deposit Insurance Corporation;

(2) In the case of an insurance product or annuity that involves investment risk, the fact that there is an investment risk, including the potential that principal may be lost and that the product may decline in value; or

(3) In the case of a bank or subsidiary of the bank at which insurance products or annuities are sold or offered for sale, the fact that:

(i) The approval of an extension of credit to a consumer by the bank or subsidiary may not be conditioned on the purchase of an insurance product or annuity by the consumer from the bank or a subsidiary of the bank; and

(ii) The consumer is free to purchase the insurance product or annuity from another source.

(c) *Prohibition on domestic violence discrimination*. You may not sell or offer for sale, as principal, agent, or broker, any life or health insurance product if the status of the applicant or insured as a victim of domestic violence or as a provider of services to victims of domestic violence is considered as a criterion in any decision with regard to insurance underwriting, pricing, renewal, or scope of coverage of such product, or with regard to the payment of insurance claims on such product, except as required or expressly permitted under State law.

§ 208.84 What you must disclose.

(a) *Insurance disclosures*. In connection with the initial purchase of an insurance product or annuity by a consumer from you, you must disclose to the consumer, except to the extent the disclosure would not be accurate, that:

(1) The insurance product or annuity is not a deposit or other obligation of, or guaranteed by, the bank or an affiliate of the bank;

(2) The insurance product or annuity is not insured by the Federal Deposit Insurance Corporation (FDIC) or any other agency of the United States, the bank, or (if applicable) an affiliate of the bank; and

(3) In the case of an insurance product or annuity that involves an investment risk, there is investment risk associated with the product, including the possible loss of value.

(b) *Credit disclosure*. In the case of an application for credit in connection with which an insurance product or annuity is solicited, offered, or sold, you must disclose that the bank may not condition an extension of credit on either:

(1) The consumer's purchase of an insurance product or annuity from the bank or any of its affiliates; or

(2) The consumer's agreement not to obtain, or a prohibition on the consumer from obtaining, an insurance product or annuity from an unaffiliated entity.

(c) *Timing and method of disclosures*—(1) *In general*. The disclosures required by paragraph (a) of this section must be provided orally and in writing before the completion of the initial sale of an insurance product or annuity to a consumer. The disclosure required by paragraph (b) of this section must be made orally and in writing at the time the consumer applies for an extension of credit in connection with which insurance is solicited, offered, or sold.

(2) *Exceptions for transactions by mail*. If a sale of an insurance product or annuity is conducted by mail, you are not required to make the oral disclosures required by paragraph (a) of this section. If you take an application for credit by mail, you are not required to make the oral disclosure required by paragraph (b) of this section.

(3) *Exception for transactions by telephone*. If a sale of an insurance product or annuity is conducted by telephone, you may provide the written disclosures required by paragraph (a) of this section by mail within 3 business days beginning on the first business day after the sale, excluding Sundays and the legal public holidays specified in 5 U.S.C 6103(a). If you take an application for such credit by telephone, you may provide the written disclosure required by paragraph (b) of this section by mail, provided you mail it to the consumer within three days beginning the first business day after the application is taken, excluding Sundays and the legal public holidays specified in 5 U.S.C. 6103(a).

(4) *Electronic form of disclosures*. (i) Subject to the requirements of section

101(c) of the Electronic Signatures in Global and National Commerce Act (12 U.S.C. 7001(c)), you may provide the written disclosures required by paragraphs (a) and (b) of this section through electronic media instead of on paper, if the consumer affirmatively consents to receiving the disclosures electronically and if the disclosures are provided in a format that the consumer may retain or obtain later, for example, by printing or storing electronically (such as by downloading).

(ii) Any disclosures required by paragraphs (a) or (b) of this section that are provided by electronic media are not required to be provided orally.

(5) *Disclosures must be readily understandable.* The disclosures provided shall be conspicuous, simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided. For instance, you may use the following disclosures, in visual media, such as television broadcasting, ATM screens, billboards, signs, posters and written advertisements and promotional materials, as appropriate and consistent with paragraphs (a) and (b) of this section:

- NOT A DEPOSIT
- NOT FDIC-INSURED
- NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY
- NOT GUARANTEED BY THE BANK
- MAY GO DOWN IN VALUE

(6) *Disclosures must be meaningful.* (i) You must provide the disclosures required by paragraphs (a) and (b) of this section in a meaningful form. Examples of the types of methods that could call attention to the nature and significance of the information provided include:

(A) A plain-language heading to call attention to the disclosures;

(B) A typeface and type size that are easy to read;

(C) Wide margins and ample line spacing;

(D) Boldface or italics for key words; and

(E) Distinctive type size, style, and graphic devices, such as shading or sidebars, when the disclosures are combined with other information.

(ii) You have not provided the disclosures in a meaningful form if you merely state to the consumer that the required disclosures are available in printed material, but you do not provide the printed material when required and do not orally disclose the information to the consumer when required.

(iii) With respect to those disclosures made through electronic media for which paper or oral disclosures are not required, the disclosures are not meaningfully provided if the consumer may bypass the visual text of the disclosures before purchasing an insurance product or annuity.

(7) *Consumer acknowledgment.* You must obtain from the consumer, at the time a consumer receives the disclosures required under paragraphs (a) or (b) of this section, or at the time of the initial purchase by the consumer of an insurance product or annuity, a written acknowledgment by the consumer that the consumer received the disclosures. You may permit a consumer to acknowledge receipt of the disclosures electronically or in paper form. If the disclosures required under paragraphs (a) or (b) of this section are provided in connection with a transaction that is conducted by telephone, you must:

(i) Obtain an oral acknowledgment of receipt of the disclosures and maintain sufficient documentation to show that the acknowledgment was given; and

(ii) Make reasonable efforts to obtain a written acknowledgment from the consumer.

(d) *Advertisements and other promotional material for insurance products or annuities.* The disclosures described in paragraph (a) of this section are required in advertisements and promotional material for insurance products or annuities unless the advertisements and promotional materials are of a general nature describing or listing the services or products offered by the bank.

§ 208.85 Where insurance activities may take place.

(a) *General rule.* A bank must, to the extent practicable, keep the area where the bank conducts transactions involving insurance products or annuities physically segregated from areas where retail deposits are routinely accepted from the general public, identify the

areas where insurance product or annuity sales activities occur, and clearly delineate and distinguish those areas from the areas where the bank's retail deposit-taking activities occur.

(b) *Referrals.* Any person who accepts deposits from the public in an area where such transactions are routinely conducted in the bank may refer a consumer who seeks to purchase an insurance product or annuity to a qualified person who sells that product only if the person making the referral receives no more than a one-time, nominal fee of a fixed dollar amount for each referral that does not depend on whether the referral results in a transaction.

§ 208.86 Qualification and licensing requirements for insurance sales personnel.

A bank may not permit any person to sell or offer for sale any insurance product or annuity in any part of its office or on its behalf, unless the person is at all times appropriately qualified and licensed under applicable State insurance licensing standards with regard to the specific products being sold or recommended.

APPENDIX A TO SUBPART H—CONSUMER GRIEVANCE PROCESS

Any consumer who believes that any bank or any other person selling, soliciting, advertising, or offering insurance products or annuities to the consumer at an office of the bank or on behalf of the bank has violated the requirements of this subpart should contact the Consumer Complaints Section, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System at the following address: 20th & C Streets, NW, Washington, D.C. 20551.

Subpart I—Interpretations

SOURCE: Reg. H, 63 FR 37658, July 13, 1998, unless otherwise noted. Redesignated at 65 FR 14814, Mar. 20, 2000. Redesignated further at 65 FR 75841, Dec. 4, 2000.

§ 208.100 Sale of bank's money orders off premises as establishment of branch office.

(a) The Board of Governors has been asked to consider whether the appointment by a member bank of an agent to sell the bank's money orders, at a location other than the premises of the bank, constitutes the establishment of a branch office.

(b) Section 5155 of the Revised Statutes (12 U.S.C. 36), which is also applicable to member banks, defines the term branch as including ''any branch bank, branch office, branch agency, additional office, or any branch place of business * * * at which deposits are received, or checks paid, or money lent.'' The basic question is whether the sale of a bank's money orders by an agent amounts to the receipt of deposits at a branch place of business within the meaning of this statute.

(c) Money orders are classified as deposits for certain purposes. However, they bear a strong resemblance to traveler's checks that are issued by banks and sold off premises. In both cases, the purchaser does not intend to establish a deposit account in the bank, although a liability on the bank's part is created. Even though they result in a deposit liability, the Board is of the opinion that the issuance of a bank's money orders by an authorized agent does not involve the receipt of deposits at a ''branch place of business'' and accordingly does not require the Board's permission to establish a branch.

§ 208.101 Obligations concerning institutional customers.

(a) As a result of broadened authority provided by the Government Securities Act Amendments of 1993 (15 U.S.C. 78o–3 and 78o–5), the Board is adopting sales practice rules for the government securities market, a market with a particularly broad institutional component. Accordingly, the Board believes it is appropriate to provide further guidance to banks on their suitability obligations when making recommendations to institutional customers.

(b) The Board's Suitability Rule, § 208.37(d), is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Banks' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Banks are expected to meet the same high

standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer.

(c) In recommending to a customer the purchase, sale, or exchange of any government security, the bank shall have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to the customer's other security holdings and financial situation and needs.

(d) The interpretation in this section concerns only the manner in which a bank determines that a recommendation is suitable for a particular institutional customer. The manner in which a bank fulfills this suitability obligation will vary, depending on the nature of the customer and the specific transaction. Accordingly, the interpretation in this section deals only with guidance regarding how a bank may fulfill customer-specific suitability obligations under § 208.37(d).[7]

(e) While it is difficult to define in advance the scope of a bank's suitability obligation with respect to a specific institutional customer transaction recommended by a bank, the Board has identified certain factors that may be relevant when considering compliance with § 208.37(d). These factors are not intended to be requirements or the only factors to be considered but are offered merely as guidance in determining the scope of a bank's suitability obligations.

(f) The two most important considerations in determining the scope of a bank's suitability obligations in making recommendations to an institutional customer are the customer's capability to evaluate investment risk independently and the extent to which the customer is exercising independent judgement in evaluating a bank's recommendation. A bank must determine, based on the information available to it, the customer's capability to evaluate investment risk. In some cases, the bank may conclude that the customer is not capable of making independent investment decisions in general. In other cases, the institutional customer may have general capability, but may not be able to understand a particular type of instrument or its risk. This is more likely to arise with relatively new types of instruments, or those with significantly different risk or volatility characteristics than other investments generally made by the institution. If a customer is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular product, the scope of a bank's customer-specific obligations under § 208.37(d) would not be diminished by the fact that the bank was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

(g) A bank may conclude that a customer is exercising independent judgement if the customer's investment decision will be based on its own independent assessment of the opportunities and risks presented by a potential investment, market factors and other investment considerations. Where the bank has reasonable grounds for concluding that the institutional customer is making independent investment decisions and is capable of independently evaluating investment risk, then a bank's obligations under § 208.25(d) for a particular customer are fulfilled.[8] Where a customer has delegated decision-making authority to an agent, such as an investment advisor or a bank trust department, the interpretation in this section shall be applied to the agent.

(h) A determination of capability to evaluate investment risk independently will depend on an examination of the customer's capability to make its own investment decisions, including

[7] The interpretation in this section does not address the obligation related to suitability that requires that a bank have''* * * a 'reasonable basis' to believe that the recommendation could be suitable for at least some customers.'' In the Matter of the Application of F.J. Kaufman and Company of Virginia and Frederick J. Kaufman, Jr., 50 SEC 164 (1989).

[8] *See* footnote 7 in paragraph (d) of this section.

the resources available to the customer to make informed decisions. Relevant considerations could include:

(1) The use of one or more consultants, investment advisers, or bank trust departments;

(2) The general level of experience of the institutional customer in financial markets and specific experience with the type of instruments under consideration;

(3) The customer's ability to understand the economic features of the security involved;

(4) The customer's ability to independently evaluate how market developments would affect the security; and

(5) The complexity of the security or securities involved.

(i) A determination that a customer is making independent investment decisions will depend on the nature of the relationship that exists between the bank and the customer. Relevant considerations could include:

(1) Any written or oral understanding that exists between the bank and the customer regarding the nature of the relationship between the bank and the customer and the services to be rendered by the bank;

(2) The presence or absence of a pattern of acceptance of the bank's recommendations;

(3) The use by the customer of ideas, suggestions, market views and information obtained from other government securities brokers or dealers or market professionals, particularly those relating to the same type of securities; and

(4) The extent to which the bank has received from the customer current comprehensive portfolio information in connection with discussing recommended transactions or has not been provided important information regarding its portfolio or investment objectives.

(j) Banks are reminded that these factors are merely guidelines that will be utilized to determine whether a bank has fulfilled its suitability obligation with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination of suitability. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular bank/customer relationship, assessed in the context of a particular transaction.

(k) For purposes of the interpretation in this section, an institutional customer shall be any entity other than a natural person. In determining the applicability of the interpretation in this section to an institutional customer, the Board will consider the dollar value of the securities that the institutional customer has in its portfolio and/or under management. While the interpretation in this section is potentially applicable to any institutional customer, the guidance contained in this section is more appropriately applied to an institutional customer with at least $10 million invested in securities in the aggregate in its portfolio and/or under management.

APPENDIX A TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS: RISK-BASED MEASURE

I. Overview

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of state member banks.[1] The principal objectives of this measure are to: (i) Make regulatory capital requirements more sensitive to differences in risk profiles among banks; (ii) factor off-balance sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banks throughout the world.[2]

The risk-based capital guidelines include both a definition of capital and a framework

[1] Supervisory ratios that relate capital to total assets for state member banks are outlined in appendix B of this part and in appendix B to part 225 of the Federal Reserve's Regulation Y, 12 CFR part 225.

[2] The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Regulations and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the BSC entitled ''International Convergence of Capital Measurement,'' July 1988.

for calculating weighted risk assets by assigning assets and off-balance sheet items to broad risk categories. A bank's risk-based capital ratio is calculated by dividing its qualifying capital (the numerator of the ratio) by its weighted risk assets (the denominator).[3] The definition of qualifying capital is outlined below in section II, and the procedures for calculating weighted risk assets are discussed in Section III. Attachment I illustrates a sample calculation of weighted risk assets and the risk-based capital ratio.

In addition, when certain banks that engage in trading activities calculate their risk-based capital ratio under this appendix A, they must also refer to appendix E of this part, which incorporates capital charges for certain market risks into the risk-based capital ratio. When calculating their risk-based capital ratio under this appendix A, such banks are required to refer to appendix E of this part for supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market risk equivalent assets, and calculate risk-based capital ratios adjusted for market risk.

The risk-based capital guidelines also establish a schedule for achieving a minimum supervisory standard for the ratio of qualifying capital to weighted risk assets and provide for transitional arrangements during a phase-in period to facilitate adoption and implementation of the measure at the end of 1992. These interim standards and transitional arrangements are set forth in section IV.

The risk-based guidelines apply to all state member banks on a consolidated basis. They are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. Thus, in considering an application filed by a state member bank, the Federal Reserve will take into account the bank's risk-based capital ratio, the reasonableness of its capital plans, and the degree of progress it has demonstrated toward meeting the interim and final risk-based capital standards.

The risk-based capital ratio focuses principally on broad categories of credit risk, although the framework for assigning assets and off-balance-sheet items to risk categories does incorporate elements of transfer risk, as well as limited instances of interest rate and market risk. The framework incorporates risks arising from traditional banking activities as well as risks arising from nontraditional activities. The risk-based ratio does not, however, incorporate other factors that can affect an institution's financial condition. These factors include overall interest-rate exposure; liquidity, funding and market risks; the quality and level of earnings; investment, loan portfolio, and other concentrations of credit; certain risks arising from nontraditional activities; the quality of loans and investments; the effectiveness of loan and investment policies; and management's overall ability to monitor and control financial and operating risks, including the risks presented by concentrations of credit and nontraditional activities.

In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of those factors, including, in particular, the level and severity of problem and classified assets as well as a bank's exposure to declines in the economic value of its capital due to changes in interest rates. For this reason, the final supervisory judgment on a bank's capital adequacy may differ significantly from conclusions that might be drawn solely from the level of its risk-based capital ratio.

The risk-based capital guidelines establish *minimum* ratios of capital to weighted risk assets. In light of the considerations just discussed, banks generally are expected to operate well above the minimum risk-based ratios. In particular, banks contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Institutions with high or inordinate levels of risk are also expected to operate well above minimum capital standards. In all cases, institutions should hold capital commensurate with the level and nature of the risks to which they are exposed. Banks that do not meet the minimum risk-based standard, or that are otherwise considered to be inadequately capitalized, are expected to develop and implement plans acceptable to the Federal Reserve for achieving adequate levels of capital within a reasonable period of time.

The Board will monitor the implementation and effect of these guidelines in relation to domestic and international developments in the banking industry. When necessary and appropriate, the Board will consider the need to modify the guidelines in light of any significant changes in the economy, financial markets, banking practices, or other relevant factors.

[3] Banks will initially be expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banks have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

II. Definition of Qualifying Capital for the Risk-Based Capital Ratio

A bank's qualifying total capital consists of two types of capital components: ''core capital elements'' (comprising tier 1 capital) and ''supplementary capital elements'' (comprising tier 2 capital). These capital elements and the various limits, restrictions, and deductions to which they are subject, are discussed below and are set forth in Attachment II.

The Federal Reserve will, on a case-by-case basis, determine whether and, if so, how much of any instrument that does not fit wholly within the terms of one of the capital categories set forth below or that does not have an ability to absorb losses commensurate with the capital treatment otherwise specified below will be counted as an element of tier 1 or tier 2 capital. In making such a determination, the Federal Reserve will consider the similarity of the instrument to instruments explicitly treated in the guidelines, the ability of the instrument to absorb losses while the bank operates as a going concern, the maturity and redemption features of the instrument, and other relevant terms and factors. To qualify as an element of tier 1 or tier 2 capital, a capital instrument may not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

Redemptions of permanent equity or other capital instruments before stated maturity could have a significant impact on a bank's overall capital structure. Consequently, a bank considering such a step should consult with the Federal Reserve before redeeming any equity or debt capital instrument (prior to maturity) if such redemption could have a material effect on the level or composition of the institution's capital base.[4]

A. The Components of Qualifying Capital

1. *Core capital elements (tier 1 capital)*. The tier 1 component of a bank's qualifying capital must represent at least 50 percent of qualifying total capital and may consist of the following items that are defined as core capital elements:

(i) Common stockholders' equity;

(ii) Qualifying noncumulative perpetual preferred stock (including related surplus); and

(iii) Minority interest in the equity accounts of consolidated subsidiaries.

Tier 1 capital is generally defined as the sum of core capital elements[5] less goodwill, other intangible assets, and interest-only strips receivables that are required to be deducted in accordance with section II.B.1. of this appendix.

a. *Common stockholders' equity*. For purposes of calculating the risk-based capital ratio, common stockholders' equity is limited to common stock; related surplus; and retained earnings, including capital reserves and adjustments for the cumulative effect of foreign currency translation, net of any treasury stock; less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values. For this purpose, net unrealized holding gains on such equity securities and net unrealized holding gains (losses) on available-for-sale debt securities are not included in common stockholders' equity.

b. *Perpetual preferred stock*. Perpetual preferred stock is defined as preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder of the instrument, and that has no other provisions that will require future redemption of the issue. Consistent with these provisions, any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as capital only if the redemption is subject to prior approval of the Federal Reserve. In general, preferred stock will qualify for inclusion in capital only if it can absorb losses while the issuer operates as a going concern (a fundamental characteristic of equity capital) *and* only if the issuer has the ability and legal right to defer or eliminate preferred dividends.

The only form of perpetual preferred stock that state member banks may consider as an element of Tier 1 capital is noncumulative perpetual preferred. While the guidelines allow for the inclusion of noncumulative perpetual preferred stock in Tier 1, it is desirable from a supervisory standpoint that voting common stockholders' equity remain the dominant form of Tier 1 capital. Thus, state member banks should avoid overreliance on preferred stock or non-voting equity elements within Tier 1.

Perpetual preferred stock in which the dividend is reset periodically based, in whole or in part, upon the bank's current credit standing (that is, auction rate perpetual preferred stock, including so-called Dutch auction, money market, and remarketable preferred) will not qualify for inclusion in Tier

[4] Consultation would not ordinarily be necessary if an instrument were redeemed with the proceeds of, or replaced by, a like amount of a similar or higher quality capital instrument and the organization's capital position is considered fully adequate by the Federal Reserve.

[5] [Reserved]

[6] [Reserved]

1 capital.[7] Such instruments, however, qualify for inclusion in Tier 2 capital.

c. *Minority interest in equity accounts of consolidated subsidiaries.* This element is included in Tier 1 because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries. While not subject to an explicit sublimit within Tier 1, banks are expected to avoid using minority interest in the equity accounts of consolidated subsidiaries as an avenue for introducing into their capital structures elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1.

2. *Supplementary capital elements (tier 2 capital).* The tier 2 component of a bank's qualifying capital may consist of the following items that are defined as supplementary capital elements:

(i) Allowance for loan and lease losses (subject to limitations discussed below);

(ii) Perpetual preferred stock and related surplus (subject to conditions discussed below);

(iii) Hybrid capital instruments (as defined below), and mandatory convertible debt securities;

(iv) Term subordinated debt and intermediate-term preferred stock, including related surplus (subject to limitations discussed below);

(v) Unrealized holding gains on equity securities (subject to limitations discussed in section II.A.2.e. of this appendix).

The maximum amount of tier 2 capital that may be included in a bank's qualifying total capital is limited to 100 percent of tier 1 capital (net of goodwill, other intangible assets, and interest-only strips receivables that are required to be deducted in accordance with section II.B.1. of this appendix).

The elements of supplementary capital are discussed in greater detail below.

a. *Allowance for loan and lease losses.* Allowances for loan and lease losses are reserves that have been established through a charge against earnings to absorb future losses on loans or lease financing receivables. Allowances for loan and lease losses exclude ''allocated transfer risk reserves,''[9] and reserves created against identified losses.

During the transition period, the risk-based capital guidelines provide for reducing the amount of this allowance that may be included in an institution's total capital. Initially, it is unlimited. However, by year-end 1990, the amount of the allowance for loan and lease losses that will qualify as capital will be limited to 1.5 percent of an institution's weighted risk assets. By the end of the transition period, the amount of the allowance qualifying for inclusion in Tier 2 capital may not exceed 1.25 percent of weighted risk assets.[10]

b. *Perpetual preferred stock.* Perpetual preferred stock, as noted above, is defined as preferred stock that has no maturity date, that cannot be redeemed at the option of the holder, and that has no other provisions that will require future redemption of the issue. Such instruments are eligible for inclusion in Tier 2 capital without limit.[11]

c. *Hybrid capital instruments and mandatory convertible debt securities.* Hybrid capital instruments include instruments that are essentially permanent in nature and that have certain characteristics of both equity and debt. Such instruments may be included in Tier 2 without limit. The general criteria hybrid capital instruments must meet in order to qualify for inclusion in Tier 2 capital are listed below:

(1) The instrument must be unsecured; fully paid-up; and subordinated to general creditors and must also be subordinated to claims of depositors.

(2) The instrument must not be redeemable at the option of the holder prior to maturity, except with the prior approval of the Federal

[7] Adjustable rate noncumulative perpetual preferred stock (that is, perpetual preferred stock in which the dividend rate is not affected by the issuer's credit standing or financial condition but is adjusted periodically according to a formula based solely on general market interest rates) may be included in Tier 1.

[8] [Reserved]

[9] Allocated transfer risk reserves are reserves that have been established in accordance with Section 905(a) of the International Lending Supervision Act of 1983, 12 U.S.C. 3904(a), against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer risk problems.

[10] The amount of the allowance for loan and lease losses that may be included in Tier 2 capital is based on a percentage of gross weighted risk assets. A bank may deduct reserves for loan and lease losses in excess of the amount permitted to be included in Tier 2 capital, as well as allocated transfer risk reserves, from the sum of gross weighted risk assets and use the resulting net sum of weighted risk assets in computing the denominator of the risk-based capital ratio.

[11] Long-term preferred stock with an original maturity of 20 years or more (including related surplus) will also qualify in this category as an element of Tier 2. If the holder of such an instrument has a right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing bank.

Reserve. (Consistent with the Board's criteria for perpetual debt and mandatory convertible securities, this requirement implies that holders of such instruments may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.)

(3) The instrument must be available to participate in losses while the issuer is operating as a going concern. (Term subordinated debt would not meet this requirement.) To satisfy this requirement, the instrument must convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

(4) The instrument must provide the option for the issuer to defer interest payments if: (a) The issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters), *and* (b) the issuer eliminates cash dividends on common and preferred stock.

Mandatory convertible debt securities in the form of equity contract notes that meet the criteria set forth in 12 CFR part 225, appendix B, also qualify as unlimited elements of Tier 2 capital. In accordance with that appendix, equity commitment notes issued prior to May 15, 1985 also qualify for inclusion in Tier 2.

d. *Subordinated debt and intermediate term preferred stock.* (i) The aggregate amount of term subordinated debt (excluding mandatory convertible debt) and intermediate-term preferred stock that may be treated as supplementary capital is limited to 50 percent of Tier 1 capital (net of goodwill and other intangible assets required to be deducted in accordance with section *II*.B.1.b. of this appendix). Amounts in excess of these limits may be issued and, while not included in the ratio calculation, will be taken into account in the overall assessment of a bank's funding and financial condition.

(ii) Subordinated debt and intermediate-term preferred stock must have an original weighted average maturity of at least five years to qualify as supplementary capital. (If the holder has the option to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing bank.)[12] In the case of subordinated debt, the instrument must be unsecured and must clearly state on its face that it is not a deposit and is not insured by a Federal agency. To qualify as capital in banks, debt must be subordinated to general creditors and claims of depositors. Consistent with current regulatory requirements, if a state member bank wishes to redeem subordinated debt before the stated maturity, it must receive prior approval of the Federal Reserve.

e. *Unrealized gains on equity securities and unrealized gains (losses) on other assets.* Up to 45 percent of pretax net unrealized holding gains (that is, the excess, if any, of the fair value over historical cost) on available-for-sale equity securities with readily determinable fair values may be included in supplementary capital. However, the Federal Reserve may exclude all or a portion of these unrealized gains from Tier 2 capital if the Federal Reserve determines that the equity securities are not prudently valued. Unrealized gains (losses) on other types of assets, such as bank premises and available-for-sale debt securities, are not included in supplementary capital, but the Federal Reserve may take these unrealized gains (losses) into account as additional factors when assessing a bank's overall capital adequacy.

f. *Revaluation reserves.* i. Such reserves reflect the formal balance sheet restatement or revaluation for capital purposes of asset carrying values to reflect current market values. The federal banking agencies generally have not included unrealized asset appreciation in capital ratio calculations, although they have long taken such values into account as a separate factor in assessing the overall financial strength of a bank.

ii. Consistent with long-standing supervisory practice, the excess of market values over book values for assets held by state member banks will generally not be recognized in supplementary capital or in the calculation of the risk-based capital ratio. However, all banks are encouraged to disclose their equivalent of premises (building) and security revaluation reserves. The Federal Reserve will consider any appreciation, as well as any depreciation, in specific asset values as additional considerations in assessing overall capital strength and financial condition.

B. DEDUCTIONS FROM CAPITAL AND OTHER ADJUSTMENTS

Certain assets are deducted from a bank's capital for the purpose of calculating the

[12] As a limited-life capital instrument approaches maturity it begins to take on characteristics of a short-term obligation. For this reason, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in Tier 2 is reduced, or discounted, as these instruments approach maturity: one-fifth of the original amount (less redemptions) is excluded each year during the instrument's last five years before maturity. When the remaining maturity is less than one year, the instrument is excluded from Tier 2 capital.

risk-based capital ratio.[13] These assets include:

(i)(a) Goodwill—deducted from the sum of core capital elements.

(b) Certain identifiable intangible assets, that is, intangible assets other than goodwill—deducted from the sum of core capital elements in accordance with section II.B.1.b. of this appendix.

(c) Certain credit-enhancing interest-only strips receivables—deducted from the sum of core capital elements in accordance with sections II.B.1.c. through e. of this appendix.

(ii) Investments in banking and finance subsidiaries that are not consolidated for accounting or supervisory purposes and, on a case-by-case basis, investments in other designated subsidiaries or associated companies at the discretion of the Federal Reserve—deducted from total capital components.

(iii) Reciprocal holdings of capital instruments of banking organizations—deducted from total capital components.

(iv) Deferred tax assets—portions are deducted from the sum of core capital elements in accordance with section II.B.4. of this Appendix A.

1. *Goodwill and other intangible assets.*—a. *Goodwill.* Goodwill in an intangible asset that represents the excess of the purchase price over the fair market value of identifiable assets acquired less liabilities assumed in acquisitions accounted for under the purchase method of accounting. State member banks generally have not been allowed to include goodwill in regulatory capital under current supervisory policies. Consistent with this policy, all goodwill in state member banks will be deducted from Tier 1 capital.

b. *Other intangible assets.* i. All servicing assets, including servicing assets on assets other than mortgages (i.e., nonmortgage servicing assets), are included in this appendix as identifiable intangible assets. The only types of identifiable intangible assets that may be included in, that is, not deducted from, a bank's capital are readily marketable mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships. The total amount of these assets that may be included in capital is subject to the limitations described below in sections II.B.1.d. and e. of this appendix.

ii. The treatment of identifiable intangible assets set forth in this section generally will be used in the calculation of a bank's capital ratios for supervisory and applications purposes. However, in making an overall assessment of a bank's capital adequacy for applications purposes, the Board may, if it deems appropriate, take into account the quality and composition of a bank's capital, together with the quality and value of its tangible and intangible assets.

c. *Credit-enhancing interest-only strips receivables (I/Os).* i. Credit-enhancing I/Os are on-balance sheet assets that, in form or in substance, represent the contractual right to receive some or all of the interest due on transferred assets and expose the bank to credit risk directly or indirectly associated with transferred assets that exceeds a *pro rata* share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Such I/Os, whether purchased or retained, including other similar ''spread'' assets, may be included in, that is, not deducted from, a bank's capital subject to the limitations described below in sections II.B.1.d. and e. of this appendix.

ii. Both purchased and retained credit-enhancing I/Os, on a non-tax adjusted basis, are included in the total amount that is used for purposes of determining whether a bank exceeds the tier 1 limitation described below in this section. In determining whether an I/O or other types of spread assets serve as a credit enhancement, the Federal Reserve will look to the economic substance of the transaction.

d. *Fair value limitation.* The amount of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that a bank may include in capital shall be the lesser of 90 percent of their fair value, as determined in accordance with section II.B.1.f. of this appendix, or 100 percent of their book value, as adjusted for capital purposes in accordance with the instructions in the commercial bank Consolidated Reports of Condition and Income (Call Reports). The amount of I/Os that a bank may include in capital shall be its fair value. If both the application of the limits on mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships and the adjustment of the balance sheet amount for these assets would result in an amount being deducted from capital, the bank would deduct only the greater of the two amounts from its core capital elements in determining tier 1 capital.

e. *Tier 1 capital limitation.* i. The total amount of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that may be included in capital, in the aggregate, cannot exceed 100 percent of tier 1 capital. The aggregate of nonmortgage servicing assets and purchased credit card relationships are subject to a separate sublimit of 25 percent of tier 1 capital. In addition, the total amount of credit-enhancing I/Os (both purchased and

[13] Any assets deducted from capital in computing the numerator of the ratio are not included in weighted risk assets in computing the denominator of the ratio.

retained) that may be included in capital cannot exceed 25 percent of tier 1 capital.[14]

ii. For purposes of calculating these limitations on mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, and credit-enhancing I/Os, tier 1 capital is defined as the sum of core capital elements, net of goodwill, and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships, prior to the deduction of any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing I/Os (both purchased and retained), and any disallowed deferred-tax assets, regardless of the date acquired.

iii. Banks may elect to deduct disallowed mortgage servicing assets, disallowed nonmortgage servicing assets, and disallowed credit-enhancing I/Os (both purchased and retained) on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred-tax assets when determining the amount of deferred-tax assets that are dependent upon future taxable income.

f. *Valuation*. Banks must review the book value of all intangible assets at least quarterly and make adjustments to these values as necessary. The fair value of mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, and credit-enhancing I/Os also must be determined at least quarterly. This determination shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or account attrition rates. Examiners will review both the book value and the fair value assigned to these assets, together with supporting documentation, during the examination process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of a bank's intangible assets or credit-enhancing I/Os.

g. *Growing organizations*. Consistent with long-standing Board policy, banks experiencing substantial growth, whether internally or by acquisition, are expected to maintain strong capital positions substantially above minimum supervisory levels, without significant reliance on intangible assets or credit-enhancing I/Os.

2. *Investments in certain subsidiaries*. The aggregate amount of investments in banking or finance subsidiaries[15] whose financial statements are not consolidated for accounting or bank regulatory reporting purposes will be deducted from a bank's total capital components.[16] Generally, investments for this purpose are defined as equity and debt capital investments and any other instruments that are deemed to be capital in the particular subsidiary.

Advances (that is, loans, extensions of credit, guarantees, commitments, or any other forms of credit exposure) to the subsidiary that are not deemed to be capital will generally not be deducted from a bank's capital. Rather, such advances generally will be included in the bank's consolidated assets and be assigned to the 100 percent risk category, unless such obligations are backed by recognized collateral or guarantees, in which case they will be assigned to the risk category appropriate to such collateral or guarantees. These advances may, however, also be deducted from the bank's capital if, in the judgment of the Federal Reserve, the risks stemming from such advances are comparable to the risks associated with capital investments or if the advances involve other risk factors that warrant such an adjustment to capital for supervisory purposes. These other factors could include, for example, the absence of collateral support.

Inasmuch as the assets of unconsolidated banking and finance subsidiaries are not fully reflected in a bank's consolidated total assets, such assets may be viewed as the equivalent of off-balance sheet exposures since the operations of an unconsolidated subsidiary could expose the bank to considerable risk. For this reason, it is generally appropriate to view the capital resources invested in these unconsolidated entities as

[14] Amounts of servicing assets, purchased credit card relationships, and credit-enhancing I/Os (both retained and purchased) in excess of these limitations, as well as all other identifiable intangible assets, including core deposit intangibles and favorable leaseholds, are to be deducted from a bank's core capital elements in determining tier 1 capital. However, identifiable intangible assets (other than mortgage servicing assets and purchased credit card relationships) acquired on or before February 19, 1992, generally will not be deducted from capital for supervisory purposes, although they will continue to be deducted for applications purposes.

[15] For this purpose, a banking and finance subsidiary generally is defined as any company engaged in banking or finance in which the parent institution holds directly or indirectly more than 50 percent of the outstanding voting stock, or which is otherwise controlled or capable of being controlled by the parent institution.

[16] An exception to this deduction would be made in the case of shares acquired in the regular course of securing or collecting a debt previously contracted in good faith. The requirements for consolidation are spelled out in the instructions to the Call Report.

primarily supporting the risks inherent in these off-balance sheet assets, and not generally available to support risks or absorb losses elsewhere in the bank.

The Federal Reserve may, on a case-by-case basis, also deduct from a bank's capital, investments in certain other subsidiaries in order to determine if the consolidated bank meets minimum supervisory capital requirements without reliance on the resources invested in such subsidiaries.

The Federal Reserve will not automatically deduct investments in other consolidated subsidiaries or investments in joint ventures and associated companies.[17] Nonetheless, the resources invested in these entities, like investments in unconsolidated banking and finance subsidiaries, support assets not consolidated with the rest of the bank's activities and, therefore, may not be generally available to support additional leverage or absorb losses elsewhere in the bank. Moreover, experience has shown that banks stand behind the losses of affiliated institutions, such as joint ventures and associated companies, in order to protect the reputation of the organization as a whole. In some cases, this has led to losses that have exceeded the investments in such organizations.

For this reason, the Federal Reserve will monitor the level and nature of such investments for individual banks and, on a case-by-case basis may, for risk-based capital purposes, deduct such investments from total capital components, apply an appropriate risk-weighted capital charge against the bank's proportionate share of the assets of its associated companies, require a line-by-line consolidation of the entity (in the event that the bank's control over the entity makes it the functional equivalent of a subsidiary), or otherwise require the bank to operate with a risk-based capital ratio above the minimum.

In considering the appropriateness of such adjustments or actions, the Federal Reserve will generally take into account whether:

(1) The bank has significant influence over the financial or managerial policies or operations of the subsidiary, joint venture, or associated company;

(2) The bank is the largest investor in the affiliated company; or

(3) Other circumstances prevail that appear to closely tie the activities of the affiliated company to the bank.

3. *Reciprocal holdings of banking organizations' capital instruments.* Reciprocal holdings of banking organizations' capital instruments (that is, instruments that qualify as Tier 1 or Tier 2 capital)[18] will be deducted from a bank's total capital components for the purpose of determining the numerator of the risk-based capital ratio.

Reciprocal holdings are cross-holdings resulting from formal or informal arrangements in which two or more banking organizations swap, exchange, or otherwise agree to hold each other's capital instruments. Generally, deductions will be limited to intentional cross-holdings. At present, the Board does not intend to require banks to deduct non-reciprocal holdings of such capital instruments.[19]

4. *Deferred-tax assets.* a. The amount of deferred-tax assets that is dependent upon future taxable income, net of the valuation allowance for deferred-tax assets, that may be included in, that is, not deducted from, a bank's capital may not exceed the lesser of:

i. The amount of these deferred-tax assets that the bank is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year,[20] or

[17] The definition of such entities is contained in the instructions to the commercial bank Call Report. Under regulatory reporting procedures, associated companies and joint ventures generally are defined as companies in which the bank owns 20 to 50 percent of the voting stock.

[18] See 12 CFR part 225, appendix A for instruments that qualify as Tier 1 and Tier 2 capital for bank holding companies.

[19] Deductions of holdings of capital securities also would not be made in the case of interstate ''stake out'' investments that comply with the Board's Policy Statement on Nonvoting Equity Investments, 12 CFR 225.143 (Federal Reserve Regulatory Service 4–172.1; 68 Federal Reserve Bulletin 413 (1982)). In addition, holdings of capital instruments issued by other banking organizations but taken in satisfaction of debts previously contracted would be exempt from any deduction from capital. The Board intends to monitor nonreciprocal holdings of other banking organizations' capital instruments and to provide information on such holdings to the Basle Supervisors' Committee as called for under the Basle capital framework.

[20] To determine the amount of expected deferred-tax assets realizable in the next 12 months, an institution should assume that all existing temporary differences fully reverse as of the report date. Projected future taxable income should not include net operating loss carry-forwards to be used during that year or the amount of existing temporary differences a bank expects to reverse within the year. Such projections should include the estimated effect of tax-planning strategies that the organization expects to implement to realize net operating losses or tax-credit carry-forwards that would otherwise expire during the year. Institutions do

ii. 10 percent of tier 1 capital.

b. The reported amount of deferred-tax assets, net of any valuation allowance for deferred-tax assets, in excess of the lesser of these two amounts is to be deducted from a bank's core capital elements in determining tier 1 capital. For purposes of calculating the 10 percent limitation, tier 1 capital is defined as the sum of core capital elements, net of goodwill and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, prior to the deduction of any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing I/Os, and any disallowed deferred-tax assets. There generally is no limit in tier 1 capital on the amount of deferred-tax assets that can be realized from taxes paid in prior carry-back years or from future reversals of existing taxable temporary differences, but, for banks that have a parent, this may not exceed the amount the bank could reasonably expect its parent to refund.

III. Procedures for Computing Weighted Risk Assets and Off-Balance Sheet Items

A. Procedures

Assets and credit equivalent amounts of off-balance sheet items of state member banks are assigned to one of several broad risk categories, according to the obligor, or, if relevant, the guarantor or the nature of the collateral. The aggregate dollar value of the amount in each category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are added together, and this sum is the bank's total weighted risk assets that comprise the denominator of the risk-based capital ratio. Attachment I provides a sample calculation.

Risk weights for all off-balance sheet items are determined by a two-step process. First, the ''credit equivalent amount'' of off-balance sheet items is determined, in most cases by multiplying the off-balance sheet item by a credit conversion factor. Second, the credit equivalent amount is treated like any balance sheet asset and generally is assigned to the appropriate risk category according to the obligor, or, if relevant, the guarantor or the nature of the collateral.

In general, if a particular item qualifies for placement in more than one risk category, it is assigned to the category that has the lowest risk weight. A holding of a U.S. municipal revenue bond that is fully guaranteed by a U.S. bank, for example, would be assigned the 20 percent risk weight appropriate to claims guaranteed by U.S. banks, rather than the 50 percent risk weight appropriate to U.S. municipal revenue bonds.[21]

The terms *claims* and *securities* used in the context of the discussion of risk weights, unless otherwise specified, refer to loans or debt obligations of the entity on whom the claim is held. Assets in the form of stock or equity holdings in commercial or financial firms are assigned to the 100 percent risk category, unless some other treatment is explicitly permitted.

The Federal Reserve will, on a case-by-case basis, determine the appropriate risk weight for any asset or credit equivalent amount of an off-balance sheet item that does not fit

not have to prepare a new 12-month projection each quarter. Rather, on interim report dates, institutions may use the future-taxable income projections for their current fiscal year, adjusted for any significant changes that have occurred or are expected to occur.

[21] An investment in shares of a fund whose portfolio consists primarily of various securities or money market instruments that, if held separately, would be assigned to different risk categories, generally is assigned to the risk category appropriate to the highest risk-weighted asset that the fund is permitted to hold in accordance with the stated investment objectives set forth in its prospectus. A bank may, at its option, assign a fund investment on a pro rata basis to different risk categories according to the investment limits in the fund's prospectus. In no case will an investment in shares in any fund be assigned to a total risk weight less than 20 percent. If a bank chooses to assign a fund investment on a pro rata basis, and the sum of the investment limits of assets in the fund's prospectus exceeds 100 percent, the bank must assign risk weights in descending order. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its assets in short-term, highly liquid securities of superior credit quality that do not qualify for a preferential risk weight, such securities generally will be disregarded when determining the risk category into which the bank's holding in the overall fund should be assigned. The prudent use of hedging instruments by a fund to reduce the risk of its assets also will not increase the risk weighting of the fund investment. For example, the use of hedging instruments by a fund to reduce the interest rate risk of its government bond portfolio will not increase the risk weight of that fund above the 20 percent category. Nonetheless, if a fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk weighting assigned to the fund's assets, holdings in the fund will be assigned to the 100 percent risk category.

wholly within one of the risk weight categories set forth below or that imposes risks on a bank that are incommensurate with the risk weight otherwise specified below for the asset or off-balance sheet item. In addition, the Federal Reserve will, on a case-by-case basis, determine the appropriate credit conversion factor for any off-balance sheet item that does not fit wholly within one of the credit conversion factors set forth below or that imposes risks on a bank that are incommensurate with the credit conversion factors otherwise specified below for the off-balance sheet item. In making such a determination, the Federal Reserve will consider the similarity of the asset or off-balance sheet item to assets or off-balance sheet items explicitly treated in the guidelines, as well as other relevant factors.

B. Collateral, Guarantees, and Other Considerations

1. *Collateral*. The only forms of collateral that are formally recognized by the risk-based capital framework are: Cash on deposit in the bank; securities issued or guaranteed by the central governments of the OECD-based group of countries,[22] U.S. Government agencies, or U.S. Government-sponsored agencies; and securities issued by multilateral lending institutions or regional development banks. Claims fully secured by such collateral generally are assigned to the 20 percent risk-weight category. Collateralized transactions meeting all the conditions described in section III.C.1. may be assigned a zero percent risk weight.

With regard to collateralized claims that may be assigned to the 20 percent risk-weight category, the extent to which qualifying securities are recognized as collateral is determined by their current market value. If such a claim is only partially secured, that is, the market value of the pledged securities is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the portion that is covered by the market value of the qualifying collateral is assigned to the 20 percent risk category, and the portion of the claim that is not covered by collateral in the form of cash or a qualifying security is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor. For example, to the extent that a claim on a private sector obligor is collateralized by the current market value of U.S. Government securities, it would be placed in the 20 percent risk category, and the balance would be assigned to the 100 percent risk category.

2. *Guarantees*. Guarantees of the OECD and non-OECD central governments, U.S. Government agencies, U.S. Government-sponsored agencies, state and local governments of the OECD-based group of countries, multilateral lending institutions and regional development banks, U.S. depository institutions, and foreign banks are also recognized. If a claim is partially guaranteed, that is, coverage of the guarantee is less than the face amount of a balance sheet asset or an off-balance sheet item, the portion that is not fully covered by the guarantee is assigned to the risk category appropriate to the obligor or, if relevant, to any collateral. The face amount of a claim covered by two types of guarantees that have different risk weights, such as a U.S. Government guarantee and a state guarantee, is to be apportioned between the two risk categories appropriate to the guarantors.

The existence of other forms of collateral or guarantees that the risk-based capital framework does not formally recognize may be taken into consideration in evaluating the risks inherent in a bank's loan portfolio—which, in turn, would affect the overall supervisory assessment of the bank's capital adequacy.

3. *Recourse obligations, direct credit substitutes, residual interests, and asset- and mortgage-backed securities*. Direct credit substitutes, assets transferred with recourse, and securities issued in connection with asset securitizations and structured financings are treated as described below. The term ''asset securitizations'' or ''securitizations'' in this rule includes structured financings, as well as asset securitization transactions.

[22]The OECD-based group of countries comprises all full members of the Organization for Economic Cooperation and Development (OECD) regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements to Borrow, but excludes any country that has rescheduled its external sovereign debt within the previous five years. As of November 1995, the OECD included the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; and Saudi Arabia had concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.

a. *Definitions*—i. *Credit derivative* means a contract that allows one party (the ''protection purchaser'') to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the ''protection provider'') The value of a credit derivative is dependent, at least in part, on the credit performance of the ''reference asset.''

ii. *Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

1. Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1–4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

2. Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

3. Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

iii. *Direct credit substitute* means an arrangement in which a bank *assumes*, in form or in substance, credit risk associated with an on-or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the *pro rata* share of the bank's interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank's assumption of *any* credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

1. Financial standby letters of credit that support financial claims on a third party that exceed a bank's *pro rata* share of losses in the financial claim;

2. Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank's *pro rata* share in the financial claim;

3. Purchased subordinated interests or securities that absorb more than their *pro rata* share of losses from the underlying assets;

4. Credit derivative contracts under which the bank assumes more than its *pro rata* share of credit risk on a third party exposure;

5. Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

6. Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not direct credit substitutes; and

7. Clean-up calls on third party assets are direct credit substittues. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not direct credit substitutes.

iv. *Externally rated* means that an instrument or obligation has received a credit rating from a nationally-recognized statistical rating organization.

v. *Face amount* means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

vi. *Financial asset* means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

vii. *Financial standby letter of credit* means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

1. To repay money borrowed by, or advanced to, or for the account of, a second party (the account party), or

2. To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

viii. *Mortgage servicer cash advance* means funds that a residential mortgage loan servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

1. The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

2. For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal balance of that loan.

ix. *Nationally recognized statistical rating organization (NRSRO)* means an entity recognized by the Division of Market Regulation

of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

x. *Recourse* means the retention, by a bank, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred and sold that exceeds a *pro rata* share of the bank's claim on the asset. If a bank has no claim on a transferred asset, then the retention of any risk of credit loss is recourse. A recourse obligation typically arises when a bank transfers assets and retains an explicit obligation to repurchase the assets or absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if a bank provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

1. Credit-enhancing representations and warranties made on the transferred assets;

2. Loan servicing assets retained pursuant to an agreement under which the bank will be responsible for credit losses associated with the loans being serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not recourse arrangements;

3. Retained subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets;

4. Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

5. Loan strips sold without contractual recourse where the maturity of the transferred loan is shorter than the maturity of the commitment under which the loan is drawn;

6. Credit derivatives issued that absorb more than the bank's *pro rata* share of losses from the transferred assets; and

7. Clean-up calls at inception that are greater than 10 percent of the balance of the original pool of transferred loans. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not recourse arrangements.

xi. *Residual interest* means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes the bank to credit risk directly or indirectly associated with the transferred assets that exceeds a *pro rata* share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests for purposes of this appendix.

xii. *Risk participation* means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (*e.g.*, a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

xiii. *Securitization* means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

xiv. *Structured finance program* means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

xv. *Traded position* means a position that is externally rated and is retained, assumed, or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

b. *Credit equivalent amounts and risk weight of recourse obligations and direct credit substitutes.* i. *Credit equivalent amount.* Except as otherwise provided in sections III.B.3.c. through f. and III.B.5. of this appendix, the credit equivalent amount for a recourse obligation or direct credit substitute is the full amount of the credit-enhanced assets for which the bank directly or indirectly retains or assumes credit risk multiplied by a 100 percent conversion factor.

ii. *Risk-weight factor.* To determine the bank's risk-weight factor for off-balance sheet recourse obligations and direct credit substitutes, the credit equivalent amount is assigned to the risk category appropriate to the obligor in the underlying transaction, after considering any associated guarantees

or collateral. For a direct credit substitute that is an on-balance sheet asset (*e.g.*, a purchased subordinated security), a bank must calculate risk-weighted assets using the amount of the direct credit substitute and the full amount of the assets it supports, *i.e.*, all the more senior positions in the structure. The treatment of direct credit substitutes that have been syndicated or in which risk participations have been conveyed or acquired is set forth in section III.D.1 of this appendix.

c. *Externally-rated positions: credit equivalent amounts and risk weights of recourse obligations, direct credit substitutes, residual interests, and asset- and mortgage-backed securities (including asset-backed commercial paper).* i. *Traded positions.* With respect to a recourse obligation, direct credit substitute, residual interest (other than a credit-enhancing I/O strip) or asset- and mortgage-backed security (including asset-backed commercial paper) that is a traded position and that has received an external rating on a long-term position that is one grade below investment grade or better or a short-term rating that is investment grade, the bank may multiply the face amount of the position by the appropriate risk weight, determined in accordance with the tables below. Stripped mortgage-backed securities and other similar instruments, such as interest-only or principal-only strips that are not credit enhancements, must be assigned to the 100 percent risk category. If a traded position has received more than one external rating, the lowest single rating will apply.

Long-term rating category	Examples	Risk weight (In percent)
Highest or second highest investment grade	AAA, AA	20
Third highest investment grade	A	50
Lowest investment grade	BBB	100
One category below investment grade	BB	200

Short-term rating	Examples	Risk weight (In percent)
Highest investment grade	A–1, P–1	20
Second highest investment grade	A–2, P–2	50
Lowest investment grade	A–3, P–3	100

ii. *Non-traded positions.* A recourse obligation, direct credit substitute, or residual interest (but not a credit-enhancing I/O strip) extended in connection with a securitization that is not a traded position may be assigned a risk weight in accordance with section III.B.3.c.i. of this appendix if:

1. It has been externally rated by more than one NRSRO;

2. It has received an external rating on a long-term position that is one grade below investment grade or better or on a short-term position that is investment grade by all NRSROs providing a rating;

3. The ratings are publicly available; and

4. The ratings are based on the same criteria used to rate traded positions.

If the ratings are different, the lowest rating will determine the risk category to which the recourse obligation, direct credit substitute, or residual interest will be assigned.

d. *Senior positions not externally rated.* For a recourse obligation, direct credit substitute, residual interest, or asset- or mortgage-backed security that is not externally rated but is senior or preferred in all features to a traded position (including collateralization and maturity), a bank may apply a risk weight to the face amount of the senior position in accordance with section III.B.3.c.i. of this appendix, based on the traded position, subject to any current or prospective supervisory guidance and the bank satisfying the Federal Reserve that this treatment is appropriate. This section will apply only if the traded subordinated position provides substantive credit support to the unrated position until the unrated position matures.

e. *Capital requirement for residual interests*—i. *Capital requirement for credit-enhancing I/O strips.* After applying the concentration limit to credit-enhancing I/O strips (both purchased and retained) in accordance with sections II.B.2.c. through e. of this appendix, a bank must maintain risk-based capital for a credit-enhancing I/O strip (both purchased and retained), regardless of the external rating on that position, equal to the remaining amount of the credit-enhancing I/O strip (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing I/O strip will be treated as if the credit-enhancing I/O strip was retained by the bank and not transferred.

ii. *Capital requirement for other residual interests. 1.* If a residual interest does not meet the requirements of sections III.B.3.c. or d. of this appendix, a bank must maintain risk-

based capital equal to the remaining amount of the residual interest that is retained on the balance sheet (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred residual interest will be treated as if the residual interest was retained by the bank and not transferred.

2. Where the aggregate capital requirement for residual interests and other recourse obligation in connection with the same transfer of assets exceed the full risk-based capital requirement for those assets, a bank must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under section III.B.3.e.ii.*1* of this appendix or the full risk-based capital requirement for the assets transferred.

f. *Positions that are not rated by an NRSRO.* A position (but not a residual interest) maintained in connection with a securitization and that is not rated by a NRSRO may be risk-weighted based on the bank's determination of the credit rating of the position, as specified in the table below, multiplied by the face amount of the position. In order to obtain this treatment, the bank's system for determining the credit rating of the position must meet one of the three alternative standards set out in sections III.B.3.f.i. through III.B.3.f.iii. of this appendix.

Rating category	Examples	Risk weight (In percent)
Highest or second highest investment grade	AAA,AA	100
Third highet investment grade	A	100
Lowest investment grade	BBB	100
One category below investment grade	BB	200

i. *Internal risk rating used for asset-backed programs.* A direct credit substitute (other than a purchased credit-enhancing I/O) is assumed in connection with an asset-backed commercial paper program sponsored by the bank and the bank is able to demonstrate to the satisfaction of the Federal Reserve, prior to relying upon its use, that the bank's internal credit risk rating system is adequate. Adequate internal credit risk rating systems usually contain the following criteria:

1. The internal credit risk system is an integral part of the bank's risk management system, which explicitly incorporates the full range of risks arising from a bank's participation in securitization activities;

2. Internal credit ratings are linked to measurable outcomes, such as the probability that the position will experience any loss, the position's expected loss given default, and the degree of variance in losses given default on that position;

3. The bank's internal credit risk system must separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of a particular securitization transaction;

4. The bank's internal credit risk system must identify gradations of risk among ''pass'' assets and other risk positions;

5. The bank must have clear, explicit criteria that are used to classify assets into each internal risk grade, including subjective factors;

6. The bank must have independent credit risk management or loan review personnel assigning or reviewing the credit risk ratings;

7. The bank must have an internal audit procedure that periodically verifies that the internal credit risk ratings are assigned in accordance with the established criteria;

8. The bank must monitor the performance of the internal credit risk ratings assigned to nonrated, nontraded direct credit substitutes over time to determine the appropriateness of the initial credit risk rating assignment and adjust individual credit risk ratings, or the overall internal credit risk ratings system, as needed; and

9. The internal credit risk system must make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

ii. *Program Ratings.* A direct credit substitute or recourse obligation (other than a residual interest) is assumed or retained in connection with a structured finance program and a NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the bank may apply the rating category that corresponds to the bank's position. In order to rely on a program rating, the bank must demonstrate to the Federal Reserve's satisfaction that the credit risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The bank must also demonstrate to the Federal Reserve's satisfaction that the criteria underlying the NRSRO's assignment of ratings

for the program are satisfied for the particular position. If a bank participates in a securitization sponsored by another party, the Federal Reserve may authorize the bank to use this approach based on a programmatic rating obtained by the sponsor of the program.

iii. *Computer Program.* The bank is using an acceptable credit assessment computer program to determine the rating of a direct credit substitute or recourse obligation (but not residual interest) issued in connection with a structured finance program. A NRSRO must have developed the computer program, and the bank must demonstrate to the Federal Reserve's satisfaction that ratings under the program correspond credibly and reliably with the rating of traded positions.

g. *Limitations on risk-based capital requirements*—i. *Low-level exposure.* If the maximum contractual exposure to loss retained or assumed by a bank in connection with a recourse obligation or a direct credit substitute is less than the effective risk-based capital requirement for the enhanced assets, the risk-based capital requirement is limited to the maximum contractual exposure, less any recourse liability account established in accordance with generally accepted accounting principles. This limitation does not apply when a bank provides credit enhancement beyond any contractual obligation to support assets it has sold.

ii. *Mortgage-related securities or participation certificates retained in a mortgage loan swap.* If a bank holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, capital is required to support the recourse obligation plus the percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of capital required for the on-balance sheet asset and the recourse obligation, however, is limited to the capital requirement for the underlying loans, calculated as if the bank continued to hold these loans as on-balance sheet assets.

iii. *Related on-balance sheet assets.* If a recourse obligation or direct credit substitute subject to section III.B.3. of this appendix also appears as a balance sheet asset, the balance sheet asset is not included in a bank's risk-weighted assets to the extent the value of the balance sheet asset is already included in the off-balance sheet credit equivalent amount for the recourse obligation or direct credit substitute, except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, both the on-balance sheet assets and the related recourse obligations and direct credit substitutes must be separately risk-weighted and incorporated into the risk-based capital calculation.

4. *Maturity.* Maturity is generally not a factor in assigning items to risk categories with the exception of claims on non-OECD banks, commitments, and interest rate and foreign exchange rate contracts. Except for commitments, short-term is defined as one year or less *remaining* maturity and long-term is defined as over one year *remaining* maturity. In the case of commitments, short-term is defined as one year or less *original* maturity and long-term is defined as over one year *original* maturity.

5. *Small Business Loans and Leases on Personal Property Transferred with Recourse.* a. Notwithstanding other provisions of this appendix A, a qualifying bank that has transferred small business loans and leases on personal property (small business obligations) with recourse shall include in weighted-risk assets only the amount of retained recourse, provided two conditions are met. First, the transaction must be treated as a sale under GAAP and, second, the bank must establish pursuant to GAAP a non-capital reserve sufficient to meet the bank's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small business concern established by the Small Business Administration under section 3(a) of the Small Business Act are eligible for this capital treatment.

b. For purposes of this appendix A, a bank is qualifying if it meets the criteria set forth in the Board's prompt corrective action regulation (12 CFR 208.40) for well capitalized or, by order of the Board, adequately capitalized. For purposes of determining whether a bank meets the criteria, its capital ratios must be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section III.B.5.a. of this appendix A. The total outstanding amount of recourse retained by a qualifying bank on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the bank's total risk-based capital. By order, the Board may approve a higher limit.

c. If a bank ceases to be qualifying or exceeds the 15 percent capital limitation, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time that the bank was qualifying and did not exceed the capital limit.

d. The risk-based capital ratios of the bank shall be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section III.B.5.a. of this appendix A for purposes of:

(i) Determining whether a bank is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under prompt corrective action (12 CFR 208.43(b)(1)); and

(ii) Reclassifying a well capitalized bank to adequately capitalized and requiring an adequately capitalized bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower prompt corrective action capital category (12 CFR 208.43(c)).

C. Risk Weights

Attachment III contains a listing of the risk categories, a summary of the types of assets assigned to each category and the weight associated with each category, that is, 0 percent, 20 percent, 50 percent, and 100 percent. A brief explanation of the components of each category follows.

1. *Category 1: zero percent*. This category includes cash (domestic and foreign) owned and held in all offices of the bank or in transit and gold bullion held in the bank's own vaults or in another bank's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities.[23] The category also includes all direct claims (including securities, loans, and leases) on, and the portions of claims that are directly and unconditionally guaranteed by, the central governments[24] of the OECD countries and U.S. Government agencies,[25] as well as all direct local currency claims on, and the portions of local currency claims that are directly and unconditionally guaranteed by, the central governments of non-OECD countries, to the extent that the bank has liabilities booked in that currency. A claim is not considered to be unconditionally guaranteed by a central government if the validity of the guarantee is dependent upon some affirmative action by the holder or a third party. Generally, securities guaranteed by the U.S. Government or its agencies that are actively traded in financial markets, such as GNMA securities, are considered to be unconditionally guaranteed.

This category also includes claims collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

2. *Category 2: 20 percent*. This category includes cash items in the process of collection, both foreign and domestic; short-term claims (including demand deposits) on, and the portions of short-term claims that are

[23] All other holdings of bullion are assigned to the 100 percent risk category.

[24] A central government is defined to include departments and ministries, including the central bank, of the central government. The U.S. central bank includes the 12 Federal Reserve Banks, and the stock held in these banks as a condition of membership is assigned to the zero percent risk category. The definition of central government does not include state, provincial, or local governments; or commercial enterprises owned by the central government. In addition, it does not include local government entities or commercial enterprises whose obligations are guaranteed by the central government, although any claims on such entities guaranteed by central governments are placed in the same general risk category as other claims guaranteed by central governments. OECD central governments are defined as central governments of the OECD-based group of countries; non-OECD central governments are defined as central governments that do not belong to the OECD-based group countries.

[25] A U.S. Government agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. Such agencies include the Government National Mortgage Association (GNMA), the Veterans Administration (VA), the Federal Housing Administration (FHA), the Export-Import Bank (Exim Bank), the Overseas Private Investment Corporation (OPIC), the Commodity Credit Corporation (CCC), and the Small Business Administration (SBA).

guaranteed[26] by, U.S. depository institutions[27] and foreign banks;[28] and long-term claims on, and the portions of long-term claims that are guaranteed by, U.S. depository institutions and OECD banks.[29]

This category also includes the portions of claims that are conditionally guaranteed by OECD central governments and U.S. Government agencies, as well as the portions of local currency claims that are conditionally guaranteed by non-OECD central governments, to the extent that the bank has liabilities booked in that currency. In addition, this category also includes claims on, and the portions of claims that are guaranteed by, U.S. government-sponsored[30] agencies and claims on, and the portions of claims guaranteed by, the International Bank for Reconstruction and Development (World Bank), the International Finance Corporation, the Interamerican Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, and other multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member. General obligation claims on, or portions of claims guaranteed by the full faith and credit of, states or other political subdivisions of the U.S. or other countries of the OECD-based group are also assigned to this category.[31]

This category also includes the portions of claims (including repurchase transactions) collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies that do not qualify for the zero percent risk-weight category; collateralized by securities issued or guaranteed by U.S. government-sponsored agencies; or collateralized by securities issued by multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member.

3. *Category 3: 50 percent.* This category includes loans fully secured by first liens[32] on

[26] Claims guaranteed by U.S. depository institutions and foreign banks include risk participations in both bankers acceptances and standby letters of credit, as well as participations in commitments, that are conveyed to other U.S. depository institutions or foreign banks.

[27] U.S. depository institutions are defined to include branches (foreign and domestic) of federally-insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, and international banking facilities of domestic banks. U.S.-chartered depository institutions owned by foreigners are also included in the definition. However, branches and agencies of foreign banks located in the U.S., as well as all bank holding companies, are excluded.

[28] Foreign banks are distinguished as either OECD banks or non-OECD banks. OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries (other than the U.S.) that belong to the OECD-based group of countries. Non-OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries that do not belong to the OECD-based group of countries. For this purpose, a bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

[29] Long-term claims on, or guaranteed by, non-OECD banks and all claims on bank holding companies are assigned to the 100 percent risk category, as are holdings of bank-issued securities that qualify as capital of the issuing banks.

[30] For this purpose, U.S. government-sponsored agencies are defined as agencies originally established or chartered by the Federal government to serve public purposes specified by the U.S. Congress but whose obligations are *not explicitly* guaranteed by the full faith and credit of the U.S. government. These agencies include the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), the Farm Credit System, the Federal Home Loan Bank System, and the Student Loan Marketing Association (SLMA). Claims on U.S. government-sponsored agencies include capital stock in a Federal Home Loan Bank that is held as a condition of membership in that Bank.

[31] Claims on, or guaranteed by, states or other political subdivisions of countries that do not belong to the OECD-based group of countries are placed in the 100 percent risk category.

[32] If a bank holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purposes of determining the loan-to-value ratio and assigning a risk weight.

1- to 4-family residential properties, either owner-occupied or rented, or on multifamily residential properties,[33] that meet certain criteria.[34] Loans included in this category must have been made in accordance with prudent underwriting standards;[35] be performing in accordance with their original terms; and not be 90 days or more past due or carried in nonaccrual status. The following additional criteria must also be applied to a loan secured by a multifamily residential property that is included in this category: all principal and interest payments on the loan must have been made on time for at least the year preceding placement in this category, or in the case where the existing property owner is refinancing a loan on that property, all principal and interest payments on the loan being refinanced must have been made on time for at least the year preceding placement in this category; amortization of the principal and interest must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years; and the annual net operating income (before debt service) generated by the property during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (115 percent if the loan is based on a floating interest rate) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the institution. Also included in this category are privately-issued mortgage-backed securities provided that

(1) The structure of the security meets the criteria described in section III(B)(3) above;

(2) If the security is backed by a pool of conventional mortgages, on 1- to 4-family residential or multifamily residential properties each underlying mortgage meets the criteria described above in this section for eligibility for the 50 percent risk category at the time the pool is originated;

(3) If the security is backed by privately-issued mortgage-backed securities, *each* underlying security qualifies for the 50 percent risk category; and

(4) If the security is backed by a pool of multifamily residential mortgages, principal

[33] Loans that qualify as loans secured by 1- to 4-family residential properties or multifamily residential properties are listed in the instructions to the commercial bank Call Report. In addition, for risk-based capital purposes, loans secured by 1- to 4-family residential properties include loans to builders with substantial project equity for the construction of 1- to 4-family residences that have been presold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. Such loans to builders will be considered prudently underwritten only if the bank has obtained sufficient documentation that the buyer of the home intends to purchase the home (i.e., has a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (i.e., has a firm written commitment for permanent financing of the home upon completion).

The instructions to the Call Report also discuss the treatment of loans, including multifamily housing loans, that are sold subject to a pro rata loss sharing arrangement. Such an arrangement should be treated by the selling bank as sold (and excluded from balance sheet assets) to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling bank. In such a transaction, from the standpoint of the selling bank, the portion of the loan that is treated as sold is not subject to the risk-based capital standards. In connection with sales of multifamily housing loans in which the purchaser of a loan shares in any loss incurred on the loan with the selling institution on other than a pro rata basis, these other loss sharing arrangements are taken into account for purposes of determining the extent to which such loans are treated by the selling bank as sold (and excluded from balance sheet assets) under the risk-based capital framework in the same manner as prescribed for reporting purposes in the instructions to the Call Report.

[34] Residential property loans that do not meet all the specified criteria or that are made for the purpose of speculative property development are placed in the 100 percent risk category.

[35] Prudent underwriting standards include a conservative ratio of the current loan balance to the value of the property. In the case of a loan secured by multifamily residential property, the loan-to-value ratio is not conservative if it exceeds 80 percent (75 percent if the loan is based on a floating interest rate). Prudent underwriting standards also dictate that a loan-to-value ratio used in the case of originating a loan to acquire a property would not be deemed conservative unless the value is based on the lower of the acquisition cost of the property or appraised (or if appropriate, evaluated) value. Otherwise, the loan-to-value ratio generally would be based upon the value of the property as determined by the most current appraisal, or if appropriate, the most current evaluation. All appraisals must be made in a manner consistent with the Federal banking agencies' real estate appraisal regulations and guidelines and with the bank's own appraisal guidelines.

and interest payments on the security are not 30 days or more past due.

Privately-issued mortgage-backed securities that do not meet these criteria or that do not qualify for a lower risk weight are generally assigned to the 100 percent risk category.

Also assigned to this category are *revenue* (non-general obligation) bonds or similar obligations, including loans and leases, that are obligations of states or other political subdivisions of the U.S. (for example, municipal revenue bonds) or other countries of the OECD-based group, but for which the government entity is committed to repay the debt with revenues from the specific projects financed, rather than from general tax funds.

Credit equivalent amounts of derivative contracts involving standard risk obligors (that is, obligors whose loans or debt securities would be assigned to the 100 percent risk category) are included in the 50 percent category, unless they are backed by collateral or guarantees that allow them to be placed in a lower risk category.

4. *Category 4: 100 percent*. a. All assets not included in the categories above are assigned to this category, which comprises standard risk assets. The bulk of the assets typically found in a loan portfolio would be assigned to the 100 percent category.

b. This category includes long-term claims on, and the portions of long-term claims that are guaranteed by, non-OECD banks, and all claims on non-OECD central governments that entail some degree of transfer risk.[36] This category includes all claims on foreign and domestic private-sector obligors not included in the categories above (including loans to nondepository financial institutions and bank holding companies); claims on commercial firms owned by the public sector; customer liabilities to the bank on acceptances outstanding involving standard risk claims;[37] investments in fixed assets, premises, and other real estate owned; common and preferred stock of corporations, including stock acquired for debts previously contracted; all stripped mortgage-backed securities and similar instruments; and commercial and consumer loans (except those assigned to lower risk categories due to recognized guarantees or collateral and loans secured by residential property that qualify for a lower risk weight).

c. Also included in this category are industrial-development bonds and similar obligations issued under the auspices of states or political subdivisions of the OECD-based group of countries for the benefit of a private party or enterprise where that party or enterprise, not the government entity, is obligated to pay the principal and interest, and all obligations of states or political subdivisions of countries that do not belong to the OECD-based group.

d. The following assets also are assigned a risk weight of 100 percent if they have not been deducted from capital: investments in unconsolidated companies, joint ventures, or associated companies; instruments that qualify as capital issued by other banking organizations; and any intangibles, including those that may have been grandfathered into capital.

D. Off-Balance Sheet Items

The face amount of an off-balance sheet item is generally incorporated into risk-weighted assets in two steps. The face amount is first multiplied by a credit conversion factor, except for direct credit substitutes and recourse obligations as discussed in section III.D.1. of this appendix. The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor or the nature of the collateral.[38] Attachment IV to this appendix sets forth the conversion factors for various types of off-balance sheet items.

1. *Items with a 100-percent conversion factor*. a. Except as otherwise provided in section III.B.3. of this appendix, the full amount of an asset or transaction supported, in whole or in part, by a direct credit substitute or a recourse obligation. Direct credit substitutes and recourse obligations are defined in section III.B.3. of this appendix.

[36] Such assets include all nonlocal currency claims on, and the portions of claims that are guaranteed by, non-OECD central governments and those portions of local currency claims on, or guaranteed by, non-OECD central governments that exceed the local currency liabilities held by the bank.

[37] Customer liabilities on acceptances outstanding involving nonstandard risk claims, such as claims on U.S. depository institutions, are assigned to the risk category appropriate to the identity of the obligor or, if relevant, the nature of the collateral or guarantees backing the claims. Portions of acceptances conveyed as risk participations to U.S. depository institutions or foreign banks are assigned to the 20 percent risk category appropriate to short-term claims guaranteed by U.S. depository institutions and foreign banks.

[38] The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B. of this appendix A.

b. Sale and repurchase agreements and forward agreements. Forward agreements are legally binding contractual obligations to purchase assets with certain drawdown at a specified future date. Such obligations include forward purchases, forward forward deposits placed,[39] and partly-paid shares and securities; they do not include commitments to make residential mortgage loans or forward foreign exchange contracts.

c. Securities lent by a bank are treated in one of two ways, depending upon whether the lender is at risk of loss. If a bank, as agent for a customer, lends the customer's securities and does not indemnify the customer against loss, then the transaction is excluded from the risk-based capital calculation. If, alternatively, a bank lends its own securities or, acting as agent for a customer, lends the customer's securities and indemnifies the customer against loss, the transaction is converted at 100 percent and assigned to the risk weight category appropriate to the obligor, or, if applicable, to any collateral delivered to the lending bank, or the independent custodian acting on the lending bank's behalf. Where a bank is acting as agent for a customer in a transaction involving the lending or sale of securities that is collateralized by cash delivered to the bank, the transaction is deemed to be collateralized by cash on deposit in the bank for purposes of determining the appropriate risk-weight category, provided that any indemnification is limited to no more than the difference between the market value of the securities and the cash collateral received and any reinvestment risk associated with that cash collateral is borne by the customer.

d. In the case of direct credit substitutes in which a risk participation[40] has been conveyed, the full amount of the assets that are supported, in whole or in part, by the credit enhancement are converted to a credit equivalent amount at 100 percent. However, the *pro rata* share of the credit equivalent amount that has been conveyed through a risk participation is assigned to whichever risk category is lower: the risk category appropriate to the obligor, after considering any relevant guarantees or collateral, or the risk category appropriate to the institution acquiring the participation.[41] Any remainder is assigned to the risk category appropriate to the obligor, guarantor, or collateral. For example, the *pro rata* share of the full amount of the assets supported, in whole or in part, by a direct credit substitute conveyed as a risk participation to a U.S. domestic depository institution or foreign bank is assigned to the 20 percent risk category.[42]

e. In the case of direct credit substitutes in which a risk participation has been acquired, the acquiring bank's percentage share of the direct credit substitute is multiplied by the full amount of the assets that are supported, in whole or in part, by the credit enhancement and converted to a credit equivalent amount at 100 percent. The credit equivalent amount of an acquisition of a risk participation in a direct credit substitute is assigned to the risk category appropriate to the account party obligor or, if relevant, the nature of the collateral or guarantees.

f. In the case of direct credit substitutes that take the form of a syndication where each bank is obligated only for its *pro rata* share of the risk and there is no recourse to the originating bank, each bank will only include its *pro rata* share of the assets supported, in whole or in part, by the direct credit substitute in its risk-based capital calculation.[43]

* * * * *

2. *Items with a 50 percent conversion factor*. Transaction-related contingencies are converted at 50 percent. Such contingencies include bid bonds, performance bonds, warranties, standby letters of credit related to particular transactions, and performance standby letters of credit, as well as acquisitions of risk participations in performance standby letters of credit. Performance standby letters of credit represent obligations backing the performance of nonfinancial or commercial contracts or undertakings. To the extent permitted by law or regulation, performance

[39] Forward forward deposits accepted are treated as interest rate contracts.

[40] That is, a participation in which the originating bank remains liable to the beneficiary for the full amount of the direct credit substitute if the party that has acquired the participation fails to pay when the instrument is drawn.

[41] A risk participation in bankers acceptances conveyed to other institutions is also assigned to the risk category appropriate to the institution acquiring the participation or, if relevant, the guarantor or nature of the collateral.

[42] Risk participations with a remaining maturity of over one year that are conveyed to non-OECD banks are to be assigned to the 100 percent risk category, unless a lower risk category is appropriate to the obligor, guarantor, or collateral.

[43] For example, if a bank has a 10 percent share of a $10 syndicated direct credit substitute that provides credit support to a $100 loan, then the bank's $1 *pro rata* share in the enhancement means that a $10 *pro rata* share of the loan is included in risk weighted assets.

standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

The unused portion of commitments with an *original* maturity exceeding one year, including underwriting commitments, and commercial and consumer credit commitments also are converted at 50 percent. Original maturity is defined as the length of time between the date the commitment is issued and the earliest date on which: (1) The bank can, at its option, unconditionally (without cause) cancel the commitment,[44] *and* (2) the bank is scheduled to (and as a normal practice actually does) review the facility to determine whether or not it should be extended. Such reviews must continue to be conducted at least annually for such a facility to qualify as a short-term commitment.

Commitments are defined as any legally binding arrangements that obligate a bank to extend credit in the form of loans or leases; to purchase loans, securities, or other assets; or to participate in loans and leases. They also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted risk assets regardless of whether they contain ''material adverse change'' clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the bank is obligated solely for its *pro rata* share, only the bank's proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio.

Facilities that are unconditionally cancellable (without cause) at any time by the bank are not deemed to be commitments, provided the bank makes a separate credit decision before each drawing under the facility. Commitments with an original maturity of one year or less are deemed to involve low risk and, therefore, are not assessed a capital charge. Such short-term commitments are defined to include the unused portion of lines of credit on retail credit cards and related plans (as defined in the instructions to the commercial bank Call Report) if the bank has the unconditional right to cancel the line of credit at any time, in accordance with applicable law.

Once a commitment has been converted at 50 percent, any portion that has been conveyed to other U.S. depository institutions or OECD banks as participations in which the originating bank retains the full obligation to the borrower if the participating bank fails to pay when the instrument is drawn, is assigned to the 20 percent risk category. This treatment is analogous to that accorded to conveyances of risk participations in standby letters of credit. The acquisition of a participation in a commitment by a bank is converted at 50 percent and assigned to the risk category appropriate to the account party obligor or, if relevant, the nature of the collateral or guarantees.

Revolving underwriting facilities (RUFs), note issuance facilities (NIFs), and other similar arrangements also are converted at 50 percent regardless of maturity. These are facilities under which a borrower can issue on a revolving basis short-term paper in its own name, but for which the underwriting banks have a legally binding commitment either to purchase any notes the borrower is unable to sell by the roll-over date or to advance funds to the borrower.

3. *Items with a 20 percent conversion factor*. Short-term, self-liquidating trade-related contingencies which arise from the movement of goods are converted at 20 percent. Such contingencies generally include commercial letters of credit and other documentary letters of credit collateralized by the underlying shipments.

4. *Items with a zero percent conversion factor*. These include unused portions of commitments with an original maturity of one year or less,[45] or which are unconditionally cancellable at any time, provided a separate credit decision is made before each drawing under the facility. Unused portions of lines of credit on retail credit cards and related plans are deemed to be short-term commitments if the bank has the unconditional right to cancel the line of credit at any time, in accordance with applicable law.

E. Derivative Contracts (Interest Rate, Exchange Rate, Commodity—(including precious metals) and Equity-Linked Contracts)

1. *Scope*. Credit equivalent amounts are computed for each of the following off-balance-sheet derivative contracts:

a. Interest Rate Contracts. These include single currency interest rate swaps, basis swaps, forward rate agreements, interest

[44] In the case of consumer home equity or mortgage lines of credit secured by liens on 1–4 family residential properties, the bank is deemed able to unconditionally cancel the commitment for the purpose of this criterion if, at its option, it can prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by relevant Federal law.

[45] Through year-end 1992, remaining maturity may be used for determining term to maturity for off-balance sheet loan commitments; thereafter, original maturity must be used.

rate options purchased (including caps, collars, and floors purchased), and any other instrument linked to interest rates that gives rise to similar credit risks (including when-issued securities and forward forward deposits accepted).

b. Exchange Rate Contracts. These include cross-currency interest rate swaps, forward foreign exchange contracts, currency options purchased, and any other instrument linked to exchange rates that gives rise to similar credit risks.

c. Equity Derivative Contracts. These include equity-linked swaps, equity-linked options purchased, forward equity-linked contracts, and any other instrument linked to equities that gives rise to similar credit risks.

d. Commodity (including precious metal) Derivative Contracts. These include commodity-linked swaps, commodity-linked options purchased, forward commodity-linked contracts, and any other instrument linked to commodities that gives rise to similar credit risks.

e. Exceptions. Exchange rate contracts with an original maturity of fourteen or fewer calendar days and derivative contracts traded on exchanges that require daily receipt and payment of cash variation margin may be excluded from the risk-based ratio calculation. Gold contracts are accorded the same treatment as exchange rate contracts except that gold contracts with an original maturity of fourteen or fewer calendar days are included in the risk-based ratio calculation. Over-the-counter options purchased are included and treated in the same way as other derivative contracts.

2. *Calculation of credit equivalent amounts.* a. The credit equivalent amount of a derivative contract that is not subject to a qualifying bilateral netting contract in accordance with section III.E.3. of this appendix A is equal to the sum of (i) the current exposure (sometimes referred to as the replacement cost) of the contract; and (ii) an estimate of the potential future credit exposure of the contract.

b. The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is equal to that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. Mark-to-market values are measured in dollars, regardless of the currency or currencies specified in the contract, and should reflect changes in underlying rates, prices, and indices, as well as counterparty credit quality.

c. The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount of the contract by a credit conversion factor. Banks should use, subject to examiner review, the effective rather than the apparent or stated notional amount in this calculation. The credit conversion factors are:

CONVERSION FACTORS

[In percent]

Remaining maturity	Interest rate	Exchange rate and gold	Equity	Commodity, excluding precious metals	Precious metals, except gold
One year or less	0.0	1.0	6.0	10.0	7.0
Over one to five years	0.5	5.0	8.0	12.0	7.0
Over five years	1.5	7.5	10.0	15.0	8.0

d. For a contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity is equal to the time until the next reset date. For an interest rate contract with a remaining maturity of more than one year that meets these criteria, the minimum conversion factor is 0.5 percent.

e. For a contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the contract. A derivative contract not included in the definitions of interest rate, exchange rate, equity, or commodity contracts as set forth in section III.E.1. of this appendix A, is subject to the same conversion factors as a commodity, excluding precious metals.

f. No potential future exposure is calculated for a single currency interest rate swap in which payments are made based upon two floating rate indices (a so called floating/floating or basis swap); the credit exposure on such a contract is evaluated solely on the basis of the mark-to-market value.

g. The Board notes that the conversion factors set forth above, which are based on observed volatilities of the particular types of instruments, are subject to review and modification in light of changing volatilities or market conditions.

3. *Netting.* a. For purposes of this appendix A, netting refers to the offsetting of positive

and negative mark-to-market values when determining a current exposure to be used in the calculation of a credit equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of derivative contracts is recognized for purposes of calculating the credit equivalent amount provided that:

i. The netting is accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the bank would have a claim to receive, or obligation to pay, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to any of the following events: default, insolvency, liquidation, or similar circumstances.

ii. The bank obtains a written and reasoned legal opinion(s) representing that in the event of a legal challenge—including one resulting from default, insolvency, liquidation, or similar circumstances—the relevant court and administrative authorities would find the bank's exposure to be the net amount under:

1. The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

2. The law that governs the individual contracts covered by the netting contract; and

3. The law that governs the netting contract.

iii. The bank establishes and maintains procedures to ensure that the legal characteristics of netting contracts are kept under review in the light of possible changes in relevant law.

iv. The bank maintains in its files documentation adequate to support the netting of derivative contracts, including a copy of the bilateral netting contract and necessary legal opinions.

b. A contract containing a walkaway clause is not eligible for netting for purposes of calculating the credit equivalent amount.[46]

c. A bank netting individual contracts for the purpose of calculating credit equivalent amounts of derivative contracts, represents that it has met the requirements of this appendix A and all the appropriate documents are in the bank's files and available for inspection by the Federal Reserve. The Federal Reserve may determine that a bank's files are inadequate or that a netting contract, or any of its underlying individual contracts, may not be legally enforceable under any one of the bodies of law described in section III.E.3.a.ii. of this appendix A. If such a determination is made, the netting contract may be disqualified from recognition for risk-based capital purposes or underlying individual contracts may be treated as though they are not subject to the netting contract.

d. The credit equivalent amount of contracts that are subject to a qualifying bilateral netting contract is calculated by adding (i) the current exposure of the netting contract (net current exposure) and (ii) the sum of the estimates of potential future credit exposures on all individual contracts subject to the netting contract (gross potential future exposure) adjusted to reflect the effects of the netting contract.[47]

e. The net current exposure is the sum of all positive and negative mark-to-market values of the individual contracts included in the netting contract. If the net sum of the mark-to-market values is positive, then the net current exposure is equal to that sum. If the net sum of the mark-to-market values is zero or negative, then the net current exposure is zero. The Federal Reserve may determine that a netting contract qualifies for risk-based capital netting treatment even though certain individual contracts included under the netting contract may not qualify. In such instances, the nonqualifying contracts should be treated as individual contracts that are not subject to the netting contract.

f. Gross potential future exposure, or A_{gross} is calculated by summing the estimates of potential future exposure (determined in accordance with section III.E.2 of this appendix A) for each individual contract subject to the qualifying bilateral netting contract.

g. The effects of the bilateral netting contract on the gross potential future exposure are recognized through the application of a formula that results in an adjusted add-on amount (A_{net}). The formula, which employs the ratio of net current exposure to gross current exposure (NGR) is expressed as:

$$A_{net} = (0.4 \times A_{gross}) + 0.6(NGR \times A_{gross})$$

h. The NGR may be calculated in accordance with either the counterparty-by-

[46] A walkaway clause is a provision in a netting contract that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the contract.

[47] For purposes of calculating potential future credit exposure to a netting counterparty for foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts falling due on each value date in each currency.

counterparty approach or the aggregate approach.

i. Under the counterparty-by-counterparty approach, the NGR is the ratio of the net current exposure for a netting contract to the gross current exposure of the netting contract. The gross current exposure is the sum of the current exposures of all individual contracts subject to the netting contract calculated in accordance with section III.E.2. of this appendix A. Net negative mark-to-market values for individual netting contracts with the same counterparty may not be used to offset net positive mark-to-market values for other netting contracts with that counterparty.

ii. Under the aggregate approach, the NGR is the ratio of the sum of all of the net current exposures for qualifying bilateral netting contracts to the sum of all of the gross current exposures for those netting contracts (each gross current exposure is calculated in the same manner as in section III.E.3.h.i. of this appendix A). Net negative mark-to-market values for individual counterparties may not be used to offset net positive mark-to-market values for other counterparties.

iii. A bank must consistently use either the counterparty-by-counterparty approach or the aggregate approach to calculate the NGR. Regardless of the approach used, the NGR should be applied individually to each qualifying bilateral netting contract to determine the adjusted add-on for that netting contract.

i. In the event a netting contract covers contracts that are normally excluded from the risk-based ratio calculation—for example, exchange rate contracts with an original maturity of fourteen or fewer calendar days or instruments traded on exchanges that require daily payment and receipt of cash variation margin—a bank may elect to either include or exclude all mark-to-market values of such contracts when determining net current exposure, provided the method chosen is applied consistently.

4. *Risk Weights.* Once the credit equivalent amount for a derivative contract, or a group of derivative contracts subject to a qualifying bilateral netting contract, has been determined, that amount is assigned to the risk category appropriate to the counterparty, or, if relevant, the guarantor or the nature of any collateral.[48] However, the maximum risk weight applicable to the credit equivalent amount of such contracts is 50 percent.

5. *Avoidance of double counting.* a. In certain cases, credit exposures arising from the derivative contracts covered by section III.E. of this appendix A may already be reflected, in part, on the balance sheet. To avoid double counting such exposures in the assessment of capital adequacy and, perhaps, assigning inappropriate risk weights, counterparty credit exposures arising from the derivative instruments covered by these guidelines may need to be excluded from balance sheet assets in calculating a bank's risk-based capital ratios.

b. Examples of the calculation of credit equivalent amounts for contracts covered under this section III.E. are contained in Attachment V of this appendix A.

IV. Minimum Supervisory Ratios and Standards

The interim and final supervisory standards set forth below specify *minimum* supervisory ratios based primarily on broad credit risk considerations. As noted above, the risk-based ratio does not take explicit account of the quality of individual asset portfolios or the range of other types of risks to which banks may be exposed, such as interest rate, liquidity, market or operational risks. For this reason, banks are generally expected to operate with capital positions above the minimum ratios.

Institutions with high or inordinate levels of risk are expected to operate well above minimum capital standards. Banks experiencing or anticipating significant growth are also expected to maintain capital, including tangible capital positions, well above the minimum levels. For example, most such institutions generally have operated at capital levels ranging from 100 to 200 basis points above the stated minimums. Higher capital ratios could be required if warranted by the particular circumstances or risk profiles of individual banks. In all cases, banks should hold capital commensurate with the level and nature of all of the risks, including the volume and severity of problem loans, to which they are exposed.

Upon adoption of the risk-based framework, any bank that does not meet the interim or final supervisory ratios, or whose capital is otherwise considered inadequate, is expected to develop and implement a plan acceptable to the Federal Reserve for achieving an adequate level of capital consistent with the provisions of these guidelines or with the special circumstances affecting the individual institution. In addition, such banks should avoid any actions, including increased risk-taking or unwarranted expansion, that would lower or further erode their capital positions.

[48] For derivative contracts, sufficiency of collateral or guarantees is generally determined by the market value of the collateral or the amount of the guarantee in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B. of this appendix A.

A. Minimum Risk-Based Ratio After Transition Period

As reflected in Attachment VI, by year-end 1992, all state member banks should meet a minimum ratio of qualifying total capital to weighted risk assets of 8 percent, of which at least 4.0 percentage points should be in the form of Tier 1 capital. For purposes of section IV.A., Tier 1 capital is defined as the sum of core capital elements less goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix. The maximum amount of supplementary capital elements that qualifies as Tier 2 capital is limited to 100 percent of Tier 1 capital. In addition, the combined maximum amount of subordinated debt and intermediate-term preferred stock that qualifies as Tier 2 capital is limited to 50 percent of Tier 1 capital. The maximum amount of the allowance for loan and lease losses that qualifies as Tier 2 capital is limited to 1.25 percent of gross weighted risk assets. Allowances for loan and lease losses in excess of this limit may, of course, be maintained, but would not be included in a bank's total capital. The Federal Reserve will continue to require banks to maintain reserves at levels fully sufficient to cover losses inherent in their loan portfolios.

Qualifying total capital is calculated by adding Tier 1 capital and Tier 2 capital (limited to 100 percent of Tier 1 capital) and then deducting from this sum certain investments in banking or finance subsidiaries that are not consolidated for accounting or supervisory purposes, reciprocal holdings of banking organization capital securities, or other items at the direction of the Federal Reserve. These deductions are discussed above in section II(B).

B. Transition Arrangements

The transition period for implementing the risk-based capital standard ends on December 31, 1992. Initially, the risk-based capital guidelines do not establish a minimum level of capital. However, by year-end 1990, banks are expected to meet a minimum interim target ratio for qualifying total capital to weighted risk assets of 7.25 percent, at least one-half of which should be in the form of Tier 1 capital. For purposes of meeting the 1990 interim target, the amount of loan loss reserves that may be included in capital is limited to 1.5 percent of weighted risk assets and up to 10 percent of a bank's Tier 1 capital may consist of supplementary capital elements. Thus, the 7.25 percent interim target ratio implies a minimum ratio of Tier 1 capital to weighted risk assets of 3.6 percent (one-half of 7.25) and a minimum ratio of core capital elements to weighted risk assets ratio of 3.25 percent (nine-tenths of the Tier 1 capital ratio).

Through year-end 1990, banks have the option of complying with the minimum 7.25 percent year-end 1990 risk-based capital standard, in lieu of the minimum 5.5 percent primary and 6 percent total capital to total assets capital ratios set forth in appendix B to part 225 of the Federal Reserve's Regulation Y. In addition, as more fully set forth in appendix B to this part, banks are expected to maintain a minimum ratio of Tier 1 capital total assets during this transition period.

ATTACHMENT I—SAMPLE CALCULATION OF RISK-BASED CAPITAL RATIO FOR STATE MEMBER BANKS

Example of a bank with $6,000 in total capital and the following assets and off-balance sheet items:

Balance Sheet Assets:	
Cash	$5,000
U.S. Treasuries	20,000
Balances at domestic banks	5,000
Loans secured by first liens on 1–4 family residential properties	5,000
Loans to private corporations	65,000
Total Balance Sheet Assets	$100,000
Off-Balance Sheet Items:	
Standby letters of credit (''SLCs'') backing general obligation debt issues of U.S. municipalities (''GOs'')	$10,000
Long-term legally binding commitments to private corporations	20,000
Total Off-Balance Sheet Items	30,000

This bank's total capital to *total* assets (leverage) ratio would be: ($6,000/$100,000)=6.00%

To compute the bank's weighted risk assets:

1. Compute the credit equivalent amount of each off-balance sheet (''OBS'') item

OBS item	Face value		Conversion factor		Credit equivalent amount
SLCS backing municipal GOs	$10,000	×	1.00	=	$10,000
Long-term commitments to private corporations	20,000	×	0.50	=	10,000
2. Multiply each balance sheet asset and the credit equivalent amount of each OBS item by the appropriate risk weight.					
0% Category:					
Cash	$ 5,000				
U.S. Treasuries	20,000				
	25,000	×	0	=	0
20% Category:					
Balances at domestic banks	5,000				
Credit equivalent amounts of SLCs backing GOs of U.S. municipalities	10,000				
	15,000	×	.20	=	$3,000
50% Category:					
Loans secured by first liens on 1–4 family residential properties	5,000	×	.50	=	2,500
100% Category:					
Loans to private corporations	65,000				
Credit equivalent amounts of long-term commitments to private corporations	10,000				
	75,000	×	1.00	=	75,000
Total risk-weighted assets					80,500

This bank's ratio of total capital to weighted risk assets (risk-based capital ratio) would be: ($6,000/$80,500)=7.45%

ATTACHMENT II.—SUMMARY OF DEFINITION OF QUALIFYING CAPITAL FOR STATE MEMBER BANKS*

[Using the year-end 1992 standard]

Components	Minimum requirements
Core Capital (Tier 1)	Must equal or exceed 4% of weighted-risk assets.
Common stockholders' equity	No limit.
Qualifying noncumulative perpetual preferred stock	No limit; banks should avoid undue reliance on preferred stock in tier 1.
Minority interest in equity accounts of consolidated subsidiaries.	Banks should avoid using minority interests to introduce elements not otherwise qualifying for tier 1 capital.
Less: Goodwill, other intangible assets, and credit-enhancing interest-only strips required to be deducted from capital [1]	
Supplementary Capital (Tier 2)	Total of tier 2 is limited to 100% of tier 1.[2]
Allowance for loan and lease losses	Limited to 1.25% of weighted-risk assets.[2]
Perpetual preferred stock	No limit within tier 2.
Hybrid capital instruments and equity contract notes	No limit within tier 2.
Subordinated debt and intermediate-term preferred stock (original weighted average maturity of 5 years or more).	Subordinated debt and intermediate-term preferred stock are limited to 50% of tier 1,[2] amortized for capital purposes as they approach maturity.
Revaluation reserves (equity and building)	Not included; banks encouraged to disclose; may be evaluated on a case-by-case basis for international comparisons; and taken into account in making an overall assessment of capital.
Deductions (from sum of tier 1 and tier 2):	
Investment in unconsolidated subsidiaries	
Reciprocal holdings of banking organizations' capital securities	
Other deductions (such as other subsidiaries or joint ventures) as determined by supervisory authority.	On a case-by-case basis or as a matter of policy after a formal rulemaking.
Total Capital (tier 1 + tier 2— deductions)	Must equal or exceed 8% or weighted-risk assets.

[1] Requirements for the deduction of other intangible assets and residual interests are set forth in section II.B.1. of this appendix.

[2] Amount in excess of limitations are permitted but do not qualify as capital.

* See discussion in section II of the guidelines for a complete description of the requirements for, and the limitations on, the components of qualifying capital.

ATTACHMENT III—SUMMARY OF RISK WEIGHTS AND RISK CATEGORIES FOR STATE MEMBER BANKS

Category 1: Zero Percent

1. Cash (domestic and foreign) held in the bank or in transit.

2. Balances due from Federal Reserve Banks (including Federal Reserve Bank stock) and central banks in other OECD countries.

3. Direct claims on, and the portions of claims that are unconditionally guaranteed by, the U.S. Treasury and U.S. Government agencies[1] and the central governments of other OECD countries, and local currency claims on, and the portions of local currency claims that are unconditionally guaranteed by, the central governments of non-OECD countries including the central banks of non-OECD countries), to the extent that the bank has liabilities booked in that currency.

4. Gold bullion held in the bank's vaults or in another's vaults on an allocated basis, to the extent offset by gold bullion liabilities.

5. Claims collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

Category 2: 20 Percent

1. Cash items in the process of collection.

2. All claims (long- or short-term) on, and the portions of claims (long- or short-term) that are guaranteed by, U.S. depository institutions and OCED banks.

3. Short-term claims (remaining maturity of one year or less) on, and the portions of short-term claims that are guaranteed by, non-OECD banks.

4. The portions of claims that are conditionally guaranteed by the central governments of OECD countries and U.S. Government agencies, and the portions of local currency claims that are conditionally guaranteed by the central governments of non-OECD countries, to the extent that the bank has liabilities booked in that currency.

[1] For the purpose of calculating the risk-based capital ratio, a U.S. Government agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

5. Claims on, and the portions of claims that are guaranteed by, U.S. Government-sponsored agencies.[2]

6. General obligation claims on, and the portions of claims that are guaranteed by the full faith and credit of, local governments and political subdivisions of the U.S. and other OECD local governments.

7. Claims on, and the portions of claims that are guaranteed by, official multilateral lending institutions or regional development banks.

8. The portions of claims that are collateralized[3] by cash on deposit in the bank or by securities issued or guaranteed by the U.S. Treasury, the central governments of other OECD countries, and U.S government agencies that do not qualify for the zero percent risk-weight category, or that are collateralized by securities issued or guaranteed by U.S. government-sponsored agencies.

9. The portions of claims that are collateralized[3] by securities issued by official multilateral lending institutions or regional development banks.

10. Certain privately-issued securities representing indirect ownership of mortgage-backed U.S. Government agency or U.S. Government-sponsored agency securities.

11. Investment in shares of a fund whose portfolio is permitted to hold only securities that would qualify for the zero or 20 percent risk categories.

Category 3: 50 Percent

1. Loans fully secured by first liens on 1-to 4-family residential properties or on multifamily residential properties that have been made in accordance with prudent underwriting standards, that are performing in accordance with their original terms, that are not past due or in nonaccrual status, and that meet other qualifying criteria, and certain privately-issued mortgage-backed securities representing indirect ownership of such loans. (Loans made for speculative purposes are excluded.)

2. Revenue bonds or similar claims that are obligations of U.S. state or local governments, or other OECD local governments, but for which the government entity is committed to repay the debt only out of revenues from the facilities financed.

3. Credit equivalent amounts of interest rate and foreign exchange rate related contracts, except for those assigned to a lower risk category.

Category 4: 100 Percent

1. All other claims on private obligors.

2. Claims on, or guaranteed by, non-OECD foreign banks with a remaining maturity exceeding one year.

3. Claims on, or guaranteed by, non-OECD central governments that are not included in item 3 of Category 1 or item 4 of Category 2; all claims on non-OECD state or local governments.

4. Obligations issued by U.S. state or local governments, or other OECD local governments (including industrial development authorities and similar entities), repayable solely by a private party or enterprise.

5. Premises, plant, and equipment; other fixed assets; and other real estate owned.

6. Investments in any unconsolidated subsidiaries, joint ventures, or associated companies—if not deducted from capital.

7. Instruments issued by other banking organizations that qualify as capital—if not deducted from capital.

8. Claims on commercial firms owned by a government.

9. All other assets, including any intangible assets that are not deducted from capital.

ATTACHMENT IV—CREDIT CONVERSION FACTORS FOR OFF-BALANCE-SHEET ITEMS FOR STATE MEMBER BANKS

100 Percent Conversion Factor

1. Direct credit substitutes. (These include general guarantees of indebtedness and all guarantee-type instruments, including standby letters of credit backing the financial obligations of other parties.)

2. Risk participations in bankers acceptances and direct credit substitutes, such as standby letters of credit.

3. Sale and repurchase agreements and assets sold with recourse that are not included on the balance sheet.

4. Forward agreements to purchase assets, including financing facilities, on which drawdown is certain.

5. Securities lent for which the bank is at risk.

50 Percent Conversion Factor

1. Transaction-related contingencies. (These include bid-bonds, performance bonds, warranties, and standby letters of credit backing the nonfinancial performance of other parties.)

2. Unused portions of commitments with an original maturity exceeding one year, including underwriting commitments and commercial credit lines.

[2] For the purpose of calculating the risk-based capital ratio, a U.S. Government-sponsored agency is defined as an agency originally established or chartered to serve public purposes specified by the U.S. Congress but whose obligations are not *explicitly* guaranteed by the full faith and credit of the U.S. Government.

[3] The extent of collateralization is determined by current market value.

3. Revolving underwriting facilities (RUFs), note issuance facilities (NIFs), and similar arrangements.

20 Percent Conversion Factor

Short-term, self-liquidating trade-related contingencies, including commercial letters of credit.

Zero Percent Conversion Factor

Unused portions of commitments with an original maturity of one year or less, or which are unconditionally cancellable at any time, provided a separate credit decision is made before each drawing.

Credit Conversion for Derivative Contracts

1. The credit equivalent amount of a derivative contract is the sum of the current credit exposure of the contract and an estimate of potential future increases in credit exposure. The current exposure is the positive mark-to-market value of the contract (or zero if the mark-to-market value is zero or negative). For derivative contracts that are subject to a qualifying bilateral netting contract, the current exposure is, generally, the net sum of the positive and negative mark-to-market values of the contracts included in the netting contract (or zero if the net sum of the mark-to-market values is zero or negative). The potential future exposure is calculated by multiplying the effective notional amount of a contract by one of the following credit conversion factors, as appropriate:

CONVERSION FACTORS

[In percent]

Remaining maturity	Interest rate	Exchange rate and gold	Equity	Commodity, excluding precious metals	Precious metals, except gold
One year or less	0.0	1.0	6.0	10.0	7.0
Over one to five years	0.5	5.0	8.0	12.0	7.0
Over five years	1.5	7.5	10.0	15.0	8.0

For contracts subject to a qualifying bilateral netting contract, the potential future exposure is, generally, the sum of the individual potential future exposures for each contract included under the netting contract adjusted by the application of the following formula:

$A_{net}=(0.4\times A_{gross})+0.6(NGR\times A_{gross})$

NGR is the ratio of net current exposure to gross current exposure.

2. No potential future exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating indices, that is, so called floating/floating or basis swaps. The credit exposure on these contracts is evaluated solely on the basis of their mark-to-market value. Exchange rate contracts with an original maturity of fourteen days or fewer are excluded. Instruments traded on exchanges that require daily receipt and payment of cash variation margin are also excluded.

ATTACHMENT V—CALCULATING CREDIT EQUIVALENT AMOUNTS FOR DERIVATIVE CONTRACTS

Type of contract	Notional principal amount	Conversion factor	Potential exposure (dollars)	Mark-to-market	Current exposure (dollars)	Credit equivalent amount
(1) 120-day forward foreign exchange	5,000,000	0.01	50,000	100,000	100,000	150,000
(2) 4-year forward foreign exchange	6,000,000	0.05	300,000	−120,000	0	300,000
(3) 3-year single-currency fixed & floating interest rate swap	10,000,000	0.005	50,000	200,000	200,000	250,000
(4) 6-month oil swap	10,000,000	0.10	1,000,000	−250,000	0	1,000,000
(5) 7-year cross-currency floating & floating interest rate swap	20,000,000	0.075	1,500,000	−1,500,000	0	1,500,000
Total	.....	.....	2,900,000	+	300,000	3,200,000

a. If contracts (1) through (5) above are subject to a qualifying bilateral netting contract, then the following applies:

Contract	Potential future exposure	Net current exposure	Credit equivalent amount
(1)	50,000		
(2)	300,000		
(3)	50,000		
(4)	1,000,000		
(5)	1,500,000		
Total	2,900,000	+0	2,900,000

NOTE: The total of the mark-to-market values from the first table is −$1,370,000. Since this is a negative amount, the net current exposure is zero.

b. To recognize the effects of bilateral netting on potential future exposure the following formula applies:

$A_{net}=(.4\times A_{gross})+.6(NGR\times A_{gross})$

c. In the above example where the net current exposure is zero, the credit equivalent amount would be calculated as follows:

NGR=0=(0/300,000)

$A_{net}=(0.4\times\$2,900,000)+0.6\ (0\times\$2,900,000)$

$A_{net}=\$1,160,000$

The credit equivalent amount is $1,160,000+0=$1,160,000.

d. If the net current exposure was a positive number, for example $200,000, the credit equivalent amount would be calculated as follows:

NGR=.67=($200,000/$300,000)

$A_{net}=(0.4\times\$2,900,000)+0.6(.67\times\$2,900,000)$

$A_{net}=\$2,325,800.$

The credit equivalent amount would be $2,325,800+$200,000=$2,525,800.

ATTACHMENT VI—SUMMARY

	Transitional arrangements for State member banks		Final arrangement—Year-end 1992
	Initial	Year-end 1990	
1. Minimum standard of total capital to weighted risk assets.	None	7.25%	8.0%
2. Definition of Tier 1 capital	Common equity, qualifying noncum. perpetual preferred stock, minority interests, *plus* supplementary elements[1] *less* goodwill.	Common equity, qualifying noncum. perpetual preferred stock, minority interests, *plus* supplementary elements[2] *less* goodwill.	Common equity, qualifying noncumulative perpetual preferred stock, and minority interest less goodwill and other intangible assets required to be deducted from capital.[3]
3. Minimum standard of Tier 1 capital to weighted risk assets.	None	3.625%	4.0%
4. Minimum standard of stockholders' equity to weighted risk assets.	None	3.25%	4.0%
5. Limitations on supplementary capital elements:			
a. Allowance for loan and lease losses	No limit within Tier 2	1.5% of weighted risk assets	1.25% of weighted risk assets.
b. Qualifying perpetual preferred stock	No limit within Tier 2	No limit within Tier 2	No limit within Tier 2.
c. Hybrid capital instruments and equity contract notes.	No limit within Tier 2	No limit within Tier 2	No limit within Tier 2.
d. Subordinated debt and intermediate term preferred stock.	Combined maximum of 50% of Tier 1	Combined maximum of 50% of Tier 1	Combined maximum of 50% of Tier 1.
e. Total qualifying Tier 2 capital	May not exceed Tier 1 capital	May not exceed Tier 1 capital	May not exceed Tier 1 capital.
6. Definition of total capital	Tier 1 *plus* Tier 2 *less* —reciprocal holdings of banking organizations' capital instruments. —investments in unconsolidated subsidiaries.	Tier 1 *plus* Tier 2 *less* —reciprocal holdings of banking organizations' capital instruments. —investments in unconsolidated subsidiaries.	Tier 1 *plus* Tier 2 *less* —reciprocal holdings of banking organizations' capital instruments. —investments in unconsolidated subsidiaries.

[1] Supplementary elements may be included in Tier 1 up to 25% of the sum of Tier 1 plus goodwill.
[2] Supplementary elements may be included in Tier 1 up to 10% of the sum of Tier 1 plus goodwill.
[3] Requirements for the deduction of other intangible assets are set forth in section II.B.1.b. of this appendix.

[54 FR 4198, Jan. 27, 1989; 54 FR 12531, Mar. 27, 1989, as amended at 55 FR 32831, Aug. 10, 1990; 56 FR 51156, Oct. 10, 1991; 57 FR 2012, Jan. 17, 1992; 57 FR 60719, Dec. 22, 1992; 57 FR 62179, 62182, Dec. 30, 1992; 58 FR 7979, Feb. 11, 1993; 58 FR 68738, Dec. 29, 1993; Reg. H, 59 FR 62992, Dec. 7, 1994; 59 FR 63244, Dec. 8, 1994; 59 FR 64563, Dec. 15, 1994; 59 FR 65924, 65925, Dec. 22, 1994; 60 FR 8180, Feb. 13, 1995; 60 FR 39229, 39230, Aug. 1, 1995; 60 FR 39493, Aug. 2, 1995; 60 FR 45615, Aug. 31, 1995; 60 FR 46176, 46178, Sept. 5, 1995; 60 FR 66044, Dec. 20, 1995; 61 FR 47370, Sept. 6, 1996; 63 FR 42675, Aug. 10, 1998; 63 FR 46522, Sept. 1, 1998; 63 FR 58621, Nov. 2, 1998; 64 FR 10200, Mar. 2, 1999; 66 FR 59636, Nov. 29, 2001; 66 FR 67074, Dec. 28, 2001]

APPENDIX B TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS: TIER 1 LEVERAGE MEASURE

I. OVERVIEW

a. The Board of Governors of the Federal Reserve System has adopted a minimum ratio of tier 1 capital to total assets to assist in the assessment of the capital adequacy of state member banks.[1] The principal objective of this measure is to place a constraint on the maximum degree to which a state member bank can leverage its equity capital base. It is intended to be used as a supplement to the risk-based capital measure.

b. The guidelines apply to all state member banks on a consolidated basis and are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. The Board will review the guidelines from time to time and will consider the need for possible adjustments in light of any significant changes in the economy, financial markets, and banking practices.

II. THE TIER 1 LEVERAGE RATIO

a. The minimum ratio of Tier 1 capital to total assets for strong banking institutions (rated composite ''1'' under the UFIRS rating system of banks) is 3.0 percent. For all other institutions, the minimum ratio of Tier 1 capital to total assets is 4.0 percent. Banking institutions with supervisory, financial, operational, or managerial weaknesses, as well as institutions that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. Moreover, higher capital ratios may be required for any banking institution if warranted by its particular circumstances or risk profile. In all cases, institutions should hold capital commensurate with the level and nature of the risks, including the volume and severity of problem loans, to which they are exposed.

b. A bank's tier 1 leverage ratio is calculated by dividing its tier 1 capital (the numerator of the ratio) by its average total consolidated assets (the denominator of the ratio). The ratio will also be calculated using period-end assets whenever necessary, on a case-by-case basis. For the purpose of this leverage ratio, the definition of tier 1 capital as set forth in the risk-based capital guidelines contained in appendix A of this part will be used.[2] As a general matter, average total consolidated assets are defined as the quarterly average total assets (defined net of the allowance for loan and lease losses) reported on the bank's Reports of Condition and Income (Call Reports), less goodwill; amounts of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that, in the aggregate, are in excess of 100 percent of tier 1 capital; amounts of nonmortgage servicing assets, purchased credit card relationships that, in the aggregate, are in excess of 25 percent of tier 1 capital; amounts of credit-enhancing interest-only strips that are in excess of 25 percent of tier 1 capital; all other identifiable intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted from tier 1 capital; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitation set forth in section II.B.4 of appendix A of this part.[3]

c. Notwithstanding other provisions of this appendix B, a qualifying bank that has transferred small business loans and leases on personal property (small business obligations) with recourse shall, for purposes of calculating its tier 1 leverage ratio, exclude from its average total consolidated assets the outstanding principal amount of the small business loans and leases transferred with recourse, provided two conditions are met. First, the transaction must be treated as a sale under generally accepted accounting principles (GAAP) and, second, the bank must establish pursuant to GAAP a non-capital reserve sufficient to meet the bank's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small

[1] Supervisory risk-based capital ratios that related capital to weighted-risk assets for state member banks are outlined in Appendix A to this part.

[2] Tier 1 capital for state member banks includes common equity, minority interest in the equity accounts of consolidated subsidiaries, and qualifying noncumulative perpetual preferred stock. In addition, as a general matter, tier 1 capital excludes goodwill; amounts of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that, in the aggregate, exceed 100 percent of tier 1 capital; amounts of nonmortgage servicing assets and purchased credit card relationships that, in the aggregate, exceed 25 percent of tier 1 capital; amounts of credit-enhancing interest-only strips in excess of 25 percent of tier 1 capital; all other identifiable intangible assets; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of certain limitations. The Federal Reserve may exclude certain investments in subsidiaries or associated companies as appropriate.

[3] Deductions from tier 1 capital and other adjustments are discussed more fully in section II.B. of appendix A of this part.

business concern established by the Small Business Administration under section 3(a) of the Small Business Act are eligible for this capital treatment.

d. For purposes of this appendix B, a bank is qualifying if it meets the criteria set forth in the Board's prompt corrective action regulation (12 CFR 208.40) for well capitalized or, by order of the Board, adequately capitalized. For purposes of determining whether a bank meets these criteria, its capital ratios must be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section II.c. of this appendix B. The total outstanding amount of recourse retained by a qualifying bank on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the bank's total risk-based capital. By order, the Board may approve a higher limit.

e. If a bank ceases to be qualifying or exceeds the 15 percent capital limitation, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time that the bank was qualifying and did not exceed the capital limit.

f. The leverage capital ratio of the bank shall be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section II of this appendix B for purposes of:

(i) Determining whether a bank is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under prompt corrective action (12 CFR 208.43(b)(1)); and

(ii) Reclassifying a well capitalized bank to adequately capitalized and requiring an adequately capitalized bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower prompt corrective action capital category (12 CFR 208.43(c)).

g. Whenever appropriate, including when a bank is undertaking expansion, seeking to engage in new activities or otherwise facing unusual or abnormal risks, the Board will continue to consider the level of an individual bank's tangible tier 1 leverage ratio (after deducting all intangibles) in making an overall assessment of capital adequacy. This is consistent with the Federal Reserve's risk-based capital guidelines an long-standing Board policy and practice with regard to leverage guidelines. Banks experiencing growth, whether internally or by acquisition, are expected to maintain strong capital position substantially above minimum supervisory levels, without significant reliance on intangible assets.

[Reg. H, 59 FR 65925, Dec. 22, 1994, as amended at 60 FR 39230, Aug. 1, 1995; 60 FR 45615, Aug. 31, 1995; 63 FR 42675, Aug. 10, 1998; 63 FR 58621, Nov. 2, 1998; 64 FR 10200, Mar. 2, 1999; 66 FR 59643, Nov. 29, 2001]

APPENDIX C TO PART 208—INTERAGENCY GUIDELINES FOR REAL ESTATE LENDING POLICIES

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.[1] These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

LOAN PORTFOLIO MANAGEMENT CONSIDERATIONS

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

- Identify the geographic areas in which the institution will consider lending.
- Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).
- Identify appropriate terms and conditions by type of real estate loan.
- Establish loan origination and approval procedures, both generally and by size and type of loan.
- Establish prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.
- Establish review and approval procedures for exception loans, including loans with

[1] The agencies have adopted a uniform rule on real estate lending. See 12 CFR part 365 (FDIC); 12 CFR part 208, subpart E (FRB); 12 CFR part 34, subpart D (OCC); and 12 CFR 563.100–101 (OTS).

loan-to-value percentages in excess of supervisory limits.

• Establish loan administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review.

• Establish real estate appraisal and evaluation programs.

• Require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.

The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include:

• The size and financial condition of the institution.

• The expertise and size of the lending staff.

• The need to avoid undue concentrations of risk.

• Compliance with all real estate related laws and regulations, including the Community Reinvestment Act, anti-discrimination laws, and for savings associations, the Qualified Thrift Lender test.

• Market conditions.

The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:

• Demographic indicators, including population and employment trends.

• Zoning requirements.

• Current and projected vacancy, construction, and absorption rates.

• Current and projected lease terms, rental rates, and sales prices, including concessions.

• Current and projected operating expenses for different types of projects.

• Economic indicators, including trends and diversification of the lending area.

• Valuation trends, including discount and direct capitalization rates.

Underwriting Standards

Prudently underwritten real estate loans should reflect all relevant credit factors, including:

• The capacity of the borrower, or income from the underlying property, to adequately service the debt.

• The value of the mortgaged property.

• The overall creditworthiness of the borrower.

• The level of equity invested in the property.

• Any secondary sources of repayment.

• Any additional collateral or credit enhancements (such as guarantees, mortgage insurance or takeout commitments).

The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address:

• The maximum loan amount by type of property.

• Maximum loan maturities by type of property.

• Amortization schedules.

• Pricing structure for different types of real estate loans.

• Loan-to-value limits by type of property.

For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property:

• Requirements for feasibility studies and sensitivity and risk analyses (*e.g.*, sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses).

• Minimum requirements for initial investment and maintenance of hard equity by the borrower (*e.g.*, cash or unencumbered investment in the underlying property).

• Minimum standards for net worth, cash flow, and debt service coverage of the borrower or underlying property.

• Standards for the acceptability of and limits on non-amortizing loans.

• Standards for the acceptability of and limits on the use of interest reserves.

• Pre-leasing and pre-sale requirements for income-producing property.

• Pre-sale and minimum unit release requirements for non-income-producing property loans.

• Limits on partial recourse or non-recourse loans and requirements for guarantor support.

• Requirements for takeout commitments.

• Minimum covenants for loan agreements.

Loan Administration

The institution should also establish loan administration procedures for its real estate portfolio that address:

• Documentation, including:

  Type and frequency of financial statements, including requirements for verification of information provided by the borrower;

  Type and frequency of collateral evaluations (appraisals and other estimates of value).

• Loan closing and disbursement.

• Payment processing.

• Escrow administration.

• Collateral administration.

• Loan payoffs.

• Collections and foreclosure, including:

  Delinquency follow-up procedures;

Foreclosure timing;
Extensions and other forms of forbearance;
Acceptance of deeds in lieu of foreclosure.

- Claims processing (*e.g.*, seeking recovery on a defaulted loan covered by a government guaranty or insurance program).
- Servicing and participation agreements.

SUPERVISORY LOAN-TO-VALUE LIMITS

Institutions should establish their own internal loan-to-value limits for real estate loans. These internal limits should not exceed the following supervisory limits:

Loan category	Loan-to-value limit (percent)
Raw land	65
Land development	75
Construction:	
Commercial, multifamily,[1] and other non-residential	80
1- to 4-family residential	85
Improved property	85
Owner-occupied 1- to 4-family and home equity	([2])

[1] Multifamily construction includes condominiums and cooperatives.

[2] A loan-to-value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1- to 4-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

The supervisory loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property. To ensure that collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.

In establishing internal loan-to-value limits, each lender is expected to carefully consider the institution-specific and market factors listed under ''Loan Portfolio Management Considerations,'' as well as any other relevant factors, such as the particular subcategory or type of loan. For any subcategory of loans that exhibits greater credit risk than the overall category, a lender should consider the establishment of an internal loan-to-value limit for that subcategory that is lower than the limit for the overall category.

The loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan. Other credit factors to be taken into account are highlighted in the ''Underwriting Standards'' section above. Because of these other factors, the establishment of these supervisory limits should not be interpreted to mean that loans at these levels will automatically be considered sound.

LOANS IN EXCESS OF THE SUPERVISORY LOAN-TO-VALUE LIMITS

The agencies recognize that appropriate loan-to-value limits vary not only among categories of real estate loans but also among individual loans. Therefore, it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits, based on the support provided by other credit factors. Such loans should be identified in the institutions's records, and their aggregate amount reported at least quarterly to the institution's board of directors. (See additional reporting requirements described under ''Exceptions to the General Policy.'')

The aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital.[2] Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non-1-to-4 family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

In determining the aggregate amount of such loans, institutions should: (a) Include all loans secured by the same property if any one of those loans exceeds the supervisory loan-to-value limits; and (b) include the recourse obligation of any such loan sold with recourse. Conversely, a loan should no longer be reported to the directors as part of aggregate totals when reduction in principal or senior liens, or additional contribution of collateral or equity (e.g., improvements to

[2] For the state member banks, the term ''total capital'' means ''total risk-based capital'' as defined in appendix A to 12 CFR part 208. For insured state non-member banks, ''total capital'' refers to that term described in table I of appendix A to 12 CFR part 325. For national banks, the term ''total capital'' is defined at 12 CFR 3.2(e). For savings associations, the term ''total capital'' is defined at 12 CFR 567.5(c).

the real property securing the loan), bring the loan-to-value ratio into compliance with supervisory limits.

EXCLUDED TRANSACTIONS

The agencies also recognize that there are a number of lending situations in which other factors significantly outweigh the need to apply the supervisory loan-to-value limits. These include:

• Loans guaranteed or insured by the U.S. government or its agencies, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.

• Loans backed by the full faith and credit of a state government, provided that the amount of the assurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.

• Loans guaranteed or insured by a state, municipal or local government, or an agency thereof, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit, and provided that the lender has determined that the guarantor or insurer has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement.

• Loans that are to be sold promptly after origination, without recourse, to a financially responsible third party.

• Loans that are renewed, refinanced, or restructured without the advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or loans that are renewed, refinanced, or restructured in connection with a workout situation, either with or without the advancement of new funds, where consistent with safe and sound banking practices and part of a clearly defined and well-documented program to achieve orderly liquidation of the debt, reduce risk of loss, or maximize recovery on the loan.

• Loans that facilitate the sale of real estate acquired by the lender in the ordinary course of collecting a debt previously contracted in good faith.

• Loans for which a lien on or interest in real property is taken as additional collateral through an abundance of caution by the lender (e.g., the institution takes a blanket lien on all or substantially all of the assets of the borrower, and the value of the real property is low relative to the aggregate value of all other collateral).

• Loans, such as working capital loans, where the lender does not rely principally on real estate as security and the extension of credit is not used to acquire, develop, or construct permanent improvements on real property.

• Loans for the purpose of financing permanent improvements to real property, but not secured by the property, if such security interest is not required by prudent underwriting practice.

EXCEPTIONS TO THE GENERAL LENDING POLICY

Some provision should be made for the consideration of loan requests from creditworthy borrowers whose credit needs do not fit within the institution's general lending policy. An institution may provide for prudently underwritten exceptions to its lending policies, including loan-to-value limits, on a loan-by-loan basis. However, any exceptions from the supervisory loan-to-value limits should conform to the aggregate limits on such loans discussed above.

The board of directors is responsible for establishing standards for the review and approval of exception loans. Each institution should establish an appropriate internal process for the review and approval of loans that do not conform to its own internal policy standards. The approval of any such loan should be supported by a written justification that clearly sets forth all of the relevant credit factors that support the underwriting decision. The justification and approval documents for such loans should be maintained as a part of the permanent loan file. Each institution should monitor compliance with its real estate lending policy and individually report exception loans of a significant size to its board of directors.

SUPERVISORY REVIEW OF REAL ESTATE LENDING POLICIES AND PRACTICES

The real estate lending policies of institutions will be evaluated by examiners during the course of their examinations to determine if the policies are consistent with safe and sound lending practices, these guidelines, and the requirements of the regulation. In evaluating the adequacy of the institution's real estate lending policies and practices, examiners will take into consideration the following factors:

• The nature and scope of the institution's real estate lending activities.

• The size and financial condition of the institution.

• The quality of the institution's management and internal controls.

• The expertise and size of the lending and loan administration staff.

• Market conditions.

Lending policy exception reports will also be reviewed by examiners during the course of their examinations to determine whether the institutions' exceptions are adequately documented and appropriate in light of all of the relevant credit considerations. An excessive volume of exceptions to an institution's real estate lending policy may signal a weakening of its underwriting practices, or may suggest a need to revise the loan policy.

DEFINITIONS

For the purposes of these Guidelines:

Construction loan means an extension of credit for the purpose of erecting or rehabilitating buildings or other structures, including any infrastructure necessary for development.

Extension of credit or *loan* means:

(1) The total amount of any loan, line of credit, or other legally binding lending commitment with respect to real property; and

(2) The total amount, based on the amount of consideration paid, of any loan, line of credit, or other legally binding lending commitment acquired by a lender by purchase, assignment, or otherwise.

Improved property loan means an extension of credit secured by one of the following types of real property:

(1) Farmland, ranchland or timberland committed to ongoing management and agricultural production;

(2) 1- to 4-family residential property that is not owner-occupied;

(3) Residential property containing five or more individual dwelling units;

(4) Completed commercial property; or

(5) Other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied 1- to 4-family residential property.

Land development loan means an extension of credit for the purpose of improving unimproved real property prior to the erection of structures. The improvement of unimproved real property may include the laying or placement of sewers, water pipes, utility cables, streets, and other infrastructure necessary for future development.

Loan origination means the time of inception of the obligation to extend credit (i.e., when the last event or prerequisite, controllable by the lender, occurs causing the lender to become legally bound to fund an extension of credit).

Loan-to-value or *loan-to-value ratio* means the percentage or ratio that is derived at the time of loan origination by dividing an extension of credit by the total value of the property(ies) securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral that secures the extension of credit. The total amount of all senior liens on or interests in such property(ies) should be included in determining the loan-to-value ratio. When mortgage insurance or collateral is used in the calculation of the loan-to-value ratio, and such credit enhancement is later released or replaced, the loan-to-value ratio should be recalculated.

Other acceptable collateral means any collateral in which the lender has a perfected security interest, that has a quantifiable value, and is accepted by the lender in accordance with safe and sound lending practices. Other acceptable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral. Other acceptable collateral includes, among other items, unconditional irrevocable standby letters of credit for the benefit of the lender.

Owner-occupied, when used in conjunction with the term *1- to 4-family residential property* means that the owner of the underlying real property occupies at least one unit of the real property as a principal residence of the owner.

Readily marketable collateral means insured deposits, financial instruments, and bullion in which the lender has a perfected interest. Financial instruments and bullion must be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, on an auction or similarly available daily bid and ask price market. Readily marketable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral.

Value means an opinion or estimate, set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agency's appraisal regulations and guidance. For loans to purchase an existing property, the term ''value'' means the lesser of the actual acquisition cost or the estimate of value.

1- to 4-family residential property means property containing fewer than five individual dwelling units, including manufactured homes permanently affixed to the underlying property (when deemed to be real property under state law).

[57 FR 62896, 62900, Dec. 31, 1992; 58 FR 4460, Jan. 14, 1993; 63 FR 58621, Nov. 2, 1998]

APPENDIX D–1 TO PART 208—INTERAGENCY GUIDELINES ESTABLISHING STANDARDS FOR SAFETY AND SOUNDNESS

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I. INTRODUCTION

i. Section 39 of the Federal Deposit Insurance Act[1] (FDI Act) requires each Federal banking agency (collectively, the agencies) to establish certain safety and soundness standards by regulation or by guideline for all insured depository institutions. Under section 39, the agencies must establish three types of standards: (1) Operational and managerial standards; (2) compensation standards; and (3) such standards relating to asset quality, earnings, and stock valuation as they determine to be appropriate.

ii. Section 39(a) requires the agencies to establish operational and managerial standards relating to: (1) Internal controls, information systems and internal audit systems, in accordance with section 36 of the FDI Act (12 U.S.C. 1831m); (2) loan documentation; (3) credit underwriting; (4) interest rate exposure; (5) asset growth; and (6) compensation, fees, and benefits, in accordance with subsection (c) of section 39. Section 39(b) requires the agencies to establish standards relating to asset quality, earnings, and stock valuation that the agencies determine to be appropriate.

iii. Section 39(c) requires the agencies to establish standards prohibiting as an unsafe and unsound practice any compensatory arrangement that would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits and any compensatory arrangement that could lead to material financial loss to an institution. Section 39(c) also requires that the agencies establish standards that specify when compensation is excessive.

iv. If an agency determines that an institution fails to meet any standard established by guideline under subsection (a) or (b) of section 39, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. In the event that an institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan, the agency must, by order, require the institution to correct the deficiency. The agency may, and in some cases must, take other supervisory actions until the deficiency has been corrected.

v. The agencies have adopted amendments to their rules and regulations to establish deadlines for submission and review of compliance plans.[2]

vi. The following Guidelines set out the safety and soundness standards that the agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The agencies believe that the standards adopted in these Guidelines serve this end without dictating how institutions must be managed and operated. These standards are designed to identify potential safety and soundness concerns and ensure that action is taken to address those concerns before they pose a risk to the deposit insurance funds.

A. *Preservation of Existing Authority*

Neither section 39 nor these Guidelines in any way limits the authority of the agencies to address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices. Action under section 39 and these Guidelines may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the agencies. Nothing in these Guidelines limits the authority of the FDIC pursuant to section 38(i)(2)(F) of the FDI Act (12 U.S.C. 1831(o)) and Part 325 of Title 12 of the Code of Federal Regulations.

B. *Definitions*

1. *In general.* For purposes of these Guidelines, except as modified in the Guidelines or unless the context otherwise requires, the terms used have the same meanings as set forth in sections 3 and 39 of the FDI Act (12 U.S.C. 1813 and 1831p–1).

2. *Board of directors,* in the case of a state-licensed insured branch of a foreign bank and in the case of a federal branch of a foreign bank, means the managing official in charge of the insured foreign branch.

3. *Compensation* means all direct and indirect payments or benefits, both cash and

[1] Section 39 of the Federal Deposit Insurance Act (12 U.S.C. 1831p–1) was added by section 132 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. 102–242, 105 Stat. 2236 (1991), and amended by section 956 of the Housing and Community Development Act of 1992, Pub. L. 102–550, 106 Stat. 3895 (1992) and section 318 of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103–325, 108 Stat. 2160 (1994).

[2] For the Office of the Comptroller of the Currency, these regulations appear at 12 CFR Part 30; for the Board of Governors of the Federal Reserve System, these regulations appear at 12 CFR Part 263; for the Federal Deposit Insurance Corporation, these regulations appear at 12 CFR Part 308, subpart R, and for the Office of Thrift Supervision, these regulations appear at 12 CFR Part 570.

non-cash, granted to or for the benefit of any executive officer, employee, director, or principal shareholder, including but not limited to payments or benefits derived from an employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement.

4. *Director* shall have the meaning described in 12 CFR 215.2(c).[3]

5. *Executive officer* shall have the meaning described in 12 CFR 215.2(d).[4]

6. *Principal shareholder* shall have the meaning described in 12 CFR 215.2(*l*).[5]

II. Operational and Managerial Standards

A. *Internal controls and information systems.* An institution should have internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities and that provide for:

1. An organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies;

2. Effective risk assessment;

3. Timely and accurate financial, operational and regulatory reports;

4. Adequate procedures to safeguard and manage assets; and

5. Compliance with applicable laws and regulations.

B. *Internal audit system.* An institution should have an internal audit system that is appropriate to the size of the institution and the nature and scope of its activities and that provides for:

1. Adequate monitoring of the system of internal controls through an internal audit function. For an institution whose size, complexity or scope of operations does not warrant a full scale internal audit function, a system of independent reviews of key internal controls may be used;

2. Independence and objectivity;

3. Qualified persons;

4. Adequate testing and review of information systems;

5. Adequate documentation of tests and findings and any corrective actions;

6. Verification and review of management actions to address material weaknesses; and

7. Review by the institution's audit committee or board of directors of the effectiveness of the internal audit systems.

C. *Loan documentation.* An institution should establish and maintain loan documentation practices that:

1. Enable the institution to make an informed lending decision and to assess risk, as necessary, on an ongoing basis;

2. Identify the purpose of a loan and the source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner;

3. Ensure that any claim against a borrower is legally enforceable;

4. Demonstrate appropriate administration and monitoring of a loan; and

5. Take account of the size and complexity of a loan.

D. *Credit underwriting.* An institution should establish and maintain prudent credit underwriting practices that:

1. Are commensurate with the types of loans the institution will make and consider the terms and conditions under which they will be made;

2. Consider the nature of the markets in which loans will be made;

3. Provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed;

4. Establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors;

5. Take adequate account of concentration of credit risk; and

6. Are appropriate to the size of the institution and the nature and scope of its activities.

E. *Interest rate exposure.* An institution should:

1. Manage interest rate risk in a manner that is appropriate to the size of the institution and the complexity of its assets and liabilities; and

2. Provide for periodic reporting to management and the board of directors regarding interest rate risk with adequate information for management and the board of directors to assess the level of risk.

F. *Asset growth.* An institution's asset growth should be prudent and consider:

1. The source, volatility and use of the funds that support asset growth;

2. Any increase in credit risk or interest rate risk as a result of growth; and

3. The effect of growth on the institution's capital.

G. *Asset quality.* An insured depository institution should establish and maintain a system that is commensurate with the institution's size and the nature and scope of its

[3] In applying these definitions for savings associations, pursuant to 12 U.S.C. 1464, savings associations shall use the terms ''savings association'' and ''insured savings association'' in place of the terms ''member bank'' and ''insured bank''.

[4] See footnote 3 in section I.B.4. of this appendix.

[5] See footnote 3 in section I.B.4. of this appendix.

operations to identify problem assets and prevent deterioration in those assets. The institution should:

1. Conduct periodic asset quality reviews to identify problem assets;
2. Estimate the inherent losses in those assets and establish reserves that are sufficient to absorb estimated losses;
3. Compare problem asset totals to capital;
4. Take appropriate corrective action to resolve problem assets;
5. Consider the size and potential risks of material asset concentrations; and
6. Provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk.

H. *Earnings.* An insured depository institution should establish and maintain a system that is commensurate with the institution's size and the nature and scope of its operations to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves. The institution should:

1. Compare recent earnings trends relative to equity, assets, or other commonly used benchmarks to the institution's historical results and those of its peers;
2. Evaluate the adequacy of earnings given the size, complexity, and risk profile of the institution's assets and operations;
3. Assess the source, volatility, and sustainability of earnings, including the effect of nonrecurring or extraordinary income or expense;
4. Take steps to ensure that earnings are sufficient to maintain adequate capital and reserves after considering the institution's asset quality and growth rate; and
5. Provide periodic earnings reports with adequate information for management and the board of directors to assess earnings performance.

I. *Compensation, fees and benefits.* An institution should maintain safeguards to prevent the payment of compensation, fees, and benefits that are excessive or that could lead to material financial loss to the institution.

III. Prohibition on Compensation That Constitutes an Unsafe and Unsound Practice

A. Excessive Compensation

Excessive compensation is prohibited as an unsafe and unsound practice. Compensation shall be considered excessive when amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder, considering the following:

1. The combined value of all cash and noncash benefits provided to the individual;
2. The compensation history of the individual and other individuals with comparable expertise at the institution;
3. The financial condition of the institution;
4. Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets;
5. For postemployment benefits, the projected total cost and benefit to the institution;
6. Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and
7. Any other factors the agencies determines to be relevant.

B. Compensation Leading to Material Financial Loss

Compensation that could lead to material financial loss to an institution is prohibited as an unsafe and unsound practice.

[60 FR 35678, 35682, July 10, 1995, as amended by Reg. H, 61 FR 43951, Aug. 27, 1996]

Appendix D–2 To Part 208—Interagency Guidelines Establishing Standards For Safeguarding Customer Information

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I. Introduction

These Interagency Guidelines Establishing Standards for Safeguarding Customer Information (Guidelines) set forth standards pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805), in the same manner, to the extent practicable, as standards prescribed pursuant to section 39 of the Federal Deposit Insurance Act (12 U.S.C. 1831p–1). These Guidelines address standards for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information.

A. *Scope*. The Guidelines apply to customer information maintained by or on behalf of state member banks (banks) and their nonbank subsidiaries, except for brokers, dealers, persons providing insurance, investment companies, and investment advisors. Pursuant to §§ 211.9 and 211.24 of this chapter, these guidelines also apply to customer information maintained by or on behalf of Edge corporations, agreement corporations, and uninsured state-licensed branches or agencies of a foreign bank.

B. *Preservation of Existing Authority*. Neither section 39 nor these Guidelines in any way limit the authority of the Board to address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices. The Board may take action under section 39 and these Guidelines independently of, in conjunction with, or in addition to, any other enforcement action available to the Board.

C. *Definitions*.

1. Except as modified in the Guidelines, or unless the context otherwise requires, the terms used in these Guidelines have the same meanings as set forth in sections 3 and 39 of the Federal Deposit Insurance Act (12 U.S.C. 1813 and 1831p–1).

2. For purposes of the Guidelines, the following definitions apply:

a. *Board of directors*, in the case of a branch or agency of a foreign bank, means the managing official in charge of the branch or agency.

b. *Customer* means any customer of the bank as defined in § 216.3(h) of this chapter.

c. *Customer* information means any record containing nonpublic personal information, as defined in § 216.3(n) of this chapter, about a customer, whether in paper, electronic, or other form, that is maintained by or on behalf of the bank.

d. *Customer information systems* means any methods used to access, collect, store, use, transmit, protect, or dispose of customer information.

e. *Service provider* means any person or entity that maintains, processes, or otherwise is permitted access to customer information through its provision of services directly to the bank.

f. *Subsidiary* means any company controlled by a bank, except a broker, dealer, person providing insurance, investment company, investment advisor, insured depository institution, or subsidiary of an insured depository institution.

II. Standards for Safeguarding Customer Information

A. *Information Security Program*. Each bank shall implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the bank and the nature and scope of its activities. While all parts of the bank are not required to implement a uniform set of policies, all elements of the information security program must be coordinated. A bank also shall ensure that each of its subsidiaries is subject to a comprehensive information security program. The bank may fulfill this requirement either by including a subsidiary within the scope of the bank's comprehensive information security program or by causing the subsidiary to implement a separate comprehensive information security program in accordance with the standards and procedures in sections II and III of this appendix that apply to banks.

B. *Objectives*. A bank's information security program shall be designed to:

1. Ensure the security and confidentiality of customer information;

2. Protect against any anticipated threats or hazards to the security or integrity of such information; and

3. Protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

III. Development and Implementation of Information Security Program

A. *Involve the Board of Directors*. The board of directors or an appropriate committee of the board of each bank shall:

1. Approve the bank's written information security program; and

2. Oversee the development, implementation, and maintenance of the bank's information security program, including assigning specific responsibility for its implementation and reviewing reports from management.

B. *Assess Risk*. Each bank shall:

1. Identify reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of customer information or customer information systems.

2. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of customer information.

3. Assess the sufficiency of policies, procedures, customer information systems, and other arrangements in place to control risks.

C. *Manage and Control Risk*. Each bank shall:

1. Design its information security program to control the identified risks, commensurate with the sensitivity of the information as well as the complexity and scope of the bank's activities. Each bank must consider whether the following security measures are appropriate for the bank and, if so, adopt those measures the bank concludes are appropriate:

a. Access controls on customer information systems, including controls to authenticate and permit access only to authorized

individuals and controls to prevent employees from providing customer information to unauthorized individuals who may seek to obtain this information through fraudulent means.

b. Access restrictions at physical locations containing customer information, such as buildings, computer facilities, and records storage facilities to permit access only to authorized individuals;

c. Encryption of electronic customer information, including while in transit or in storage on networks or systems to which unauthorized individuals may have access;

d. Procedures designed to ensure that customer information system modifications are consistent with the bank's information security program;

e. Dual control procedures, segregation of duties, and employee background checks for employees with responsibilities for or access to customer information;

f. Monitoring systems and procedures to detect actual and attempted attacks on or intrusions into customer information systems;

g. Response programs that specify actions to be taken when the bank suspects or detects that unauthorized individuals have gained access to customer information systems, including appropriate reports to regulatory and law enforcement agencies; and

h. Measures to protect against destruction, loss, or damage of customer information due to potential environmental hazards, such as fire and water damage or technological failures.

2. Train staff to implement the bank's information security program.

3. Regularly test the key controls, systems and procedures of the information security program. The frequency and nature of such tests should be determined by the bank's risk assessment. Tests should be conducted or reviewed by independent third parties or staff independent of those that develop or maintain the security programs.

D. *Oversee Service Provider Arrangements.* Each bank shall:

1. Exercise appropriate due diligence in selecting its service providers;

2. Require its service providers by contract to implement appropriate measures designed to meet the objectives of these Guidelines; and

3. Where indicated by the bank's risk assessment, monitor its service providers to confirm that they have satisfied their obligations as required by paragraph D.2. As part of this monitoring, a bank should review audits, summaries of test results, or other equivalent evaluations of its service providers.

E. *Adjust the Program.* Each bank shall monitor, evaluate, and adjust, as appropriate, the information security program in light of any relevant changes in technology, the sensitivity of its customer information, internal or external threats to information, and the bank's own changing business arrangements, such as mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, and changes to customer information systems.

F. *Report to the Board.* Each bank shall report to its board or an appropriate committee of the board at least annually. This report should describe the overall status of the information security program and the bank's compliance with these Guidelines. The reports should discuss material matters related to its program, addressing issues such as: risk assessment; risk management and control decisions; service provider arrangements; results of testing; security breaches or violations and management's responses; and recommendations for changes in the information security program.

G. *Implement the Standards.*

1. *Effective date.* Each bank must implement an information security program pursuant to these Guidelines by July 1, 2001.

2. *Two-year grandfathering of agreements with service providers.* Until July 1, 2003, a contract that a bank has entered into with a service provider to perform services for it or functions on its behalf satisfies the provisions of section III.D., even if the contract does not include a requirement that the servicer maintain the security and confidentiality of customer information, as long as the bank entered into the contract on or before March 5, 2001.

[Reg. H, 66 FR 8634, Feb. 1, 2001]

APPENDIX E TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS; MARKET RISK MEASURE

Section 1. Purpose, Applicability, Scope, and Effective Date

(a) *Purpose.* The purpose of this appendix is to ensure that banks with significant exposure to market risk maintain adequate capital to support that exposure.[1] This appendix supplements and adjusts the risk-based capital ratio calculations under appendix A of this part with respect to those banks.

(b) *Applicability.* (1) This appendix applies to any insured state member bank whose

[1] This appendix is based on a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Supervision and endorsed by the Group of Ten Central Bank Governors. The framework is described in a Basle Committee paper entitled ''Amendment to the Capital Accord to Incorporate Market Risks,'' January 1996. Also see modifications issued in September 1997.

trading activity[2] (on a worldwide consolidated basis) equals:

(i) 10 percent or more of total assets;[3] or

(ii) $1 billion or more.

(2) The Federal Reserve may additionally apply this appendix to any insured state member bank if the Federal Reserve deems it necessary or appropriate for safe and sound banking practices.

(3) The Federal Reserve may exclude an insured state member bank otherwise meeting the criteria of paragraph (b)(1) of this section from coverage under this appendix if it determines the bank meets such criteria as a consequence of accounting, operational, or similar considerations, and the Federal Reserve deems it consistent with safe and sound banking practices.

(c) *Scope*. The capital requirements of this appendix support market risk associated with a bank's covered positions.

(d) *Effective date*. This appendix is effective as of January 1, 1997. Compliance is not mandatory until January 1, 1998. Subject to supervisory approval, a bank may opt to comply with this appendix as early as January 1, 1997.[4]

Section 2. Definitions

For purposes of this appendix, the following definitions apply:

(a) *Covered positions* means all positions in a bank's trading account, and all foreign exchange[5] and commodity positions, whether or not in the trading account.[6] Positions include on-balance-sheet assets and liabilities and off-balance-sheet items. Securities subject to repurchase and lending agreements are included as if they are still owned by the lender.

(b) *Market risk* means the risk of loss resulting from movements in market prices. Market risk consists of general market risk and specific risk components.

(1) *General market risk* means changes in the market value of covered positions resulting from broad market movements, such as changes in the general level of interest rates, equity prices, foreign exchange rates, or commodity prices.

(2) *Specific risk* means changes in the market value of specific positions due to factors other than broad market movements and includes event and default risk as well as idiosyncratic variations.

(c) *Tier 1* and *Tier 2 capital* are defined in appendix A of this part.

(d) *Tier 3 capital* is subordinated debt that is unsecured; is fully paid up; has an original maturity of at least two years; is not redeemable before maturity without prior approval by the Federal Reserve; includes a lock-in clause precluding payment of either interest or principal (even at maturity) if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the minimum required under appendix A of this part; and does not contain and is not covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

(e) *Value-at-risk (VAR)* means the estimate of the maximum amount that the value of covered positions could decline during a fixed holding period within a stated confidence level, measured in accordance with section 4 of this appendix.

Section 3. Adjustments to the Risk-Based Capital Ratio Calculations

(a) *Risk-based capital ratio denominator*. A bank subject to this appendix shall calculate its risk-based capital ratio denominator as follows:

(1) *Adjusted risk-weighted assets*. Calcuate adjusted risk-weighted assets, which equals risk-weighted assets (as determined in accordance with appendix A of this part), excluding the risk-weighted amounts of all covered positions (except foreign exchange positions outside the trading account and over-the counter derivative positions)[7] and receivables arising from the posting of cash collateral that is associated with securities borrowing transactions to the extent the receivables are collateralized by the market value of the borrowed securities, provided that the following conditions are met:

(i) The transaction is based on securities includable in the trading book that are liquid and readily marketable,

(ii) The transaction is marked to market daily,

(iii) The transaction is subject to daily margin maintenance requirements,

(iv) The transaction is a securities contract for the purposes of section 555 of the

[2] Trading activity means the gross sum of trading assets and liabilities as reported in the bank's most recent quarterly Consolidated Report of Condition and Income (Call Report).

[3] Total assets means quarter-end total assets as reported in the bank's most recent Call Report.

[4] A bank that voluntarily complies with the final rule prior to January 1, 1998, must comply with all of its provisions.

[5] Subject to supervisory review, a bank may exclude structural positions in foreign currencies from its covered positions.

[6] The term trading account is defined in the instructions to the Call Report.

[7] Foreign exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in the adjusted risk weighted assets asdetermined in appendix A of this part.

Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407), or the Board's Regulation EE (12 CFR part 231).

(2) *Measure for market risk*. Calculate the measure for market risk, which equals the sum of the VAR-based capital charge, the specific risk add-on (if any), and the capital charge for de minimis exposures (if any).

(i) *VAR-based capital charge*. The VAR-based capital charge equals the higher of:

(A) The previous day's VAR measure; or

(B) The average of the daily VAR measures for each of the preceding 60 business days multiplied by three, except as provided in section 4(e) of this appendix;

(ii) *Specific risk add-on*. The specific risk add-on is calculated in accordance with section 5 of this appendix; and

(iii) *Capital charge for de minimis exposure*. The capital charge for de minimis exposure is calculated in accordance with section 4(a) of this appendix.

(3) *Market risk equivalent assets*. Calculate market risk equivalent assets by multiplying the measure for market risk (as calculated in paragraph (a)(2) of this section) by 12.5.

(4) *Denominator calculation*. Add market risk equivalent assets (as calculated in paragraph (a)(3) of this section) to adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section). The resulting sum is the bank's risk-based capital ratio denominator.

(b) *Risk-based capital ratio numerator*. A bank subject to this appendix shall calculate its risk-based capital ratio numerator by allocating capital as follows:

(1) *Credit risk allocation*. Allocate Tier 1 and Tier 2 capital equal to 8.0 percent of adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section).[8]

(2) *Market risk allocation*. Allocate Tier 1, Tier 2, and Tier 3 capital equal to the measure for market risk as calculated in paragraph (a)(2) of this section. The sum of Tier 2 and Tier 3 capital allocated for market risk must not exceed 250 percent of Tier 1 capital allocated for market risk. (This requirement means that Tier 1 capital allocated in this paragraph (b)(2) must equal at least 28.6 percent of the measure for market risk.)

(3) *Restrictions*. (i) The sum of Tier 2 capital (both allocated and excess) and Tier 3 capital (allocated in paragraph (b)(2) of this section) may not exceed 100 percent of Tier 1 capital (both allocated and excess).[9]

(ii) Term subordinated debt (and intermediate-term preferred stock and related surplus) included in Tier 2 capital (both allocated and excess) may not exceed 50 percent of Tier 1 capital (both allocated and excess).

(4) *Numerator calculation*. Add Tier 1 capital (both allocated and excess), Tier 2 capital (both allocated and excess), and Tier 3 capital (allocated under paragraph (b)(2) of this section). The resulting sum is the bank's risk-based capital ratio numerator.

Section 4. Internal Models.

(a) *General*. For risk-based capital purposes, a bank subject to this appendix must use its internal model to measure its daily VAR, in accordance with the requirements of this section.[10] The Federal Reserve may permit a bank to use alternative techniques to measure the market risk of de minimis exposures so long as the techniques adequately measure associated market risk.

(b) *Qualitative requirements*. A bank subject to this appendix must have a risk management system that meets the following minimum qualitative requirements:

(1) The bank must have a risk control unit that reports directly to senior management and is independent from business trading units.

(2) The bank's internal risk measurement model must be integrated into the daily management process.

(3) The bank's policies and procedures must identify, and the bank must conduct, appropriate stress tests and backtests.[11] The

[8] A bank may not allocate Tier 3 capital to support credit risk (as calculated under appendix A of this part).

[9] Excess Tier 1 capital means Tier 1 capital that has not been allocated in paragraphs (b)(1) and (b)(2) of this section. Excess Tier 2 capital means Tier 2 capital that has not been allocated in paragraph (b)(1) and (b)(2) of this section, subject to the restrictions in paragraph (b)(3) of this section.

[10] A bank's internal model may use any generally accepted measurement techniques, such as variance-covariance models, historical simulations, or Monte Carlo simulations. However, the level of sophistication and accuracy of a bank's internal model must be commensurate with the nature and size of its covered positions. A bank that modifies its existing modeling procedures to comply with the requirements of this appendix for risk-based capital purposes should, nonetheless, continue to use the internal model it considers most appropriate in evaluating risks for other purposes.

[11] Stress tests provide information about the impact of adverse market events on a bank's covered positions. Backtests provide information about the accuracy of an internal model by comparing a bank's daily VAR

bank's policies and procedures must identify the procedures to follow in response to the results of such tests.

(4) The bank must conduct independent reviews of its risk measurement and risk management systems at least annually.

(c) *Market risk factors.* The bank's internal model must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must address interest rate risk,[12] equity price risk, foreign exchange rate risk, and commodity price risk.

(d) *Quantitative requirements.* For regulatory capital purposes, VAR measures must meet the following quantitative requirements:

(1) The VAR measures must be calculated on a daily basis using a 99 percent, one-tailed confidence level with a price shock equivalent to a ten-business day movement in rates and prices. In order to calculate VAR measures based on a ten-day price shock, the bank may either calculate ten-day figures directly or convert VAR figures based on holding periods other than ten days to the equivalent of a ten-day holding period (for instance, by multiplying a one-day VAR measure by the square root of ten).

(2) The VAR measures must be based on an historical observation period (or effective observation period for a bank using a weighting scheme or other similar method) of at least one year. The bank must update data sets at least once every three months or more frequently as market conditions warrant.

(3) The VAR measures must include the risks arising from the non-linear price characteristics of options positions and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates or prices. A bank with a large or complex options portfolio must measure the volatility of options positions by different maturities.

(4) The VAR measures may incorporate empirical correlations within and across risk categories, provided that the bank's process for measuring correlations is sound. In the event that the VAR measures do not incorporate empirical correlations across risk categories, then the bank must add the separate VAR measures for the four major risk categories to determine its aggregate VAR measure.

(e) *Backtesting.* (1) Beginning one year after a bank starts to comply with this appendix, a bank must conduct backtesting by comparing each of its most recent 250 business days' actual net trading profit or loss[13] with the corresponding daily VAR measures generated for internal risk measurement purposes and calibrated to a one-day holding period and a 99 percent, one-tailed confidence level.

(2) Once each quarter, the bank must identify the number of exceptions, that is, the number of business days for which the magnitude of the actual daily net trading loss, if any, exceeds the corresponding daily VAR measure.

(3) A bank must use the multiplication factor indicated in Table 1 of this appendix in determining its capital charge for market risk under section 3(a)(2)(i)(B) of this appendix until it obtains the next quarter's backtesting results, unless the Federal Reserve determines that a different adjustment or other action is appropriate.

TABLE 1—MULTIPLICATION FACTOR BASED ON RESULTS OF BACKTESTING

Number of exceptions	Multiplication factor
4 or fewer	3.00
5	3.40
6	3.50
7	3.65
8	3.75
9	3.85
10 or more	4.00

Section 5. Specific Risk

(a) *Modeled specific risk.* A bank may use its internal model to measure specific risk. If the bank has demonstrated to the Federal Reserve that its internal model measures the specific risk, including event and default risk as well as idiosyncratic variation, of covered debt and equity positions and includes the specific risk measures in the VAR-based capital charge in section 3(a)(2)(i) of this appendix, then the bank has no specific risk add-on for purposes of section 3(a)(2)(ii) of this appendix. The model should explain the historical price variation in the trading portfolio and capture concentration, both magnitude and changes in composition. The model should also be robust to an adverse environment and have been validated through backtesting which assesses whether specific risk is being accurately captured.

(b) *Partially modeled specific risk.* (1) A bank that incorporates specific risk in its internal

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measures to its corresponding daily trading profits and losses.

[12] For material exposures in the major currencies and markets, modeling techniques must capture spread risk and must incorporate enough segments of the yield curve—at least six—to capture differences in volatility and less than perfect correlation of rates along the yield curve.

[13] Actual net trading profits and losses typically include such things as realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with trading activities.

model but fails to demonstrate to the Federal Reserve that its internal model adequately measures all aspects of specific risk for covered debt and equity positions, including event and default risk, as provided by section 5(a), of this appendix must calculate its specific risk add-on in accordance with one of the following methods:

(i) If the model is susceptible to valid separation of the VAR measure into a specific risk portion and a general market risk portion, then the specific risk add-on is equal to the previous day's specific risk portion.

(ii) If the model does not separate the VAR measure into a specific risk portion and a general market risk portion, then the specific risk add-on is the sum of the previous day's VAR measures for subportfolios of covered debt and equity positions that contain specific risk.

(2) If a bank models the specific risk of covered debt positions but not covered equity positions (or vice versa), then the bank may determine its specific risk charge for the included positions under section 5(a) or 5(b)(1) of this appendix, as appropriate. The specific risk charge for the positions not included equals the standard specific risk capital charge under paragraph (c) of this section.

(c) *Specific risk not modeled*. If a bank does not model specific risk in accordance with section 5(a) or 5(b) of this appendix, then the bank's specific risk capital charge shall equal the standard specific risk capital charge, calculated as follows:

(1) *Covered debt positions*. (i) For purposes of this section 5, covered debt positions means fixed-rate or floating-rate debt instruments located in the trading account and instruments located in the trading account with values that react primarily to changes in interest rates, including certain non-convertible preferred stock, convertible bonds, and instruments subject to repurchase and lending agreements. Also included are derivatives (including written and purchased options) for which the underlying instrument is a covered debt instrument that is subject to a non-zero specific risk capital charge.

(A) For covered debt positions that are derivatives, a bank must risk-weight (as described in paragraph (c)(1)(iii) of this section) the market value of the effective notional amount of the underlying debt instrument or index portfolio. Swaps must be included as the notional position in the underlying debt instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(B) For covered debt positions that are options, whether long or short, a bank must risk-weight (as described in paragraph (c)(1)(iii) of this section) the market value of the effective notional amount of the underlying debt instrument or index multiplied by the option's delta.

(ii) A bank may net long and short covered debt positions (including derivatives) in identical debt issues or indices.

(iii) A bank must multiply the absolute value of the current market value of each net long or short covered debt position by the appropriate specific risk weighting factor indicated in Table 2 of this appendix. The specific risk capital charge component for covered debt positions is the sum of the weighted values.

TABLE 2—SPECIFIC RISK WEIGHTING FACTORS FOR COVERED DEBT POSITIONS

Category	Remaining maturity (contractual)	Weighting factor (in percent)
Government	N/A	0.00
Qualifying	6 months or less	0.25
	Over 6 months to 24 months.	1.00
	Over 24 months	1.60
Other	N/A	8.00

(A) The *government* category includes all debt instruments of central governments of OECD-based countries[14] including bonds, Treasury bills, and other short-term instruments, as well as local currency instruments of non-OECD central governments to the extent the bank has liabilities booked in that currency.

(B) The *qualifying* category includes debt instruments of U.S. government-sponsored agencies, general obligation debt instruments issued by states and other political subdivisions of OECD-based countries, multilateral development banks, and debt instruments issued by U.S. depository institutions or OECD-banks that do not qualify as capital of the issuing institution.[15] This category also includes other debt instruments, including corporate debt and revenue instruments issued by states and other political subdivisions of OECD countries, that are:

(*1*) Rated investment-grade by at least two nationally recognized credit rating services;

(*2*) Rated investment-grade by one nationally recognized credit rating agency and not rated less than investment-grade by any other credit rating agency; or

(*3*) Unrated, but deemed to be of comparable investment quality by the reporting bank and the issuer has instruments listed on a recognized stock exchange, subject to review by the Federal Reserve.

[14] Organization for Economic Cooperation and Development (OECD)-based countries is defined in appendix A of this part.

[15] U.S. government-sponsored agencies, multilateral development banks, and OECD banks are defined in appendix A of this part.

(C) The *other* category includes debt instruments that are not included in the government or qualifying categories.

(2) *Covered equity positions.* (i) For purposes of this section 5, covered equity positions means equity instruments located in the trading account and instruments located in the trading account with values that react primarily to changes in equity prices, including voting or non-voting common stock, certain convertible bonds, and commitments to buy or sell equity instruments. Also included are derivatives (including written and purchased options) for which the underlying is a covered equity position.

(A) For covered equity positions that are derivatives, a bank must risk weight (as described in paragraph (c)(2)(iii) of this section) the market value of the effective notional amount of the underlying equity instrument or equity portfolio. Swaps must be included as the notional position in the underlying equity instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(B) For covered equity positions that are options, whether long or short, a bank must risk weight (as described in paragraph (c)(2)(iii) of this section) the market value of the effective notional amount of the underlying equity instrument or index multiplied by the option's delta.

(ii) A bank may net long and short covered equity positions (including derivatives) in identical equity issues or equity indices in the same market.[16]

(iii)(A) A bank must multiply the absolute value of the current market value of each net long or short covered equity position by a risk weighting factor of 8.0 percent, or by 4.0 percent if the equity is held in a portfolio that is both liquid and well-diversified.[17] For covered equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the net long or short position is multiplied by a risk weighting factor of 2.0 percent.

(B) For covered equity positions from the following futures-related arbitrage strategies, a bank may apply a 2.0 percent risk weighting factor to one side (long or short) of each position with the opposite side exempt from charge, subject to review by the Federal Reserve:

(*1*) Long and short positions in exactly the same index at different dates or in different market centers; or

(*2*) Long and short positions in index contracts at the same date in different but similar indices.

(C) For futures contracts on broadly-based indices that are matched by offsetting positions in a basket of stocks comprising the index, a bank may apply a 2.0 percent risk weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and that the basket of stocks comprises at least 90 percent of the capitalization of the index.

(iv) The specific risk capital charge component for covered equity positions is the sum of the weighted values.

[Reg. H, 61 FR 47370, Sept. 6, 1996, as amended at 62 FR 68067, Dec. 30, 1997; 64 FR 19037, 19038, Apr. 19, 1999; 65 FR 75858, Dec. 5, 2000]

[16] A bank may also net positions in depository receipts against an opposite position in the underlying equity or identical equity in different markets, provided that the bank includes the costs of conversion.

[17] A portfolio is liquid and well-diversified if: (1) It is characterized by a limited sensitivity to price changes of any single equity issue or closely related group of equity issues held in the portfolio; (2) the volatility of the portfolio's value is not dominated by the volatility of any individual equity issue or by equity issues from any single industry or economic sector; (3) it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value; and (4) it consists mainly of issues traded on organized exchanges or in well-established over-the-counter markets.

PART 209—ISSUE AND CANCELLATION OF FEDERAL RESERVE BANK CAPITAL STOCK (REGULATION I)

Sec.
209.1 Authority, purpose, and scope.
209.2 Banks desiring to become member banks.
209.3 Cancellation of Reserve Bank stock.
209.4 Amounts and payments.
209.5 The share register.

AUTHORITY: 12 U.S.C. 222, 248, 282, 286–288, 321, 323, 327–328, 333, 466.

SOURCE: 63 FR 37663, July 13, 1998, unless otherwise noted.

§ 209.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued pursuant to 12 U.S.C. 222, 248, 282, 286–288, 321, 323, 327–328, and 466.

(b) *Purpose.* The purpose of this part is to implement the provisions of the Federal Reserve Act relating to the issuance and cancellation of Federal Reserve Bank stock upon becoming or ceasing to be a member bank, or upon changes in the capital and surplus of a member bank, of the Federal Reserve System.

(c) *Scope*. This part applies to member banks of the Federal Reserve System, to national banks in process of organization, and to state banks applying for membership. National banks and locally-incorporated banks located in United States dependencies and possessions are eligible (with the consent of the Board) but not required to apply for membership under section 19(h) of the Federal Reserve Act, 12 U.S.C. 466.[1]

§ 209.2 Banks desiring to become member banks.

(a) *Application for stock or deposit*. Each national bank in process of organization,[2] each nonmember state bank converting into a national bank, and each nonmember state bank applying for membership in the Federal Reserve System under Regulation H, 12 CFR part 208, shall file with the Federal Reserve Bank (Reserve Bank) in whose district it is located an application for stock (or deposit in the case of mutual savings banks not authorized to purchase Reserve Bank stock[3]) in the Reserve Bank. The bank shall pay for the stock (or deposit) in accordance with § 209.4 of this regulation.

(b) *Issuance of stock; acceptance of deposit*. Upon authorization to commence business by the Comptroller of the Currency in the case of a national bank in organization or upon approval of conversion by the Comptroller of the Currency in the case of a state nonmember bank converting to a national bank, or when all applicable requirements have been complied with in the case of a state bank approved for membership, the Reserve Bank shall issue the appropriate number of shares by crediting the bank with the appropriate number of shares on its books. In the case of a national or state member bank in organization, such issuance shall be as of the date the bank opens for business. In the case of a mutual savings bank not authorized to purchase Reserve Bank shares, the Reserve Bank shall accept the deposit in place of issuing shares. The bank's membership shall become effective on the date of such issuance or acceptance.

(c) *Location of bank*. (1) *General rule*. For purposes of this part, a national bank or a state bank is located in the Federal Reserve District that contains the location specified in the bank's charter or organizing certificate, or, if no such location is specified, the location of its head office, unless otherwise determined by the Board under paragraph (c)(2) of this section.

(2) *Board determination*. If the location of a bank as specified in paragraph (c)(1) of this section, in the judgment of the Board of Governors of the Federal Reserve System (Board), is ambiguous, would impede the ability of the Board or the Reserve Banks to perform their functions under the Federal Reserve Act, or would impede the ability of the bank to operate efficiently, the Board will determine the Federal Reserve District in which the bank is located, after consultation with the bank and the relevant Reserve Banks. The relevant Reserve Banks are the Reserve Bank whose District contains the location specified in paragraph (c)(1) of this section and the Reserve Bank in whose District the bank is proposed to be located. In making this determination, the Board will consider any applicable laws, the business needs of the bank, the location of the bank's head office, the locations where the bank performs its business, and the locations that would allow the bank, the Board, and the Reserve Banks to perform their functions efficiently and effectively.

[1] If such a bank desires to become a member bank under the provisions of § 19(h) of the Federal Reserve Act, it should communicate with the Federal Reserve Bank with which it desires to do business.

[2] A new national bank organized by the Federal Deposit Insurance Corporation under § 11(n) of the Federal Deposit Insurance Act (12 U.S.C. 1821(n)) should not apply until in the process of issuing stock pursuant to § 11(n)(15) of that act. Reserve Bank approval of such an application shall not be effective until the issuance of a certificate by the Comptroller of the Currency pursuant to § 11(n)(16) of that act.

[3] A mutual savings bank not authorized to purchase Federal Reserve Bank stock may apply for membership evidenced initially by a deposit. (*See* § 208.3(a) of Regulation H, 12 CFR part 208.) The membership of the savings bank shall be terminated if the laws under which it is organized are not amended to authorize such purchase at the first session of the legislature after its admission, or if it fails to purchase such stock within six months after such an amendment.

§ 209.3 Cancellation of Reserve Bank stock.

(a) *Application for cancellation.* Any bank that desires to withdraw from membership in the Federal Reserve System, voluntarily liquidates or ceases business, is merged or consolidated into a nonmember bank, or is involuntarily liquidated by a receiver or conservator or otherwise, shall promptly file with its Reserve Bank an application for cancellation of all its Reserve Bank stock (or withdrawal of its deposit, as the case may be) and payment therefor in accordance with § 209.4.

(b) *Involuntary termination of membership.* If an application is not filed promptly after a cessation of business by a state member bank, a vote to place a member bank in voluntary liquidation, or the appointment of a receiver for (or a determination to liquidate the bank by a conservator of) a member bank, the Board may, after notice and an opportunity for hearing where required under Section 9(9) of the Federal Reserve Act (12 U.S.C. 327), order the membership of the bank terminated and all of its Reserve Bank stock canceled.

(c) *Effective date of cancellation.* Cancellation in whole of a bank's Reserve Bank capital stock shall be effective, in the case of:

(1) Voluntary withdrawal from membership by a state bank, as of the date of such withdrawal;

(2) Merger into, consolidation with, or (for a national bank) conversion into, a State nonmember bank, as of the effective date of the merger, consolidation, or conversion; and

(3) Involuntary termination of membership, as of the date the Board issues the order of termination.

(d) *Exchange of stock on merger or change in location.* (1) *Merger of member banks in the same Federal Reserve District.* Upon a merger or consolidation of member banks located in the same Federal Reserve District, the Reserve Bank shall cancel the shares of the nonsurviving bank (or in the case of a mutual savings bank not authorized to purchase Reserve Bank stock, shall credit the deposit to the account of the surviving bank) and shall credit the appropriate number of shares on its books to (or in the case of a mutual savings bank not authorized to purchase Reserve Bank stock, shall accept an appropriate increase in the deposit of) the surviving bank, subject to paragraph (e)(2) of § 209.4.

(2) *Change of location or merger of member banks in different Federal Reserve Districts.* Upon a determination under paragraph (c)(2) of § 209.2 that a member bank is located in a Federal Reserve District other than the District of the Reserve Bank of which it is a member, or upon a merger or consolidation of member banks located in different Federal Reserve Districts,—

(i) The Reserve Bank of the member bank's former District, or of the nonsurviving member bank, shall cancel the bank's shares and transfer the amount paid in for those shares, plus accrued dividends (at the rate specified in paragraph (d) of § 209.4) and subject to paragraph (e)(2) of § 209.4 (or, in the case of a mutual savings bank member not authorized to purchase Federal Reserve Bank stock, the amount of its deposit, adjusted in a like manner), to the Reserve Bank of the bank's new District or of the surviving bank; and

(ii) The Reserve Bank of the member bank's new District or of the surviving bank shall issue the appropriate number of shares by crediting the bank with the appropriate number of shares on its books (or, in the case of a mutual savings bank, by accepting the deposit or an appropriate increase in the deposit).

(e) *Voluntary withdrawal.* Any bank withdrawing voluntarily from membership shall give 6 months written notice, and shall not cause the withdrawal of more than 25 percent of any Reserve Bank's capital stock in any calendar year, unless the Board waives these requirements.

§ 209.4 Amounts and payments.

(a) *Amount of subscription.* The total subscription of a member bank (other than a mutual savings bank) shall equal six percent of its capital and surplus. Whenever any member bank (other than a mutual savings bank) experiences a cumulative increase or decrease in capital and surplus requiring a change in excess of the lesser of 15 percent or 100 shares of its Reserve

Bank capital stock, it shall file with the appropriate Reserve Bank an application for issue or cancellation of Reserve Bank capital stock in order to adjust its Reserve Bank capital stock subscription to equal six percent of the member bank's capital and surplus. Such application shall be filed promptly after the first report of condition that reflects the increase or decrease occasioning the adjustment. In addition, every member bank shall file an application for issue or cancellation of Reserve Bank capital stock if needed in order to adjust its Reserve Bank capital stock subscription to equal six percent of the member bank's capital and surplus as shown on its report of condition as of December 31 of each year promptly after filing such report.

(b) *Capital Stock and Surplus defined.* Capital stock and surplus of a member bank means the paid-in capital stock[4] and paid-in surplus of the bank, less any deficit in the aggregate of its retained earnings, gains (losses) on available for sale securities, and foreign currency translation accounts, all as shown on the bank's most recent report of condition. Paid-in capital stock and paid-in surplus of a bank in organization means the amount which is to be paid in at the time the bank commences business.

(c) *Mutual savings banks.* The total subscription of a member bank that is a mutual savings bank shall equal six-tenths of 1 percent of its total deposit liabilities as shown on its most recent report of condition. Whenever any member bank that is a mutual savings bank experiences a cumulative increase or decrease in total deposit liabilities as shown on its most recent report of condition requiring a change in its holding of Reserve Bank stock in excess of the lesser of 15 percent or 100 shares, it shall file with the appropriate Reserve Bank an application for issue or cancellation of Reserve Bank capital stock in order to adjust its Reserve Bank capital stock subscription to equal six-tenths of 1 percent of the member bank's total deposit liabilities. Such application shall be filed promptly after the first report of condition that reflects the increase or decrease occasioning the adjustment. In addition, every member bank that is a mutual savings bank shall file an application for issue or cancellation of Reserve Bank capital stock if needed in order to adjust its Reserve Bank capital stock subscription to equal six-tenths of 1 percent of its total deposit liabilities as shown on its report of condition as of December 31 of each year promptly after filing such report. A mutual savings bank that is applying for or has a deposit with the appropriate Reserve Bank in lieu of Reserve Bank capital stock shall file for acceptance or adjustment of its deposit in a like manner.

(d) *Payment for subscriptions.* Upon approval by the Reserve Bank of an application for capital stock (or for a deposit in lieu thereof), the applying bank shall pay the Reserve Bank one-half of the subscription amount plus accrued dividends. For purposes of this part, dividends shall accrue at the rate of one half of one percent per month calculated on the basis of a 360-day year of twelve 30-day months. Upon payment (and in the case of a national banks in organization or state nonmember bank converting into a national bank, upon authorization or approval by the Comptroller of the Currency), the Reserve Bank shall issue the appropriate number of shares by crediting the bank with the appropriate number of shares on its books. In the case of a mutual savings bank not authorized to purchase Reserve Bank stock, the Reserve Bank will accept the deposit or addition to the deposit in place of issuing shares. The remaining half of the subscription or additional subscription (including subscriptions for deposits or additions to deposits) shall be subject to call by the Board.

(e) *Payment for cancellations.* (1) Upon approval of an application for cancellation of Reserve Bank capital stock, or (in the case of involuntary termination of membership) upon the effective date of cancellation specified in § 209.3(c)(3), the Reserve Bank shall reduce the bank's shareholding on the Reserve Bank's books by the number of shares required to be canceled and shall pay

[4] Capital stock includes common stock and preferred stock (including sinking fund preferred stock).

therefor a sum equal to the cash subscription paid on the canceled stock plus accrued dividends (at the rate specified in paragraph (d) of this section), such sum not to exceed the book value of the stock.[5]

(2) In the case of any cancellation of Reserve Bank stock under this Part, the Reserve Bank may first apply such sum to any liability of the bank to the Reserve Bank and pay over the remainder to the bank (or receiver or conservator, as appropriate).

§ 209.5 The share register.

(a) *Electronic or written record.* A member bank's holding of Reserve Bank capital stock shall be represented by one (or at the option of the Reserve Bank, more than one) notation on the Reserve Bank's books. Such books may be electronic or in writing. Upon any issue or cancellation of Reserve Bank capital stock, the Reserve Bank shall record the member bank's new share position in its books (or eliminate the bank's share position from its books, as the case may be).

(b) *Certification.* A Reserve Bank may certify on request as to the number of shares held by a member bank and purchased before March 28, 1942, or as to the purchase and cancellation dates and prices of shares cancelled, as the case may be.

PART 210—COLLECTION OF CHECKS AND OTHER ITEMS BY FEDERAL RESERVE BANKS AND FUNDS TRANSFERS THROUGH FEDWIRE (REGULATION J)

Subpart A—Collection of Checks and Other Items By Federal Reserve Banks

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APPENDIX A TO SUBPART B—COMMENTARY
APPENDIX B TO SUBPART B—ARTICLE 4A, FUNDS TRANSFERS

AUTHORITY: 12 U.S.C. 248 (i), (j), and (o), 342, 360, 464, and 4001–4010.

SOURCE: 45 FR 68634, Oct. 16, 1980, unless otherwise noted.

Subpart A—Collection of Checks and Other Items By Federal Reserve Banks

§ 210.1 Authority, purpose, and scope.

The Board of Governors of the Federal Reserve System (Board) has issued this subpart pursuant to the Federal Reserve Act, sections 11 (i) and (j) (12 U.S.C. 248 (i) and (j)), section 13 (12 U.S.C. 342), section 16 (12 U.S.C. 248(o) and 360), and section 19(f) (12 U.S.C. 464); the Expedited Funds Availability Act (12 U.S.C. 4001 *et seq.*); and other laws. This subpart governs the collection of checks and other cash and noncash items and the handling of returned checks by Federal Reserve Banks. Its purpose is to provide rules

[5] Under sections 6 and 9(10) of the Act, a Reserve Bank is under no obligation to pay unearned accrued dividends on redemption of its capital stock from an insolvent member bank for which a receiver has been appointed or from state member banks on voluntary withdrawal from or involuntary termination of membership.

for collecting and returning items and settling balances.

[53 FR 21984, June 13, 1988, as amended at Reg. J, 59 FR 22965, May 4, 1994]

§ 210.2 Definitions.

As used in this subpart, unless the context otherwise requires:

(a) *Account* means an account with reserve or clearing balances on the books of a Federal Reserve Bank. A subaccount is an informational record of a subset of transactions that affect an account and is not a separate account.

(b) *Actually and finally collected funds* means cash or any other form of payment that is, or has become, final and irrevocable.

(c) *Administrative Reserve Bank* with respect to an entity means the Reserve Bank in whose District the entity is located, as determined under the procedure described in § 204.3(b)(2) of this chapter (Regulation D), even if the entity is not otherwise subject to that section.

(d) *Bank* means any person engaged in the business of banking. A branch or separate office of a bank is a separate bank to the extent provided in the Uniform Commercial Code.

(e) *Bank draft* means a check drawn by one bank on another bank.

(f) *Banking day* means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions.

(g) *Cash item* means —

(1) A check other than one classified as a noncash item under this section; or

(2) Any other item payable on demand and collectible at par that the Reserve Bank that receives the item is willing to accept as a cash item. *Cash item* does not include a returned check.

(h) *Check* means a draft, as defined in the Uniform Commercial Code, that is drawn on a bank and payable on demand. *Check as defined in 12 CFR 229.2(k)* means an item defined as a check in 12 CFR 229.2(k) for purposes of subpart C of part 229.

(i) *Item* means an instrument or a promise or order to pay money, whether negotiable or not, that is:

(1) Payable in a Federal Reserve District[1] (*District*);

(2) Sent by a sender to a Reserve Bank for handling under this subpart; and

(3) Collectible in funds acceptable to the Reserve Bank of the District in which the instrument is payable.

Unless otherwise indicated, *item* includes both a cash and a noncash item, and includes a returned check sent by a paying or returning bank. *Item* does not include a check that cannot be collected at par, or a *payment order* as defined in § 210.26(i) and handled under subpart B of this part.

(j) *Nonbank payor* means a payor of an item, other than a bank.

(k) *Noncash item* means an item that a receiving Reserve Bank classifies in its operating circulars as requiring special handling. The term also means an item normally received as a cash item if a Reserve Bank decides that special conditions require that it handle the item as a noncash item.

(l) *Paying bank* means—

(1) The bank by which an item is payable unless the item is payable or collectible at or through another bank and is sent to the other bank for payment or collection;

(2) The bank at or through which an item is payable or collectible and to which it sent for payment or collection; or

(3) The bank whose routing number appears on a check in magnetic characters or fractional form and to which the check is sent for payment or collection.

(m) *Returned check* means a cash item or a check as defined in 12 CFR 229.2(k) returned by a paying bank, including a notice of nonpayment in lieu of a returned check, whether or not a Reserve Bank handled the check for collection.

(n) *Sender* means any of the following that sends an item to a Reserve Bank for forward collection:

[1] For purposes of this subpart, the Virgin Islands and Puerto Rico are deemed to be in the Second District, and Guam, American Samoa, and the Northern Mariana Islands in the Twelfth District.

(1) *Depository institution* means a depository institution as defined in section 19(b) of the Federal Reserve Act. (12 U.S.C. 461(b))

(2) *Clearing institution* means:

(i) An institution that is not a depository institution, but maintains with a Reserve Bank the balance referred to in the first paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342); or

(ii) A corporation that maintains an account with a Reserve Bank in conformity with §211.4 of this chapter (Regulation K).

(3) *International Organization* means an international organization for which a Reserve Bank is empowered to act as depository or fiscal agent and maintains an account.

(4) *Foreign correspondent* means any of the following for which a Reserve Bank maintains an account: a foreign bank or banker, a foreign state as defined in section 25(b) of the Federal Reserve Act (12 U.S.C. 632), or a foreign correspondent or agency referred to in section 14(e) of that Act (12 U.S.C. 358).

(o) *State* means a State of the United States, the District of Columbia, Puerto Rico, or a territory, possession, or dependency of the United States.

Unless the context otherwise requires, the terms not defined herein have the meanings set forth in 12 CFR 229.2 applicable to subpart C of part 229, and the terms not defined herein or in 12 CFR 229.2 have the meanings set forth in the Uniform Commercial Code.

(p) *Clock hour* means a time that is on the hour, such as 1:00, 2:00, etc.

(q) *Fedwire* has the same meaning as that set forth in §210.26(e).

(r) *Uniform Commercial Code* means the Uniform Commercial Code as adopted in a state.

[45 FR 68634, Oct. 16, 1980, as amended at 46 FR 42059, Aug. 19, 1981; 51 FR 21744, June 16, 1986; 53 FR 21984, June 13, 1988; 57 FR 46955, Oct. 14, 1992; Reg. J, 59 FR 22965, May 4, 1994; 62 FR 48171, Sept. 15, 1997]

§210.3 General provisions.

(a) *General*. Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its handling of items and other matters deemed appropriate by the Reserve Bank. The circulars may, among other things, classify cash items and noncash items, require separate sorts and letters, provide different closing times for the receipt of different classes or types of items, provide for instructions by an Administrative Reserve Bank to other Reserve Banks, set forth terms of services, and establish procedures for adjustments on a Reserve Bank's books, including amounts, waiver of expenses, and payment of interest by as-of adjustment.

(b) *Binding effect*. This subpart, together with subpart C of part 229 and the operating circulars of the Reserve Banks, are binding on all parties interested in an item handled by any Reserve Bank.

(c) *Government items*. As depositaries and fiscal agents of the United States, Reserve Banks handle certain items payable by the United States or certain Federal agencies as cash or noncash items. To the extent provided by regulations issued by, and arrangements made with, the United States Treasury Department and other Government departments and agencies, the handling of such items is governed by this subpart. The Reserve Banks shall include in their operating circulars such information regarding these regulations and arrangements as the Reserve Banks deem appropriate.

(d) *Government senders*. Except as otherwise provided by statutes of the United States, or regulations issued or arrangements made thereunder, this subpart and the operating circulars of the Reserve Banks apply to the following when acting as a sender: a department, agency, instrumentality, independent establishment, or office of the United States, or a wholly owned or controlled Government corporation, that maintains or uses an account with a Reserve Bank.

(e) *Foreign items*. A Reserve Bank also may receive and handle certain items payable outside a Federal Reserve District, as provided in its operating circulars. The handling of such items in a state is governed by this subpart, and the handling of such items outside a state is governed by the local law.

(f) *Relation to other law*. The provisions of this subpart supersede any inconsistent provisions of the Uniform

Commercial Code, of any other state law, or of part 229 of this title, but only to the extent of the inconsistency.

[45 FR 68634, Oct. 16, 1980, as amended at 51 FR 21744, June 16, 1986; 53 FR 21984, June 13, 1988; Reg. J, 59 FR 22965, May 4, 1994; 62 FR 48171, Sept. 15, 1997]

§ 210.4 Sending items to Reserve Banks.

(a) *Sending of items.* A sender, other than a Reserve Bank, may send any item to any Reserve Bank, whether or not the item is payable within the Reserve Bank's District, unless the sender's Administrative Reserve Bank directs the sender to send the item to a specific Reserve Bank.

(b) *Handling of items.* (1) The following parties, in the following order, are deemed to have handled an item that is sent to a Reserve Bank for collection—

(i) The initial sender

(ii) The initial sender's Administrative Reserve Bank

(iii) The Reserve Bank that receives the item from the initial sender (if different from the initial sender's Administrative Reserve Bank); and

(iv) Another Reserve Bank, if any, that receives the item from a Reserve Bank.

(2) A Reserve Bank that is not described in paragraph (b)(1) of this section is not a party that handles an item and is not a collecting bank with respect to an item.

(3) The identity and order of the parties under paragraph (b)(1) of this section determine the relationships and the rights and liabilities of the parties under this subpart, part 229 of this chapter (Regulation CC), and the Uniform Commercial Code. An initial sender's Administrative Reserve Bank that is deemed to handle an item is also deemed to be a sender with respect to that item. The Reserve Banks that are deemed to handle an item are deemed to be agents or subagents of the owner of the item, as provided in § 210.6(a) of this subpart.

(c) *Checks received at par.* The Reserve Banks shall receive cash items and other checks at par.

[Reg. J, 62 FR 48171, Sept. 15, 1997]

§ 210.5 Sender's agreement; recovery by Reserve Bank.

(a) *Sender's agreement.* The warranties, authorizations, and agreements made pursuant to this paragraph may not be disclaimed and are made whether or not the item bears an indorsement of the sender. By sending an item to a Reserve Bank, the sender:

(1) Authorizes the sender's Administrative Reserve Bank and any other Reserve Bank or collecting bank to which the item is sent to handle the item (and authorizes any Reserve Bank that handles settlement for the item to make accounting entries), subject to this subpart and to the Reserve Banks' operating circulars, and warrants its authority to give this authorization;

(2) Warrants to each Reserve Bank handling the item that:

(i) The sender is a person entitled to enforce the item or authorized to obtain payment of the item on behalf of a person entitled to enforce the item; and

(ii) The item has not been altered; but this paragraph (a)(2) does not limit any warranty by a sender or other prior party arising under state law or under subpart C of part 229 of this title; and

(3) Agrees to indemnify each Reserve Bank for any loss of expense sustained (including attorneys' fees and expenses of litigation) resulting from (i) the sender's lack of authority to make the warranty in paragraph (a)(1) of this section; (ii) any action taken by the Reserve Bank within the scope of its authority in handling the item; or (iii) any warranty made by the Reserve Bank under § 210.6(b) of this subpart.

(b) *Recovery by Reserve Bank.* If an action or proceeding is brought against (or if defense is tendered to) a Reserve Bank that has handled an item, based on:

(1) The alleged failure of the sender to have the authority to make the warranty and agreement in paragraph (a)(1) of this section;

(2) Any action by the Reserve Bank within the scope of its authority in handling the item; or

(3) Any warranty made by the Reserve Bank under § 210.6(b) of this subpart, the Reserve Bank may, upon

entry of a final judgment or decree, recover from the sender the amount of attorneys' fees and other expenses of litigation incurred, as well as any amount the Reserve Bank is required to pay because of the judgment or decree or the tender of defense, together with interest thereon.

(c) *Methods of recovery*. (1) The Reserve Bank may recover the amount stated in paragraph (b) of this section by charging any account on its books that is maintained or used by the sender (or by charging a Reserve Bank sender), if—

(i) The Reserve Bank made seasonable written demand on the sender to assume defense of the action or proceeding; and

(ii) The sender has not made any other arrangement for payment that is acceptable to the Reserve Bank.

(2) The Reserve Bank is not responsible for defending the action or proceeding before using this method of recovery. A Reserve Bank that has been charged under this paragraph (c) may recover from its sender in the manner and under the circumstances set forth in this paragraph (c). A Reserve Bank's failure to avail itself of the remedy provided in this paragraph (c) does not prejudice its enforcement in any other manner of the indemnity agreement referred to in paragraph (a)(3) of this section.

(d) *Security interest*. When a sender sends an item to a Reserve Bank, the sender and any prior collecting bank grant to the sender's Administrative Reserve Bank a security interest in all of their respective assets in the possession of, or held for the account of, any Reserve Bank to secure their respective obligations due or to become due to the Administrative Reserve Bank under this subpart or subpart C of part 229 of this chapter (Regulation CC). The security interest attaches when a warranty is breached or any other obligation to the Reserve Bank is incurred. If the Reserve Bank, in its sole discretion, deems itself insecure and gives notice thereof to the sender or prior collecting bank, or if the sender or prior collecting bank suspends payments or is closed, the Reserve Bank may take any action authorized by law to recover the amount of an obligation, including, but not limited to, the exercise of rights of set off, the realization on any available collateral, and any other rights it may have as a creditor under applicable law.

[45 FR 68634, Oct. 16, 1980, as amended at 51 FR 21745, June 16, 1986; Reg. J, 59 FR 22965, May 4, 1994; 62 FR 48171, Sept. 15, 1997]

§210.6 Status, warranties, and liability of Reserve Bank.

(a)(1) *Status and liability*. A Reserve Bank that handles an item shall act as agent or subagent of the owner with respect to the item. This agency terminates when a Reserve Bank receives final payment for the item in actually and finally collected funds, a Reserve Bank makes the proceeds available for use by the sender, and the time for commencing all actions against the Reserve Bank has expired. A Reserve Bank shall not have or assume any liability with respect to an item or its proceeds except—

(i) For the Reserve Bank's own lack of good faith or failure to exercise ordinary care;

(ii) As provided in paragraph (b) of this section; and

(iii) As provided in subpart C of part 229 of this chapter (Regulation CC).

(2) *Reliance on routing designation appearing on item*. A Reserve Bank may present or send an item based on the routing number or other designation of a paying bank or nonbank payor appearing in any form on the item when the Reserve Bank receives it. A Reserve Bank shall not be responsible for any delay resulting from its acting on any designation, whether inscribed by magnetic ink or by other means, and whether or not the designation acted on is consistent with any other designation appearing on the item.

(b) *Warranties and liability*. (1) By presenting or sending an item, a Reserve Bank warrants to a subsequent collecting bank and to the paying bank and any other payor—

(i) That the Reserve Bank is a person entitled to enforce the item (or is authorized to obtain payment of the item on behalf of a person who is either entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item); and

(ii) That the item has not been altered.

(2) The Reserve Bank also makes the warranties set forth in § 229.34(c) of this chapter, subject to the terms of part 229 of this chapter (Regulation CC). The Reserve Bank shall not have or assume any other liability to the paying bank or other payor, except for the Reserve Bank's own lack of good faith or failure to exercise ordinary care.

(c) *Time for commencing action against Reserve Bank.* A claim against a Reserve Bank for lack of good faith or failure to exercise ordinary care shall be barred unless the action on the claim is commenced within two years after the claim accrues. A claim accrues on the date when a Reserve Bank's alleged failure to exercise ordinary care or to act in good faith first results in damages to the claimant. This paragraph does not lengthen the time limit for claims under § 229.38(g) of this title (which include claims for breach of warranty under § 229.34 of this title).

[45 FR 68634, Oct. 16, 1980, as amended at 51 FR 21745, June 16, 1986; 53 FR 21984, June 13, 1988; Reg. J, 59 FR 22966, May 4, 1994; 62 FR 48172, Sept. 15, 1997]

§ 210.7 Presenting items for payment.

(a) *Presenting or sending.* As provided under State law or as otherwise permitted by this section: (1) a Reserve Bank or a subsequent collecting bank may present an item for payment or send the item for presentment and payment; and

(2) A Reserve Bank may send an item to a subsequent collecting bank with authority to present it for payment or to send it for presentment and payment.

(b) *Place of presentment.* A Reserve Bank or subsequent collecting bank may present an item—

(1) At a place requested by the paying bank;

(2) In the case of a check as defined in 12 CFR 229.2(k), in accordance with 12 CFR 229.36;

(3) At a place requested by the nonbank payor, if the item is payable by a nonbank payor other than through or at a paying bank;

(4) Under a special collection agreement consistent with this subpart; or

(5) Through a clearinghouse and subject to its rules and practices.

(c) *Presenting or sending direct.* A Reserve Bank or subsequent collecting bank may, with respect to an item that may be sent to the paying bank or nonbank payor in the Reserve Bank's District—

(1) Present or send the item direct to the paying bank, or to a place requested by the paying bank; or

(2) If the item is payable by a nonbank payor other than through a paying bank, present it direct to the nonbank payor. Documents, securities, or other papers accompanying a noncash item shall not be delivered to the nonbank payor before the item is paid unless the sender specifically authorizes delivery.

(d) *Item sent to another district.* A Reserve Bank receiving an item that may be sent to a paying bank or nonbank payor in another District ordinarily sends the item to the Reserve Bank of the other District, but with the agreement of the other Reserve Bank, may present or send the item as if it were sent to a paying bank or nonbank payor in its own District.

[45 FR 68634, Oct. 16, 1980, as amended at 53 FR 21985, June 13, 1988; 62 FR 48172, Sept. 15, 1997]

§ 210.8 Presenting noncash items for acceptance.

(a) A Reserve Bank or a subsequent collecting bank may, if instructed by the sender, present a noncash item for acceptance in any manner authorized by law if—

(1) The item provides that it must be presented for acceptance;

(2) The item may be presented elsewhere than at the residence or place of business of the payor; or

(3) The date of payment of the item depends on presentment for acceptance.

(b) Documents accompanying a noncash item shall not be delivered to the payor upon acceptance of the item unless the sender specifically authorizes delivery. A Reserve Bank shall not have or assume any other obligation to present or to send for presentment for acceptance any noncash item.

[62 FR 48172, Sept. 15, 1997]

§210.9 Settlement and payment.

(a) *Settlement through Administrative Reserve Bank.* A paying bank shall settle for an item under this subpart with its Administrative Reserve Bank, whether or not the paying bank received the item from that Reserve Bank. A paying bank's settlement with its Administrative Reserve Bank is deemed to be settlement with the Reserve Bank from which the paying bank received the item. A paying bank may settle for an item using any account on a Reserve Bank's books by agreement with its Administrative Reserve Bank, any other Reserve Bank holding the settlement account, and the account-holder. The paying bank remains responsible for settlement if the Reserve Bank holding the settlement account does not, for any reason, obtain settlement in that account.

(b) *Cash items*—(1) *Settlement obligation.* On the day a paying bank receives[2] a cash item from a Reserve Bank, it shall settle for the item such that the proceeds of the settlement are available to its Administrative Reserve Bank by the close of Fedwire on that day, or it shall return the item by the later of the close of its banking day or the close of Fedwire. If the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(1), it is accountable for the amount of the item as of the close of its banking day or the close of Fedwire on the day it receives the item, whichever is earlier.

(2) *Time of settlement.* (i) On the day a paying bank receives a cash item from a Reserve Bank, it shall settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank, or return the item, by the latest of—

(A) The next clock hour that is at least one hour after the paying bank receives the item;

(B) 9:30 a.m. Eastern Time; or

(C) Such later time as provided in the Reserve Banks' operating circulars.

(ii) If the paying bank fails to settle for or return a cash item in accordance with paragraph (b)(2)(i) of this section, it shall be subject to any applicable overdraft charges. Settlement under paragraph (b)(2)(i) of this section satisfies the settlement requirements of paragraph (b)(1) of this section.

(3) *Paying bank closes voluntarily.* (i) If a paying bank closes voluntarily so that it does not receive a cash item on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes the cash item available to the paying bank on that day, the paying bank shall either—

(A) On that day, settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank, or return the item, by the latest of the next clock hour that is at least one hour after it ordinarily would have received the item, 9:30 a.m. Eastern Time, or such later time as provided in the Reserve Banks' operating circulars; or

(B) On the next day that is a banking day for both the paying bank and the Reserve Bank, settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by 9:30 a.m. Eastern Time on that day or such later time as provided in the Reserve Banks' operating circulars and compensate the Reserve Bank for the value of the float associated with the item in accordance with procedures provided in the Reserve Bank's operating circular.

(ii) If a paying bank closes voluntarily so that it does not receive a cash item on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes the cash item available to the paying bank on that day, the paying bank is not considered to have received the item until its next banking day, but it shall be subject to any applicable overdraft charges if it fails to settle for or return the item in accordance with paragraph (b)(3)(i) of this section. The settlement requirements of paragraphs (b)(1) and (b)(2) of this section do not apply to a paying bank that settles in accordance with paragraph (b)(3)(i) of this section.

[2] A paying bank is deemed to receive a cash item on its next banking day if it receives the item—

(1) On a day other than a banking day for it; or

(2) On a banking day for it, but after a ''cut-off hour'' established by it in accordance with state law.

(4) *Reserve Bank closed.* (i) If a paying bank receives a cash item from a Reserve Bank on a banking day that is not a banking day for the Reserve Bank, the paying bank shall—

(A) Settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by the close of Fedwire on the Reserve Bank's next banking day, or return the item by midnight of the day it receives the item (if the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(4)(i)(A), it shall become accountable for the amount of the item as of the close of its banking day on the day it receives the item); and

(B) Settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by 9:30 a.m. Eastern Time on the Reserve Bank's next banking day or such later time as provided in the Reserve Bank's operating circular, or return the item by midnight of the day it receives the item. If the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(4)(i)(B), it shall be subject to any applicable overdraft charges. Settlement under this paragraph (b)(4)(i)(B) satisfies the settlement requirements of paragraph (b)(4)(i)(A) of this section.

(ii) The settlement requirements of paragraphs (b)(1) and (b)(2) of this section do not apply to a paying bank that settles in accordance with paragraph (b)(4)(i) of this section.

(5) *Manner of settlement.* Settlement with a Reserve Bank under paragraphs (b) (1) through (4) of this section shall be made by debit to an account on the Reserve Bank's books, cash, or other form of settlement to which the Reserve Bank agrees, except that the Reserve Bank may, in its discretion, obtain settlement by charging the paying bank's account. A paying bank may not set off against the amount of a settlement under this section the amount of a claim with respect to another cash item, cash letter, or other claim under § 229.34(c) of this chapter (Regulation CC) or other law.

(6) *Notice in lieu of return.* If a cash item is unavailable for return, the paying bank may send a notice in lieu of return as provided in § 229.30(f) of this chapter (Regulation CC).

(c) *Noncash items.* A Reserve Bank may require the paying or collecting bank to which it has presented or sent a noncash item to pay for the item in cash, but the Reserve Bank may permit payment by a debit to an account maintained or used by the paying or collecting bank on a Reserve Bank's books or by any of the following that is in a form acceptable to the collecting Reserve Bank: bank draft, transfer of funds or bank credit, or any other form of payment authorized by State law.

(d) *Nonbank payor.* A Reserve Bank may require a nonbank payor to which it has presented an item to pay for it in cash, but the Reserve Bank may permit payment in any of the following that is in a form acceptable to the Reserve Bank: cashier's check, certified check, or other bank draft or obligation.

(e) *Handling of payment.* A Reserve Bank may handle a bank draft or other form of payment it receives in payment of a cash item as a cash item. A Reserve Bank may handle a bank draft or other form of payment it receives in payment of a noncash item as either a cash item or a noncash item.

(f) *Liability of Reserve Bank.* Except as set forth in 12 CFR 229.35(b), a Reserve Bank shall not be liable for the failure of a collecting bank, paying bank, or nonbank payor to pay for an item, or for any loss resulting from the Reserve Bank's acceptance of any form of payment other than cash authorized in paragraphs (b), (c), and (d) of this section. A Reserve Bank that acts in good faith and exercises ordinary care shall not be liable for the nonpayment of, or failure to realize upon, a bank draft or other form of payment that it accepts under paragraphs (b), (c), and (d) of this section.

[45 FR 68634, Oct. 16, 1980, as amended at 49 FR 4200, Feb. 3, 1984; 51 FR 21745, June 16, 1986; 53 FR 21985, June 13, 1988; 57 FR 46955, Oct. 14, 1992; Reg. J, 59 FR 22966, May 4, 1994; 62 FR 48172, Sept. 15, 1997]

§ 210.10 Time schedule and availability of credits for cash items and returned checks.

(a) Each Reserve Bank shall include in its operating circulars a time schedule for each of its offices indicating

when the amount of any cash item or returned check received by it is counted as reserves for purposes of part 204 of this chapter (Regulation D) and becomes available for use by the sender or paying or returning bank. The Reserve Bank that holds the settlement account shall give either immediate or deferred credit to a sender, a paying bank, or a returning bank (other than a foreign correspondent) in accordance with the time schedule of the receiving Reserve Bank. A Reserve Bank ordinarily gives credit to a foreign correspondent only when the Reserve Bank receives payment of the item in actually and finally collected funds, but, in its discretion, a Reserve Bank may give immediate or deferred credit in accordance with its time schedule.

(b) Notwithstanding its time schedule, a Reserve Bank may refuse at any time to permit the use of credit given by it for any cash item or returned check, and may defer availability after credit is received by the Reserve Bank for a period of time that is reasonable under the circumstances.

[62 FR 48173, Sept. 15, 1997]

§ 210.11 Availability of proceeds of noncash items; time schedule.

(a) *Availability of credit.* A Reserve Bank shall give credit to the sender for the proceeds of a noncash item when it receives payment in actually and finally collected funds (or advice from another Reserve Bank of such payment to it). The amount of the item is counted as reserve for purposes of part 204 of this chapter (Regulation D) and becomes available for use by the sender when the Reserve Bank receives the payment or advice, except as provided in paragraph (b) of this section.

(b) *Time schedule.* A Reserve Bank may give credit for the proceeds of a noncash item subject to payment in actually and finally collected funds in accordance with a time schedule included in its operating circulars. The time schedule shall indicate when the proceeds of the noncash item will be counted as reserve for purposes of part 204 of this chapter (Regulation D) and become available for use by the sender. A Reserve Bank may, however, refuse at any time to permit the use of credit given by it for a noncash item for which the Reserve Bank has not yet received payment in actually and finally collected funds.

(c) *Handling of payment.* If a Reserve Bank receives, in payment for a noncash item, a bank draft or other form of payment that it elects to handle as a noncash item, the Reserve Bank shall neither count the proceeds as reserve for purposes of part 204 of this chapter (Regulation D) nor make the proceeds available for use until it receives payment in actually and finally collected funds.

[45 FR 68634, Oct. 16, 1980, as amended at 62 FR 48173, Sept. 15, 1997]

§ 210.12 Return of cash items and handling of returned checks.

(a) *Return of items*—(1) *Return of cash items handled by Reserve Banks.* A paying bank that receives a cash item from a Reserve Bank, other than for immediate payment over the counter, and that settles for the item as provided in § 210.9(b) of this subpart, may, before it has finally paid the item, return the item to any Reserve Bank (unless its Administrative Reserve Bank directs it to return the item to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code, and the Reserve Banks' operating circulars. A paying bank that receives a cash item from a Reserve Bank also may return the item prior to settlement, in accordance with § 210.9(b) of this subpart and the Reserve Banks' operating circulars. The rules or practices of a clearinghouse through which the item was presented, or a special collection agreement under which the item was presented, may not extend these return times, but may provide for a shorter return time.

(2) *Return of checks not handled by Reserve Banks.* A paying bank that receives a check as defined in § 229.2(k) of this chapter (Regulation CC), other than from a Reserve Bank, and that determines not to pay the check, may send the returned check to any Reserve Bank (unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code,

and the Reserve Banks' operating circulars. A returning bank may send a returned check to any Reserve Bank (unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code, and the Reserve Banks' operating circulars.

(b) *Handling of returned checks.* (1) The following parties, in the following order, are deemed to have handled a returned check sent to a Reserve Bank under paragraph (a) of this section—

(i) The paying or returning bank;

(ii) The paying bank's or returning bank's Administrative Reserve Bank;

(iii) The Reserve Bank that receives the returned check from the paying or returning bank (if different from the paying bank's or returning bank's Administrative Reserve Bank); and

(iv) Another Reserve Bank, if any, that receives the returned check from a Reserve Bank.

(2) A Reserve Bank that is not described in paragraph (b)(1) of this section is not a party that handles a returned check and is not a returning bank with respect to a returned check.

(3) The identity and order of the parties under paragraph (b)(1) of this section determine the relationships and the rights and liabilities of the parties under this subpart, part 229 of this chapter (Regulation CC), and the Uniform Commercial Code.

(c) *Paying bank's and returning bank's agreement.* The warranties, authorizations, and agreements made pursuant to this paragraph may not be disclaimed and are made whether or not the returned check bears an indorsement of the paying bank or returning bank. By sending a returned check to a Reserve Bank, the paying bank or returning bank—

(1) Authorizes the paying or returning bank's Administrative Reserve Bank, and any other Reserve Bank or returning bank to which the returned check is sent, to handle the returned check (and authorizes any Reserve Bank that handles settlement for the returned check to make accounting entries) subject to this subpart and to the Reserve Banks' operating circulars;

(2) Makes the warranties set forth in § 229.34 of this title (but this paragraph does not limit any warranty by a paying or returning bank arising under state law); and

(3) Agrees to indemnify each Reserve Bank for any loss or expense (including attorneys' fees and expenses of litigation) resulting from—

(i) The paying or returning bank's lack of authority to give the authorization in paragraph (c)(1) of this section;

(ii) Any action taken by a Reserve Bank within the scope of its authority in handling the returned check; or

(iii) Any warranty made by the Reserve Bank under 12 CFR 229.34.

(d) *Warranties by Reserve Bank.* By handling a returned check under this subpart, a Reserve Bank makes the returning bank warranties as set forth in § 229.34 of this chapter, subject to the terms of part 229 of this chapter (Regulation CC). The Reserve Bank shall not have or assume any other liability to the transferee returning bank, to any subsequent returning bank, to the depository bank, to the owner of the check, or to any other person, except for the Reserve Bank's own lack of good faith or failure to exercise ordinary care as provided in subpart C of part 229 of this title.

(e) *Recovery by Reserve Bank.* If an action or proceeding is brought against (or if defense is tendered to) a Reserve Bank that has handled a returned Check based on—

(1) The alleged failure of the paying or returning bank to have the authority to give the authorization in paragraph (c)(1) of this section;

(2) Any action by the Reserve Bank within the scope of its authority in handling the returned check; or

(3) Any warranty made by the Reserve Bank under 12 CFR 229.34,

The Reserve Bank may, upon the entry of a final judgment or decree, recover from the paying bank or returning bank the amount of attorneys' fees and other expenses of litigation incurred, as well as any amount the Reserve Bank is required to pay because of the judgment or decree or the tender of defense, together with interest thereon.

(f) *Methods of recovery.* (1) The Reserve Bank may recover the amount stated in paragraph (d) of this section

by charging any account on its books that is maintained or used by the paying or returning bank (or by charging another returning Reserve Bank), if—

(i) The Reserve Bank made seasonable written demand on the paying or returning bank to assume defense of the action or proceeding; and

(ii) The paying or returning bank has not made any other arrangement for payment that is acceptable to the Reserve Bank.

(2) The Reserve Bank is not responsible for defending the action or proceeding before using this method of recovery. A Reserve Bank that has been charged under this paragraph (f) may recover from the paying or returning bank in the manner and under the circumstances set forth in this paragraph (f). A Reserve Bank's failure to avail itself of the remedy provided in this paragraph (f) does not prejudice its enforcement in any other manner of the indemnity agreement referred to in paragraph (c)(3) of this section.

(g) *Reserve Bank's responsibility*. A Reserve Bank shall handle a returned check, or a notice of nonpayment, in accordance with subpart C of part 229 and its operating circular.

(h) *Settlement*. A subsequent returning bank or depositary bank shall settle with its Administrative Reserve Bank for returned checks in the same manner and by the same time as for cash items presented for payment under this subpart. Settlement with its Administrative Reserve Bank is deemed to be settlement with the Reserve Bank from which the returning bank or depositary bank received the item.

(i) *Security interest*. When a paying or returning bank sends a returned check to a Reserve Bank, the paying bank, returning bank, and any prior returning bank grant to the paying bank's or returning bank's Administrative Reserve Bank a security interest in all of their respective assets in the possession of, or held for the account of, any Reserve Bank, to secure their respective obligations due or to become due to the Administrative Reserve Bank under this subpart or subpart C of part 229 of this chapter (Regulation CC). The security interest attaches when a warranty is breached or any other obligation to the Reserve Bank is incurred. If the Reserve Bank, in its sole discretion, deems itself insecure and gives notice thereof to the paying bank, returning bank, or prior returning bank, or if the paying bank, returning bank, or prior returning bank suspends payments or is closed, the Reserve Bank may take any action authorized by law to recover the amount of an obligation, including, but not limited to, the exercise of rights of set off, the realization on any available collateral, and any other rights it may have as a creditor under applicable law.

[53 FR 21985, June 13, 1988, as amended at Reg. J, 59 FR 22966, May 4, 1994; 62 FR 48173, Sept. 15, 1997]

§ 210.13 Unpaid items.

(a) *Right of recovery*. If a Reserve Bank does not receive payment in actually and finally collected funds for an item, the Reserve Bank shall recover by charge-back or otherwise the amount of the item from the sender, prior collecting bank, paying bank, or returning bank from or through which it was received, whether or not the item itself can be sent back. In the event of recovery from such a party, no party, including the owner or holder of the item, shall, for the purpose of obtaining payment of the amount of the item, have any interest in any reserve balance or other funds or property in the Reserve Bank's possession of the bank that failed to make payment in actually and finally collected funds.

(b) *Suspension or closing of bank*. A Reserve Bank shall not pay or act on a draft, authorization to charge (including a charge authorized by § 210.9(a)(5)), or other order on a reserve balance or other funds in its possession for the purpose of settling for items under § 210.9 or § 210.12 after it receives notice of suspension or closing of the bank making the settlement for that bank's own or another's account.

[Reg. J, 59 FR 22966, May 4, 1994]

§ 210.14 Extension of time limits.

If a bank (including a Reserve Bank) or nonbank payor is delayed in acting

on an item beyond applicable time limits because of interruption of communication or computer facilities, suspension of payments by a bank or nonbank payor, war, emergency conditions, failure of equipment, or other circumstances beyond its control, its time for acting is extended for the time necessary to complete the action, if it exercises such diligence as the circumstances require.

[Reg. J, 59 FR 22967, May 4, 1994]

§ 210.15 Direct presentment of certain warrants.

If a Reserve Bank elects to present direct to the payor a bill, note, or warrant that is issued and payable by a State or a political subdivision and that is a cash item not payable or collectible through a bank: (a) Sections 210.9, 210.12, and 210.13 and the operating circulars of the Reserve Banks apply to the payor as if it were a paying bank; (b) § 210.14 applies to the payor as if it were a bank; and (c) under § 210.9 each day on which the payor is open for the regular conduct of its affairs or the accommodation of the public is considered a banking day.

Subpart B—Funds Transfers Through Fedwire

SOURCE: 55 FR 40801, Oct. 5, 1990, unless otherwise noted.

§ 210.25 Authority, purpose, and scope.

(a) *Authority and purpose.* This subpart provides rules to govern funds transfers through Fedwire, and has been issued pursuant to the Federal Reserve Act—section 13 (12 U.S.C. 342), paragraph (f) of section 19 (12 U.S.C. 464), paragraph 14 of section 16 (12 U.S.C. 248(o)), and paragraphs (i) and (j) of section 11 (12 U.S.C. 248(i) and (j))—and other laws and has the force and effect of federal law. This subpart is not a funds-transfer system rule as defined in Section 4A–501(b) of Article 4A.

(b) *Scope.* (1) This subpart incorporates the provisions of Article 4A set forth in appendix B to this subpart. In the event of an inconsistency between the provisions of the sections of this subpart and appendix B, to this subpart, the provisions of the sections of this subpart shall prevail.

(2) Except as otherwise provided in paragraphs (b)(3) and (b)(4) of this section, this Subpart governs the rights and obligations of:

(i) Federal Reserve Banks sending or receiving payment orders;

(ii) Senders that send payment orders directly to a Federal Reserve Bank;

(iii) Receiving banks that receive payment orders directly from a Federal Reserve Bank;

(iv) Beneficiaries that receive payment for payment orders sent to a Federal Reserve Bank by means of credit to an account maintained or used at a Federal Reserve Bank; and

(v) Other parties to a funds transfer any part of which is carried out through Fedwire to the same extent as if this subpart were considered a funds-transfer system rule under Article 4A.

(3) This subpart governs a funds transfer that is sent through Fedwire, as provided in paragraph (b)(2) of this section, even though a portion of the funds transfer is governed by the Electronic Fund Transfer Act, but the portion of such funds transfer that is governed by the Electronic Fund Transfer Act is not governed by this subpart.

(4) In the event that any portion of this Subpart establishes rights or obligations with respect to the availability of funds that are also governed by the Expedited Funds Availability Act or the Board's Regulation CC, Availability of Funds and Collection of Checks, those provisions of the Expedited Funds Availability Act or Regulation CC shall apply and the portion of this Subpart, including Article 4A as incorporated herein, shall not apply.

(c) *Operating Circulars.* Each Federal Reserve Bank shall issue an Operating Circular consistent with this Subpart that governs the details of its funds-transfer operations and other matters it deems appropriate. Among other things, the Operating Circular may: set cut-off hours and funds-transfer business days; address available security procedures; specify format and media requirements for payment orders; identify messages that are not payment orders; and impose charges for funds-transfer services.

(d) *Govenment senders, receiving banks, and beneficiaries.* Except as otherwise expressly provided by the statutes of the United States, the parties specified in paragraphs (b)(2)(ii) through (v) of this section include:

(1) A department, agency, instrumentality, independent establishment, or office of the United States, or a wholly-owned or controlled Government corporation;

(2) An international organization;

(3) A foreign central bank; and

(4) A department, agency, instrumentality, independent establishment, or office of a foreign government, or a wholly-owned or controlled corporation of a foreign government.

[55 FR 40801, Oct. 5, 1990; 55 FR 47428, Nov. 13, 1990]

§ 210.26 Definitions.

As used in this subpart, the following definitions apply:

(a) *Article 4A* means article 4A of the Uniform Commercial Code as set forth in appendix B of this subpart.

(b) *As of adjustment* means a debit or credit, for reserve or clearing balance maintenance purposes only, applied to the reserve or clearing balance of a bank that either sends a payment order to a Federal Reserve Bank, or that receives a payment order from a Federal Reserve Bank, in lieu of an interest charge or payment.

(c) *Automated clearing house transfer* means any transfer designated as an automated clearing house transfer in a Federal Reserve Bank Operating Circular.

(d) *Beneficiary's bank* has the same meaning as in Article 4A, except that:

(1) A Federal Reserve Bank need not be identified in the payment order in order to be the beneficiary's bank; and

(2) The term includes a Federal Reserve Bank when that Federal Reserve Bank is the beneficiary of a payment order.

(e) *Fedwire* is the funds-transfer system owned and operated by the Federal Reserve Banks that is used primarily for the transmission and settlement of payment orders governed by this subpart. Fedwire does not include the system for making automated clearing house transfers.

(f) *Interdistrict transfer* means a funds transfer involving entries to accounts maintained at two Federal Reserve Banks.

(g) *Intradistrict transfer* means a funds transfer involving entries to accounts maintained at one Federal Reserve Bank.

(h) *Off-line bank* means a bank that transmits payment orders to and receives payment orders from a Federal Reserve Bank by telephone orally or by other means other than electronic data transmission.

(i) *Payment order* has the same meaning as in Article 4A, except that the term does not include automated clearing house transfers or any communication designated in a Federal Reserve Bank Operating Circular issued under this Subpart as not being a payment order.

(j) *Sender's account, receiving bank's account*, and *beneficiary's account* mean the reserve, clearing, or other funds deposit account at a Federal Reserve Bank maintained or used by the sender, receiving bank, or beneficiary, respectively.

(k) *Sender's Federal Reserve Bank* and *receiving bank's Federal Reserve Bank* mean the Federal Reserve Bank at which the sender or receiving bank, respectively, maintains or uses an account.

[55 FR 40801, Oct. 5, 1990; 55 FR 47428, Nov. 13, 1990]

§ 210.27 Reliance on identifying number.

(a) *Reliance by a Federal Reserve Bank on number to identify an intermediary bank or beneficiary's bank.* A Federal Reserve Bank may rely on the number in a payment order that identifies the intermediary bank or beneficiary's bank, even if it identifies a bank different from the bank identified by name in the payment order, if the Federal Reserve Bank does not know of such an inconsistency in identification. A Federal Reserve Bank has no duty to detect any such inconsistency in identification.

(b) *Reliance by a Federal Reserve Bank on number to identify beneficiary.* A Federal Reserve Bank, acting as a beneficiary's bank, may rely on the number in a payment order that identifies the

beneficiary, even if it identifies a person different from the person identified by name in the payment order, if the Federal Reserve Bank does not know of such an inconsistency in identification. A Federal Reserve Bank has no duty to detect any such inconsistency in identification.

§ 210.28 Agreement of sender.

(a) *Payment of sender's obligation to a Federal Reserve Bank.* A sender (other than a Federal Reserve Bank), by maintaining or using an account with a Federal Reserve Bank, authorizes the sender's Federal Reserve Bank to obtain payment for the sender's payment orders by debiting the amount of the payment order from the sender's account.

(b) *Overdrafts.* (1) A sender does not have the right to an overdraft in the sender's account. In the event an overdraft is created, the overdraft shall be due and payable immediately without the need for a demand by the Federal Reserve Bank, at the earliest of the following times:

(i) At the end of the funds-transfer business day;

(ii) At the time the Federal Reserve Bank, in its sole discretion, deems itself insecure and gives notice thereof to the sender; or

(iii) At the time the sender suspends payments or is closed.

(2) The sender shall have in its account, at the time the overdraft is due and payable, a balance of actually and finally collected funds sufficient to cover the aggregate amount of all its obligations to the Federal Reserve Bank, whether the obligations result from the execution of a payment order or otherwise.

(3) To secure any overdraft, as well as any other obligation due or to become due to its Federal Reserve Bank, each sender, by sending a payment order to a Federal Reserve Bank that is accepted by the Federal Reserve Bank, grants to the Federal Reserve Bank a security interest in all of the sender's assets in the possession of, or held for the account of, the Federal Reserve Bank. The security interest attaches when an overdraft, or any other obligation to the Federal Reserve Bank, becomes due and payable.

(4) A Federal Reserve Bank may take any action authorized by law to recover the amount of an overdraft that is due and payable, including, but not limited to, the exercise of rights of set off, the realization on any available collateral, and any other rights it may have as a creditor under applicable law.

(5) If a sender, other than a government sender described in § 210.25(d), incurs an overdraft in its account as a result of a debit to the account by a Federal Reserve Bank under paragraph (a) of this section, the account will be subject to any applicable overdraft charges, regardless of whether the overdraft has become due and payable. A Federal Reserve Bank may debit a sender's account under paragraph (a) of this section immediately on acceptance of the payment order.

(c) *Review of payment orders.* A sender, by sending a payment order to a Federal Reserve Bank, agrees that for the purposes of sections 4A–204(a) and 4A–304 of Article 4A, a reasonable time to notify a Federal Reserve Bank of the relevant facts concerning an unauthorized or erroneously executed payment order is within 30 calendar days after the sender receives notice that the payment order was accepted or executed, or that the sender's account was debited with respect to the payment order.

[55 FR 40801, Oct. 5, 1990, as amended at 57 FR 46956, Oct. 14, 1992]

§ 210.29 Agreement of receiving bank.

(a) *Payment.* A receiving bank (other than a Federal Reserve Bank) that receives a payment order from its Federal Reserve Bank authorizes that Federal Reserve Bank to pay for the payment order by crediting the amount of the payment order to the receiving bank's account.

(b) *Off-line banks.* An off-line bank that does not expressly notify its Federal Reserve Bank in writing that it maintains an account for another bank warrants to that Federal Reserve Bank that the off-line bank does not act as an intermediary bank or a beneficiary's bank with respect to payment orders received through Fedwire for a beneficiary that is a bank.

[55 FR 40801, Oct. 5, 1990; 55 FR 47428, Nov. 13, 1990]

§ 210.30 Payment orders.

(a) *Rejection*. A sender shall not send a payment order to a Federal Reserve Bank unless authorized to do so by the Federal Reserve Bank. A Federal Reserve Bank may reject, or impose conditions that must be satisfied before it will accept, a payment order for any reason.

(b) *Selection of an intermediary bank*. For an interdistrict transfer, a Federal Reserve Bank is authorized and directed to execute a payment order through another Federal Reserve Bank. A sender shall not send a payment order to a Federal Reserve Bank that requires the Federal Reserve Bank to issue a payment order to an intermediary bank (other than a Federal Reserve Bank) unless that intermediary bank is designated in the sender's payment order. A sender shall not send to a Federal Reserve Bank a payment order instructing use by a Federal Reserve Bank of a funds-transfer system or means of transmission other than Fedwire, unless the Federal Reserve Bank agrees with the sender in writing to follow such instructions.

(c) *Same-day execution*. A sender shall not issue a payment order that instructs a Federal Reserve Bank to execute the payment order on a funds-transfer business day that is later than the funds-transfer business day on which the order is received by the Federal Reserve Bank, unless the Federal Reserve Bank agrees with the sender in writing to follow such instructions.

§ 210.31 Payment by a Federal Reserve Bank to a receiving bank or beneficiary.

(a) *Payment to a receiving bank*. Payment of a Federal Reserve Bank's obligation to pay a receiving bank (other than a Federal Reserve Bank) occurs at the earlier of the time when the amount of the payment order is credited to the receiving bank's account or when the payment order is sent to the receiving bank.

(b) *Payment to a beneficiary*. Payment by a Federal Reserve Bank to a beneficiary of a payment order, where the Federal Reserve Bank is the beneficiary's bank, occurs at the earlier of the time when the amount of the payment order is credited to the beneficiary's account or when notice of the credit is sent to the beneficiary.

§ 210.32 Federal Reserve Bank liability; payment of interest.

(a) *Damages*. In connection with its handling of a payment order under this subpart, a Federal Reserve Bank shall not be liable to a sender, receiving bank, beneficiary, or other Federal Reserve Bank, governed by this subpart, for any damages other than those payable under Article 4A. A Federal Reserve Bank shall not agree to be liable to a sender, receiving bank, beneficiary, or other Federal Reserve Bank for consequential damages under section 4A–305(d) of Article 4A.

(b) *Payment of interest*. (1) A Federal Reserve Bank, in its discretion, may satisfy its obligation, or that of another Federal Reserve Bank, to pay compensation in the form of interest under Article 4A by—

(i) Providing an as of adjustment to its sender, its receiving bank, or its beneficiary, as provided in the Federal Reserve Bank's Operating Circular, in an amount equal to the amount on which interest is to be calcuated multiplied by the number of days for which interest is to be calculated; or

(ii) Paying compensation in the form of interest to its sender, its receiving bank, its beneficiary, or another party to the funds transfer that is entitled to such payment, in an amount that is calculated in accordance with section 4A–506 of Article 4A.

(2) If the sender or receiving bank that is the recipient of an as of adjustment or an interest payment is not the party entitled to compensation under Article 4A, the sender or receiving bank shall pass through the benefit of the as of adjustment or interest payment by making an interest payment, as of the day the as of adjustment or interest payment is effected, to the party entitled to compensation. The interest payment that is made to the party entitled to compensation shall not be less than the value of the as of adjustment or interest payment that was provided by the Federal Reserve Bank to the sender or receiving bank. The party entitled to compensation may agree to accept compensation in a

form other than a direct interest payment, provided that such an alternative form of compensation is not less than the value of the interest payment that otherwise would be made.

(c) *Nonwaiver of right of recovery.* Nothing in this subpart or any Operating Circular issued hereunder shall constitute, or be construed as constituting, a waiver by a Federal Reserve Bank of a cause of action for recovery under any applicable law of mistake and restitution.

APPENDIX A TO SUBPART B—COMMENTARY

The Commentary provides background material to explain the intent of the Board of Governors of the Federal Reserve System (Board) in adopting a particular provision in the subpart and to help readers interpret that provision. In some comments, examples are offered. The Commentary constitutes an official Board interpretation of subpart B of this part. Commentary is not provided for every provision of subpart B of this part, as some provisions are self-explanatory.

Section 210.25—Authority, Purpose, and Scope

(a) *Authority and purpose.* Section 210.25(a) states that the purpose of subpart B of this part is to provide rules to govern funds transfers through Fedwire and recites the Board's rulemaking authority for this subpart. Subpart B of this part is federal law and is not a ''funds-transfer system rule,'' as defined in section 4A–501(b) of Article 4A, Funds Transfers, of the Uniform Commercial Code (UCC), as set forth in appendix B of this subpart. Certain provisions of Article 4A may not be varied by a funds-transfer system rule, but under section 4A–107, regulations of the Board and Operating Circulars of the Federal Reserve Banks supersede inconsistent provisions of Article 4A to the extent of the inconsistency. In addition, regulations of the Board may preempt inconsistent provisions of state law. Accordingly, subpart B of this part supersedes or preempts inconsistent provisions of state law. It does not affect state law governing funds transfers that does not conflict with the provisions of subpart B of this part, such as Article 4A, as enacted in any state, as it applies to parties to funds transfers through Fedwire whose rights are not governed by subpart B of this part.

(b) *Scope.* (1) Subpart B of this part incorporates the provisions of Article 4A set forth in appendix B of this subpart. The provisions set forth expressly in the sections of subpart B of this part supersede or preempt any inconsistent provisions of Article 4A as set forth in appendix B of this subpart or as enacted in any state. The official comments to Article 4A are not incorporated in subpart B of this part or this Commentary to subpart B of this part, but the official comments may be useful in interpreting Article 4A. Because section 4A–105 refers to other provisions of the Uniform Commercial Code, e.g., definitions in Article 1 of the UCC, these other provisions of the UCC, as approved by the National Conference of Commissioners on Uniform State Laws and the American Law Institute, from time to time, are also incorporated in subpart B of this part. Subpart B of this part applies to any party to a Fedwire funds transfer that is in privity with a Federal Reserve Bank. These parties include a sender (bank or nonbank) that sends a payment order directly to a Federal Reserve Bank, a receiving bank that receives a payment order directly from a Federal Reserve Bank, and a beneficiary that receives credit to an account that it uses or maintains at a Federal Reserve Bank for a payment order sent to a Federal Reserve Bank. Other parties to a funds transfer are covered by this subpart to the same extent that this subpart would apply to them if this subpart were a ''funds-transfer system rule'' under Article 4A that selected subpart B of this part as the governing law.

(2) The scope of the applicability of a funds-transfer system rule under Article 4A is specified in section 4A–501(b), and the scope of the choice of law provision is specified in section 4A–507(c). Under section 4A–507(c), a choice of law provision is binding on the participants in a funds-transfer system and certain other parties having notice that the funds-transfer system might be used for the funds transfer and of the choice of law provision. The Uniform Commercial Code provides that a person has notice when the person has actual knowledge, receives notification or has reason to know from all the facts and circumstances known to the person at the time in question. (*See* UCC section 1–201(25).) However, under sections 4A–507(b) and 4A–507(d), a choice of law by agreement of the parties takes precedence over a choice of law made by funds-transfer system rule.

(3) If originators, receiving banks, and beneficiaries that are not in privity with a Federal Reserve Bank have the notice contemplated by section 4A–507(c) or if those parties agree to be bound by subpart B of this part, subpart B of this part generally would apply to payment orders between those remote parties, including participants in other funds-transfer systems. For example, a funds transfer may be sent from an originator's bank through a funds-transfer system other than Fedwire to a receiving bank which, in turn, sends a payment order through Fedwire to execute the funds transfer. Similarly, a Federal Reserve Bank may execute a payment order through Fedwire to a receiving bank that sends it through a

funds-transfer system other than Fedwire to a beneficiary's bank. In the first example, if the originator's bank has notice that Fedwire may be used to effect part of the funds transfer, the sending of the payment order through the other funds-transfer system to the receiving bank will be governed by subpart B of this part unless the parties to the payment order have agreed otherwise. In the second example, if the beneficiary's bank has notice that Fedwire may be used to effect part of the funds transfer, the sending of the payment order to the beneficiary's bank through the other funds-transfer system will be governed by subpart B of this part unless the parties have agreed otherwise. In both cases, the other funds-transfer system's rules would also apply to, at a minimum, the portion of these funds transfers going through that funds-transfer system. Because subpart B of this part is federal law, to the extent of any inconsistency, subpart B of this part will take precedence over any funds-transfer system rule applicable to the remote sender or receiving bank or to a Federal Reserve Bank. If remote parties to a funds transfer, a portion of which is sent through Fedwire, have expressly selected by agreement a law other than subpart B of this part under section 4A–507(b), subpart B of this part would not take precedence over the choice of law made by the agreement even though the remote parties had notice that Fedwire may be used and of the governing law. (*See* 4A–507(d)). In addition, subpart B of this part would not apply to a funds transfer sent through another funds-transfer system where no Federal Reserve Bank handles the funds transfer, even though settlement for the funds transfer is made by means of a separate net settlement or funds transfer through Fedwire.

(4) Under section 4A–108, Article 4A does not apply to a funds transfer, any part of which is governed by the Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*). Fedwire funds transfers to or from consumer accounts are exempt from the Electronic Fund Transfer Act and Regulation E (12 CFR part 205). A funds transfer from a consumer originator or a funds transfer to a consumer beneficiary could be carried out in part through Fedwire and in part through an automated clearing house or other means that is subject to the Electronic Fund Transfer Act or Regulation E. In these cases, subpart B of this part would not govern the portion of the funds transfer that is governed by the Electronic Fund Transfer Act or Regulation E. (*See* Commentary to §210.26(i) ''payment order''.)

(5) Finally, section 4A–404(a) provides that a beneficiary's bank is obliged to pay the amount of a payment order to the beneficiary on the payment date unless acceptance of the payment order occurs on the payment date after the close of the funds-transfer business day of the bank. The Expedited Funds Availability Act provides that funds received by a bank by wire transfer shall be available for withdrawal not later than than the banking day after the business day on which such funds are received (12 U.S.C. 4002(a)). That Act also preempts any provision of state law that was not effective on September 1, 1989 that is inconsistent with that Act or its implementing Regulation CC (12 CFR part 229). Accordingly, the Expedited Funds Availability Act and Regulation CC may preempt section 4A–404(a) as enacted in any state. In order to ensure that section 4A–404(a), or other provisions of Article 4A, as incorporated in subpart B of this part, do not take precedence over provisions of the Expedited Funds Availability Act, this section provides that where subpart B of this part establishes rights or obligations that are also governed by the Expedited Funds Availability Act or Regulation CC, the Expedited Funds Availability Act or Regulation CC provision shall apply and subpart B of this part shall not apply.

(c) *Operating Circulars*. The Federal Reserve Banks issue Operating Circulars consistent with this Subpart that contain additional provisions applicable to payment orders sent through Fedwire. Under section 4A–107, these Operating Circulars supersede inconsistent provisions of Article 4A, as set forth in appendix B and as enacted in any state. These Operating Circulars are not funds-transfer system rules, but, by their terms, they are binding on all parties covered by this Subpart.

(d) *Government senders, receiving banks, and beneficiaries*. This section clarifies that unless a statute of the United States provides otherwise, subpart B of this part applies to governmental entities, domestic or foreign, including foreign central banks as specified in paragraph (b)(1) of this section.

Section 210.26—Definitions

Article 4A defines many terms (e.g., *beneficiary, intermediary bank, receiving bank, security procedure*) used in this subpart. These terms are defined or listed in sections 4A–103 through 4A–105. These terms, such as the term *bank* (defined in section 4A–105(d)(2)), may differ from comparable terms in subpart A of this part. As subpart B of this part incorporates consistent provisions of Article 4A, it incorporates these definitions unless these terms are expressly defined otherwise in subpart B of this part. This subpart modifies the definitions of two Article 4A terms, *beneficiary's bank* and *payment order*. This subpart also defines terms not defined in Article 4A.

(a) *Article 4A. Article 4A* means the version of that article of the Uniform Commercial Code set forth in appendix B of this subpart. It does not refer to the law of any particular state unless the context indicates otherwise.

Subject to the express provisions of this Subpart, this version of Article 4A is incorporated into this Subpart and made federal law for transactions covered by this subpart.

(b) *As of adjustments*. As of adjustments are memorandum items that affect a bank's reserve or clearing balance for the purpose of meeting the required balance, but do not represent funds that can be used for other purposes. As discussed in the Commentary to §210.32(b), the Federal Reserve Banks generally provide as of adjustments as a means of effecting interest payments or charges.

(d) *Beneficiary's bank*. The definition of *beneficiary's bank* in subpart B of this part differs from the section 4A–103(a)(3) definition. The subpart B definition clarifies that where a Federal Reserve Bank functions as the beneficiary's bank, it need not be identified in the payment order as the beneficiary's bank and that a Federal Reserve Bank that receives a payment order as beneficiary is also the beneficiary's bank with respect to that payment order.

(e) *Fedwire*. Fedwire refers to the funds-transfer system owned and operated by the Federal Reserve Banks that is governed by this Subpart. The term does not refer to any particular computer, telecommunications facility, or funds transfer, but to the system as a whole, which may include transfers by telephone or by written instrument in particular circumstances. Fedwire does not include the system used for automated clearing house transfers.

(h) *Off-line bank*. Most Fedwire payment orders are transmitted electronically from a sender to a Federal Reserve Bank or from a Federal Reserve Bank to a receiving bank. Banks transmitting payment orders to Federal Reserve Banks electronically are often referred to as on-line banks. Some Fedwire participants, however, transmit payment orders to a Federal Reserve Bank or receive payment orders from a Federal Reserve Bank orally by telephone, or, in unusual circumstances, in writing. A bank that does not use either a terminal or a computer that links it electronically to a terminal or computer at its Federal Reserve Bank to send payment orders through Fedwire is an off-line bank.

(i) *Payment order*. (1) The definition of *payment order* in subpart B of this part differs from the section 4A–103(a)(1) definition. The subpart B definition clarifies that, for the purposes of subpart B of this part, automated clearing house transfers and certain messages that are transmitted through Fedwire are not payment orders. Federal Reserve Banks and banks participating in Fedwire send various types of messages, relating to payment orders or to other matters, through Fedwire that are not intended to be payment orders. Under the subpart B definition, these messages, and messages involved with automated clearing house transfers, are not *payment orders* and therefore are not governed by this subpart. The Operating Circulars of the Federal Reserve Banks specify those messages that may be transmitted through Fedwire but that are not payment orders.

(2) In some cases, messages sent through Fedwire, such as certain requests for credit transfer, may be payment orders under Article 4A, but are not treated as payment orders under subpart B because they are not an instruction to a Federal Reserve Bank to pay money.

(3) This subpart and Article 4A govern a payment order even though the originator's or beneficiary's account may be a consumer account established primarily for personal, family, or household purposes. Under section 4A–108, Article 4A does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act. That Act, and Regulation E implementing it, do not apply to funds transfers through Fedwire (*see* 15 U.S.C. 1693a(6)(B) and 12 CFR 205.3(b)). Thus, this Subpart applies to all funds transfers through Fedwire even though some such transfers involve originators or beneficiaries that are consumers. (*See also* §210.25(b) and accompanying Commentary.)

Section 210.27—Reliance on Identifying Number

(a) *Reliance by a Federal Reserve Bank on number to identify intermediary bank or beneficiary's bank*. Section 4A–208 provides that a receiving bank, such as a Federal Reserve Bank, may rely on the routing number of an intermediary bank or the beneficiary's bank specified in a payment order as identifying the appropriate intermediary bank or beneficiary's bank, even if the payment order identifies another bank by name, provided that the receiving bank does not know of the inconsistency. Under section 4A–208(b)(2), if the sender of the payment order is not a bank, a receiving bank may rely on the number only if the sender had notice before the receiving bank accepted the sender's order that the receiving bank might rely on the number. This section provides this notice to entities that are not banks, such as the Department of the Treasury, that send payment orders directly to a Federal Reserve Bank.

(b) *Reliance by a Federal Reserve Bank on number to identify beneficiary*. Section 4A–207 provides that a beneficiary's bank, such as a Federal Reserve Bank, may rely on the number identifying a beneficiary, such as the beneficiary's account number, specified in a payment order as identifying the appropriate beneficiary, even if the payment order identifies another beneficiary by name, provided that the beneficiary's bank does not know of the inconsistency. Under section 4A–207(c)(2), if the originator is not a bank, an originator is not obliged to pay for a payment order if the originator did not have notice that the

beneficiary's bank might rely on the identifying number and the person paid on the basis of the identifying number was not entitled to receive payment. This section of subpart B provides this notice to entities that are not banks, such as the Department of the Treasury, that are originators of payment orders sent directly by the originators to a Federal Reserve Bank, where that Federal Reserve Bank or another Federal Reserve Bank is the beneficiary's bank (*see also* section 4A–402(b), providing that a sender must pay a beneficiary's bank for a payment order accepted by the beneficiary's bank).

Section 210.28—Agreement of Sender

(a) *Payment of sender's obligation to a Federal Reserve Bank.* When a sender issues a payment order to a Federal Reserve Bank and the Federal Reserve Bank issues a conforming order implementing the sender's payment order, under section 4A–403, the sender is indebted to the Federal Reserve Bank for the amount of the payment order. A sender, other than a Federal Reserve Bank, that maintains or uses an account at a Federal Reserve Bank authorizes the Federal Reserve Bank to debit that account so that the Federal Reserve Bank can obtain payment for the payment order.

(b) *Overdrafts.* (1) In some cases, debits to a sender's account will create an overdraft in the sender's account. The Board and the Federal Reserve Banks have established policies concerning when a Federal Reserve Bank will permit a bank to incur an overdraft in its account at a Federal Reserve Bank. These policies do not give a bank or other sender a right to an overdraft in its account. Subpart B clarifies that a sender does not have a right to such an overdraft. If an overdraft arises, it becomes immediately due and payable at the earliest of: The end of the funds-transfer business day of the Federal Reserve Bank; the time the Federal Reserve Bank in its sole discretion, deems itself insecure and gives notice to the sender; or the time that the sender suspends payments or is closed by governmental action, such as the appointment of a receiver. In some cases, a Federal Reserve Bank extends its Fedwire operations beyond its cut-off hour for that funds-transfer business day. For the purposes of this section, unless otherwise specified by the Federal Reserve Bank making such an extension, an overdraft becomes due and payable at the end of the extended operating hours. An overdraft becomes due and payable prior to a Federal Reserve Bank's cut-off hour if the Federal Reserve Bank deems itself insecure and gives notice to the sender. Notice that the Federal Reserve Bank deems itself insecure may be given in accordance with the provisions on notice in section 1–201(27) of the UCC, in accordance with any other applicable law or agreement, or by any other reasonable means. An overdraft also becomes due and payable at the time that a bank is closed or suspends payments. For example, an overdraft becomes due and payable if a receiver is appointed for the bank or the bank is prevented from making payments by governmental order. The Federal Reserve Bank need not make demand on the sender for the overdraft to become due and payable.

(2) A sender must cover any overdraft and any other obligation of the sender to the Federal Reserve Bank by the time the overdraft becomes due and payable. By sending a payment order to a Federal Reserve Bank, the sender grants a security interest to the Federal Reserve Bank in any assets of the sender held by, or for the account of, the Federal Reserve Bank in order to secure all obligations due or to become due to the Federal Reserve Bank. The security interest attaches when the overdraft, or other obligation of the sender to the Federal Reserve Bank, becomes due and payable. The security interest does not apply to assets held by the sender as custodian or trustee for the sender's customers or third parties. Once an overdraft is due and payable, a Federal Reserve Bank may exercise its right of set off, liquidate collateral, or take other similar action to satisfy the overdrafting bank's obligation owed to the Federal Reserve Bank.

(c) *Review of payment orders.* (1) Under section 4A–204, a receiving bank is required to refund the principal amount of an unauthorized payment order that the sender was not obliged to pay, together with interest on the refundable amount calculated from the date that the receiving bank received payment to the date of the refund. The sender is not entitled to compensation in the form of interest if the sender fails to exercise ordinary care to determine that the order was not authorized and to notify the receiving bank within a reasonable period of time after the sender receives a notice that the payment order was accepted or that the sender's account was debited with respect to the order. Similarly, under section 4A–304, if a sender of a payment order that was erroneously executed does not notify the bank receiving the payment order within a reasonable time, the bank is not liable to the sender for compensation in the form of interest on any amount refundable to the sender. Section 210.28(c) establishes 30 calendar days as the reasonable period of time for the purposes of these provisions of Article 4A.

(2) Section 4A–505 provides that a customer must object to a debit to its account by a receiving bank within one year after the customer received notification reasonably identifying the payment order. Subpart B of this part does not vary this one-year period.

Section 210.29—Agreement of Receiving Bank

(b) *Off-line banks.* (1) Generally, an on-line bank receiving payment orders or advices of

credit for payment orders from a Federal Reserve Bank receives the payment orders or advices electronically a short time after the corresponding payment orders are received by the on-line bank's Federal Reserve Bank. An off-line bank receiving payment orders or advices of credit from a Federal Reserve Bank does not have an electronic connection with the Federal Reserve Bank; therefore, payment orders or advices are transmitted either by telephone on the day the payment order is received by the receiving bank's Federal Reserve Bank, or sent by courier or mail along with the off-line bank's daily account statement, on the funds-transfer business day following the day the payment order is received by the off-line bank's Federal Reserve Bank.

(2) Under section 4A–302(a)(2), a Federal Reserve Bank must transmit payment orders at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date, or as soon thereafter as is feasible. Therefore, where an off-line receiving bank is an intermediary bank or beneficiary's bank in a payment order, its Federal Reserve Bank attempts to transmit the payment order to the off-line bank by telephone on the day the payment order is received by the Federal Reserve Bank. A Federal Reserve Bank can generally identify these payment orders from the type code designated in the payment order.

(3) Under section 4A–404(b), if a payment order instructs payment to the account of the beneficiary, the beneficiary's bank must notify the beneficiary of the receipt of a payment order before midnight of the next funds-transfer business day following the payment date. Where an off-line bank is the beneficiary of a payment order, telephone notice by a Federal Reserve Bank to the off-line bank of the receipt of the order is not required by Article 4A because the Federal Reserve Bank sends notice to the off-line bank by courier or mail, along with its daily account statement, on the day after the payment order is received by its Federal Reserve Bank. Payment orders for which an off-line bank is the beneficiary of the order are generally designated as settlement transactions.

(4) If an off-line receiving bank maintains an account for another bank, the off-line bank may receive payment orders designated as settlement transactions in its capacity as beneficiary's bank or intermediary bank. A Federal Reserve Bank cannot readily distinguish these payment orders from settlement transactions for which the off-line bank is the beneficiary of the order. If an off-line bank notifies its Federal Reserve Bank that it maintains an account for another bank, the Federal Reserve Bank will attempt to telephone the off-line bank with respect to all settlement transactions received by such bank, whether the off-line bank is the beneficiary, the beneficiary's bank, or an intermediary bank in the payment order. Under this section, an off-line bank that does not expressly notify its Federal Reserve Bank in writing that it maintains an account for another bank warrants to that Federal Reserve Bank that it does not act as an intermediary bank or a beneficiary's bank for a bank beneficiary with respect to payment orders received through Fedwire.

Section 210.30—Payment Orders

(a) *Rejection.* (1) A sender must make arrangements with its Federal Reserve Bank before it can send payment orders to the Federal Reserve Bank. Federal Reserve Banks reserve the right to reject or impose conditions on the acceptance of payment orders for any reason. For example, a Federal Reserve Bank might reject or impose conditions on accepting a payment order where a sender does not have sufficient funds in its account with the Federal Reserve Bank to cover the amount of the sender's payment order and other obligations of the sender due or to become due to the Federal Reserve Bank. A Federal Reserve Bank may require a sender to execute a written agreement concerning security procedures or other matters before the sender may send payment orders to the Federal Reserve Bank.

(b) *Selection of an intermediary bank.* (1) Under section 4A–302, if a receiving bank (other than a beneficiary's bank), such as a Federal Reserve Bank, accepts a payment order, it must issue a payment order that complies with the sender's order. The sender's order may include instructions concerning an intermediary bank to be used that must be followed by a receiving bank (*see* section 4A–302(a)(1)). If the sender does not designate any intermediary bank in its payment order, the receiving bank may select an intermediary bank through which the sender's payment order can be expeditiously issued to the beneficiary's bank so long as the receiving bank exercises ordinary care in selecting the intermediary bank (*see* section 4A–302(b)).

(2) This section provides that in an interdistrict transfer, a Federal Reserve Bank is authorized and directed to select another Federal Reserve Bank as an intermediary bank. A sender may, however, instruct a Federal Reserve Bank to use a particular intermediary bank by designating that bank as the bank to be credited by that Federal Reserve Bank (or the second Federal Reserve Bank in the case of an interdistrict transfer) in its payment order, in which case the Federal Reserve Bank will send the payment order to that bank if that bank receives payment orders through Fedwire. A sender may not instruct a Federal Reserve Bank to use its discretion to select an intermediary bank other than a Federal Reserve Bank or an intermediary bank designated by the sender.

In addition, a sender may not instruct a Federal Reserve Bank to use a funds-transfer system or means of transmission other than Fedwire unless the sender and the Federal Reserve Bank agree in writing to the use of the funds-transfer system or means of transmission.

(c) *Same-day execution.* Generally, Fedwire is a same-day value transfer system through which funds may be transferred from the originator to the beneficiary on the same funds-transfer business day. A sender may not send a payment order to a Federal Reserve Bank that specifies an execution date or payment date later than the day on which the payment order is issued, unless the sender of the order and the Federal Reserve Bank agree in writing to the arrangement.

Section 210.31—Payment by a Federal Reserve Bank to a Receiving Bank or Beneficiary

(a) *Payment to a receiving bank.* (1) Under section 4A–402, when a Federal Reserve Bank executes a sender's payment order by issuing a conforming order to a receiving bank that accepts the payment order, the Federal Reserve Bank must pay the receiving bank the amount of the payment order. Section 210.29(a) authorizes a Federal Reserve Bank to make the payment by crediting the account at the Federal Reserve Bank maintained or used by the receiving bank. Section 210.31(a) provides that the payment occurs when the receiving bank's account is credited or when the payment order is sent by the Federal Reserve Bank to the receiving bank, whichever is earlier. Ordinarily, payment will occur during the funds-transfer business day a short time after the payment order is received, even if the receiving bank is an off-line bank. This credit is final and irrevocable when made and constitutes final settlement under section 4A–403. Payment does not waive a Federal Reserve Bank's right of recovery under the applicable law of mistake and restitution (*see* §210.32(c)), affect a Federal Reserve Bank's right to apply the funds to any obligation due or to become due to the Federal Reserve Bank, or affect legal process or claims by third parties on the funds.

(2) This section on final payment does not apply to settlement for payment orders between Federal Reserve Banks. These payment orders are settled by other means.

(b) *Payment to a beneficiary.* Section 210.31(b) specifies when a Federal Reserve Bank makes payment to a beneficiary for which it is the beneficiary's bank. As in the case of payment to a receiving bank, this payment occurs at the earlier of the time that the Federal Reserve Bank credits the beneficiary's account or sends notice of the credit to the beneficiary, and is final and irrevocable when made.

Section 210.32—Federal Reserve Bank Liability; Payment of Interest

(a) *Damages.* (1) Under section 4A–305(d), damages for failure of a receiving bank to execute a payment order that it was obligated to execute by express agreement are limited to expenses in the transaction and incidental expenses and interest and do not include additional damages, including consequential damages, unless they are provided for in an express written agreement of the receiving bank. This section clarifies that in connection with the handling of payment orders, Federal Reserve Banks may not agree to be liable for consequential damages under this provision and shall not be liable for damages other than those that may be due under Article 4A to parties governed by this subpart. Any agreement in conflict with these provisions would not be effective, because it would be in violation of subpart B.

(2) This section does not affect the ability of other parties to a funds transfer to agree to be liable for consequential damages, the liability of a Federal Reserve Bank under section 4A–404, or the liability to parties governed by subpart B for claims not based on the handling of a payment order under this subpart.

(b) *Payment of interest.* (1) Under Article 4A, a Federal Reserve Bank may be required to pay compensation in the form of interest to another party in connection with its handling of a funds transfer. For example, payment of compensation in the form of interest is required in certain situations pursuant to sections 4A–204 (relating to refund of payment and duty of customer to report with respect to unauthorized payment order), 4A–209 (relating to acceptance of payment order), 4A–210 (relating to rejection of payment order), 4A–304 (relating to duty of sender to report erroneously executed payment order), 4A–305 (relating to liability for late or improper execution or failure to execute a payment order), 4A–402 (relating to obligation of sender to pay receiving bank), and 4A–404 (relating to obligation of beneficiary's bank to pay and give notice to beneficiary). Under section 4A–506(a), the amount of such interest may be determined by agreement between the sender and receiving bank or by funds-transfer system rule. If there is no such agreement, under section 4A–506(b), the amount of interest is based on the Federal funds rate. Section 210.32(b) provides two means by which Federal Reserve Banks may provide compensation in the form of interest: through an as of adjustment or through an explicit interest payment.

(2) An as of adjustment is a memorandum credit or debit that is applied to the reserve or clearing balance of the bank that sent the payment order to, or received the payment order from, a Federal Reserve Bank. Federal

Reserve Banks generally provide as of adjustments to correct errors and recover float. An as of adjustment differs from a debit or credit to an account in that it does not affect the actual balance of the account; it only affects the balance for reserve or clearing balance computation purposes. These adjustments affect the level of reserve or clearing balances that the bank must fund by other means and are therefore an effective substitute for explicit interest payments.

(3) A party that sent or received a payment order from a Federal Reserve Bank may be unable to make use of an as of adjustment as compensation in lieu of explicit interest. For example, if the sender or receiving bank is not subject to reserve requirements or satisfies its reserve requirements with vault cash, the as of adjustment could not be used to free other balances for investment. A Federal Reserve Bank may, in its discretion, provide compensation by an explicit interest payment rather than through an as of adjustment. Interest would be calculated in accordance with the procedures specified in section 4A–506(b). Similarly, compensation in the form of explicit interest will be paid to Government senders, receiving banks, or beneficiaries described in §210.25(d) if they are entitled to interest under this subpart. A Federal Reserve Bank may also, in its discretion, pay explicit interest directly to a remote party to a Fedwire funds transfer that is entitled to interest, rather than providing compensation to its direct sender or receiving bank.

(4) If a bank that received an as of adjustment or explicit interest payment is not the party entitled to interest compensation under Article 4A, the bank must pass the benefit of the as of adjustment or explicit interest payment made to it to the party that is entitled to compensation in the form of interest from a Federal Reserve Bank. The benefit may be passed on either in the form of a direct payment of interest or in the form of a compensating balance, if the party entitled to interest agrees to accept the other form of compensation, and the value of the compensating balance is at least equivalent to the value of the explicit interest that otherwise would have been provided.

(c) *Nonwaiver of right of recovery.* Several sections of Article 4A allow for a party to a funds transfer to make a claim pursuant to the applicable law of mistake and restitution. Nothing in subpart B of this part or any Operating Circular issued under subpart B of this part waives any such claim. A Federal Reserve Bank, however, may waive such a claim by express written agreement in order to settle litigation or for other purposes.

[55 FR 40801, Oct. 5, 1990; 55 FR 47428, Nov. 13, 1990]

APPENDIX B TO SUBPART B—ARTICLE 4A, FUNDS TRANSFERS

Part 1—Subject Matter and Definitions

Section 4A–101. Short Title

This Article may be cited as Uniform Commercial Code—Funds Transfers.

Section 4A–102. Subject Matter

Except as otherwise provided in section 4A–108, this Article applies to funds transfers defined in section 4A–104.

Section 4A–103. Payment Order—Definitions

(a) In this Article:

(1) *Payment order* means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) The instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) The receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) The instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(2) *Beneficiary* means the person to be paid by the beneficiary's bank.

(3) *Beneficiary's bank* means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(4) *Receiving bank* means the bank to which the sender's instruction is addressed.

(5) *Sender* means the person giving the instruction to the receiving bank.

(b) If an instruction complying with subsection (a)(1) is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank.

Section 4A–104. Funds Transfer—Definitions

In this Article:

(a) *Funds transfer* means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(b) *Intermediary bank* means a receiving bank other than the originator's bank or the beneficiary's bank.

(c) *Originator* means the sender of the first payment order in a funds transfer.

(d) *Originator's bank* means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank.

Section 4A–105. Other Definitions

(a) In this Article:

(1) *Authorized account* means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(2) *Bank* means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.

(3) *Customer* means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(4) *Funds-transfer business day* of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(5) *Funds-transfer system* means a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(6) *Good faith* means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) *Prove* with respect to a fact means to meet the burden of establishing the fact (section 1–201(8)).

(b) Other definitions applying to this Article and the sections in which they appear are:

Acceptance ....Sec. 4A–209
Beneficiary ....Sec. 4A–103
Beneficiary's bank ....Sec. 4A–103
Executed ....Sec. 4A–301
Execution date ....Sec. 4A–301
Funds transfer ....Sec. 4A–104
Funds-transfer system rule ....Sec. 4A–501
Intermediary bank ....Sec. 4A–104
Originator ....Sec. 4A–104
Originator's bank ....Sec. 4A–104
Payment by beneficiary's bank to beneficiary ....Sec. 4A–405
Payment by originator to beneficiary ....Sec. 4A–406
Payment by sender to receiving bank ....Sec. 4A–403
Payment date ....Sec. 4A–401
Payment order ....Sec. 4A–103
Receiving bank ....Sec. 4A–103
Security procedure ....Sec. 4A–201
Sender ....Sec. 4A–103

(c) The following definitions in Article 4 apply to this Article:

Clearing house ....Sec. 4–104
Item ....Sec. 4–104
Suspends payments ....Sec. 4–104

(d) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Section 4A–106. Time Payment Order is Received

(a) The time of receipt of a payment order or communication canceling or amending a payment order is determined by the rules applicable to receipt of a notice stated in section 1–201(27). A receiving bank may fix a cut-off time or times on a funds-transfer business day for the receipt and processing of payment orders and communications canceling or amending payment orders. Different cut-off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cut-off time may apply to senders generally or different cut-off times may apply to different senders or categories of payment orders. If a payment order or communication canceling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cut-off time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this Article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this Article.

Section 4A–107. Federal Reserve Regulations and Operating Circulars

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

Section 4A–108. Exclusion of Consumer Transactions Governed by Federal Law

This Article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 (title

XX, Pub. L. 95–630, 92 Stat. 3728, 15 U.S.C. 1693 *et seq.*) as amended from time to time.

Part 2—Issue and Acceptance of Payment Order

Section 4A–201. Security Procedure

Security procedure means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or canceling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

Section 4A–202. Authorized and Verified Payment Orders

(a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term *sender* in this Article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (a), or it is effective as the order of the customer under subsection (b).

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in section 4A–203(a)(1), rights and obligations arising under this section or section 4A–203 may not be varied by agreement.

Section 4A–203. Unenforceability of Certain Verified Payment Orders

(a) If an accepted payment order is not, under section 4A–202(a), an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to section 4A–202(b), the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders.

Section 4A–204. Refund of Payment and Duty of Customer To Report with Respect to Unauthorized Payment Order

(a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under section 4A–202, or (ii) not enforceable, in whole or in part, against the customer under section 4A–203, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not

entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) may be fixed by agreement as stated in section 1–204(1), but the obligation of a receiving bank to refund payment as stated in subsection (a) may not otherwise be varied by agreement.

Section 4A–205. Erroneous Payment Orders

(a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to section 4A–206 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (2) and (3).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of subsection (a), the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in clause (ii) of subsection (a), the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in subsection (a) is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding 90 days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders.

Section 4A–206. Transmission of Payment Order Through Funds-Transfer or Other Communication System

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the Federal Reserve Banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders.

Section 4A–207. Misdescription of Beneficiary

(a) Subject to subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in subsection (c), if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the

name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in subsection (b) is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by subsection (b)(1), the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by subsection (b)(1), if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) If the originator is obliged to pay its payment order as stated in subsection (c), the originator has the right to recover.

(2) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover.

Section 4A–208. Misdescription of Intermediary Bank or Beneficiary's Bank

(a) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in section 4A–302(a)(1).

Section 4A–209. Acceptance of Payment Order

(a) Subject to subsection (d), a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to subsections (c) and (d), a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) When the bank (i) pays the beneficiary as stated in section 4A–405(a) or 4A–405(b), or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or

used until receipt of payment from the sender of the order;

(2) When the bank receives payment of the entire amount of the sender's order pursuant to section 4A–403(a)(1) or 4A–403(a)(2); or

(3) The opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (b)(2) or (b)(3) if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently canceled pursuant to section 4A–211(b), the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution.

Section 4A–210. Rejection of Payment Order

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is canceled pursuant to section 4A–211(d) or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order.

Section 4A–211. Cancellation and Amendment of Payment Order

(a) A communication of the sender of a payment order canceling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to subsection (a), a communication by the sender canceling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is canceled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is canceled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A canceled payment order cannot be accepted. If an accepted payment order is canceled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorney's fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with subsection (c)(2).

Section 4A–212. Liability and Duty of Receiving Bank Regarding Unaccepted Payment Order

If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this Article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in section 4A–209, and liability is limited to that provided in this Article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this Article or by express agreement.

Part 3—Execution of Sender's Payment Order by Receiving Bank

Section 4A–301. Execution and Execution Date

(a) A payment order is *executed* by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) *Execution date* of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date.

Section 4A–302. Obligations of Receiving Bank in Execution of Payment Order

(a) Except as provided in subsections (b) through (d), if the receiving bank accepts a payment order pursuant to section 4A–209(a), the bank has the following obligations in executing the order:

(1) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment

order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(2) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless subsection (a)(2) applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by a particular means, the receiving bank may issue its payment order by transmitting its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner.

Section 4A–303. Erroneous Execution of Payment Order

(a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under section 4A–402(c) if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under section 4A–402(c) if (i) that subsection is otherwise satisfied and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution.

Section 4A–304. Duty of Sender to Report Erroneously Executed Payment Order

If the sender of a payment order that is erroneously executed as stated in section 4A–303 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the notification from the bank was received by

the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under section 4A–402(d) for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section.

Section 4A–305. Liability for Late or Improper Execution or Failure To Execute Payment Order

(a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of section 4A–302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of section 4A–302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a), resulting from the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidential expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorney's fees are recoverable if demand for compensation under subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) may not be varied by agreement.

Part 4—Payment

Section 4A–401. Payment Date

Payment date of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank.

Section 4A–402. Obligation of Sender To Pay Receiving Bank

(a) This section is subject to sections 4A–205 and 4A–207.

(b) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection is subject to subsection (e) and to section 4A–303. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in sections 4A–204 and 4A–304, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in subsection (c) and an intermediary bank is obliged to refund payment as stated in subsection (d) but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in section 4A–302(a)(1), to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in subsection (d).

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (c) or

to receive refund under subsection (d) may not be varied by agreement.

Section 4A–403. Payment by Sender To Receiving Bank

(a) Payment of the sender's obligation under section 4A–402 to pay the receiving bank occurs as follows:

(1) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a Federal Reserve Bank or through a funds-transfer system.

(2) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(3) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under section 4A–402 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by subsection (a), the time when payment of the sender's obligation under section 4A–402(b) or 4A–402(c) occurs is governed by applicable principles of law that determine when an obligation is satisfied.

Section 4A–404. Obligation of Beneficiary's Bank To Pay and Give Notice to Beneficiary

(a) Subject to sections 4A–211(e), 4A–405(d), and 4A–405(e), if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in subsection (a) may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (b) may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer.

Section 4A–405. Payment by Beneficiary's Bank To Beneficiary

(a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under section 4A–404(a) occurs when and to the extent (i) the beneficiary is notified of the right to

withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under section 4A–404(a) occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in subsections (d) and (e), if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfer made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under section 4A–406.

(e) This subsection applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations-multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under section 4A–406, and (iv) subject to section 4A–402(e), each sender in the funds transfer is excused from its obligation to pay its payment order under section 4A–402(c) because the funds transfer has not been completed.

Section 4A–406. Payment by Originator to Beneficiary; Discharge of Underlying Obligation

(a) Subject to sections 4A–211(e), 4A–405(d), and 4A–405(e), the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under subsection (a) is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under subsection (a) was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract. If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under section 4A–404(a).

(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary.

Part 5—Miscellaneous Provisions

Section 4A–501. Variation by Agreement and Effect of Funds-Transfer System Rule

(a) Except as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) *Funds-transfer system rule* means a rule of an association of banks (i) governing transmission of payment orders by means of

a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in sections 4A–404(c), 4A–405(d), and 4A–507(c).

Section 4A–502. Creditor Process Served on Receiving Bank; Setoff by Beneficiary's Bank

(a) As used in this section, *creditor process* means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(2) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(3) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owned by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process.

Section 4A–503. Injunction or Restraining Order with Respect to Funds Transfer

For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer.

Section 4A–504. Order In Which Items and Payment Orders May Be Charged to Account; Order of Withdrawals from Account

(a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied.

Section 4A–505. Preclusion of Objection to Debit of Customer's Account

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer.

Section 4A–506. Rate of Interest

(a) If, under this Article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in subsection (a), the amount is calculated by multiplying the applicable Federal Funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable Federal Funds rate is the average of the Federal Funds rates published by the Federal Reserve Bank of New York for each of the days for which interest is payable divided by 360. The Federal Funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank.

Section 4A–507. Choice of Law

(a) The following rules apply unless the affected parties otherwise agree or subsection (c) applies:

(1) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(2) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(3) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of subsection (a) have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to clause (i) is binding on participating banks. A choice of law made pursuant to clause (ii) is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under subsection (b) and a choice-of-law rule under subsection (c), the agreement under subsection (b) prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue.

[55 FR 40801, Oct. 5, 1990; 55 FR 47428, Nov. 13, 1990]

PART 211—INTERNATIONAL BANKING OPERATIONS (REGULATION K)

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AUTHORITY: 12 U.S.C. 221 *et seq.*, 1818, 1835a, 1841 *et seq.*, 3101 *et seq.*, and 3901 *et seq.*; 15 U.S.C. 6801 and 6805.

Subpart A—International Operations of U.S. Banking Organizations

SOURCE: 66 FR 54374, Oct. 26, 2001, unless otherwise noted.

§211.1 Authority, purpose, and scope.

(a) *Authority*. This subpart is issued by the Board of Governors of the Federal Reserve System (Board) under the authority of the Federal Reserve Act (FRA) (12 U.S.C. 221 *et seq.*); the Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978 (IBA) (12 U.S.C. 3101 *et seq.*).

(b) *Purpose*. This subpart sets out rules governing the international and foreign activities of U.S. banking organizations, including procedures for establishing foreign branches and Edge and agreement corporations to engage in international banking, and for investments in foreign organizations.

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

(1) Member banks with respect to their foreign branches and investments in foreign banks under section 25 of the FRA (12 U.S.C. 601–604a);[1] and

(2) Corporations organized under section 25A of the FRA (12 U.S.C. 611–631) (Edge corporations);

(3) Corporations having an agreement or undertaking with the Board under section 25 of the FRA (12 U.S.C. 601–604a) (agreement corporations); and

(4) Bank holding companies with respect to the exemption from the nonbanking prohibitions of the BHC Act afforded by section 4(c)(13) of that act (12 U.S.C. 1843(c)(13)).

§211.2 Definitions.

Unless otherwise specified, for purposes of this subpart:

(a) An *affiliate* of an organization means:

(1) Any entity of which the organization is a direct or indirect subsidiary; or

(2) Any direct or indirect subsidiary of the organization or such entity.

(b) *Capital Adequacy Guidelines* means the ''Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure'' (12 CFR part 208, app. A) or the ''Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure'' (12 CFR part 225, app. A).

(c) *Capital and surplus* means, unless otherwise provided in this part:

(1) For organizations subject to the Capital Adequacy Guidelines:

(i) Tier 1 and tier 2 capital included in an organization's risk-based capital (under the Capital Adequacy Guidelines); and

[1] Section 25 of the FRA (12 U.S.C. 601–604a), which refers to national banking associations, also applies to state member banks of the Federal Reserve System by virtue of section 9 of the FRA (12 U.S.C. 321)

(ii) The balance of allowance for loan and lease losses not included in an organization's tier 2 capital for calculation of risk-based capital, based on the organization's most recent consolidated Report of Condition and Income.

(2) For all other organizations, paid-in and unimpaired capital and surplus, and includes undivided profits but does not include the proceeds of capital notes or debentures.

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

(e) *Eligible country* means any country:

(1) For which an allocated transfer risk reserve is required pursuant to § 211.43 of this part and that has restructured its sovereign debt held by foreign creditors; and

(2) Any other country that the Board deems to be eligible.

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

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

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

(1) Voting or nonvoting shares;

(2) General or limited partnership interests;

(3) Any other form of interest conferring ownership rights, including warrants, debt, or any other interests that are convertible into shares or other ownership rights in the organization; or

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

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

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

(1) Is organized under the laws of a foreign country;

(2) Engages in the business of banking;

(3) Is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations;

(4) Receives deposits to a substantial extent in the regular course of its business; and

(5) Has the power to accept demand deposits.

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

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

(m) *Investment* means:

(1) The ownership or control of equity;

(2) Binding commitments to acquire equity;

(3) Contributions to the capital and surplus of an organization; or

(4) The holding of an organization's subordinated debt when the investor and the investor's affiliates hold more than 5 percent of the equity of the organization.

(n) *Investment grade* means a security that is rated in one of the four highest rating categories by:

(1) Two or more NRSROs; or

(2) One NRSRO if the security has been rated by only one NRSRO.

(o) *Investor* means an Edge corporation, agreement corporation, bank holding company, or member bank.

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

(q) *Loans and extensions of credit* means all direct and indirect advances of funds to a person made on the basis

of any obligation of that person to repay the funds.

(r) *NRSRO* means a nationally recognized statistical rating organization as designated by the Securities and Exchange Commission.

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

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

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

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

(1) Engages solely in representational and administrative functions (such as soliciting new business or acting as liaison between the organization's head office and customers in the United States); and

(2) Does not have authority to make any business decision (other than decisions relating to its premises or personnel) for the account of the organization it represents, including contracting for any deposit or deposit-like liability on behalf of the organization.

(w) *Subsidiary* means an organization that has more than 50 percent of its voting shares held directly or indirectly, or that otherwise is controlled or capable of being controlled, by the investor or an affiliate of the investor under any authority. Among other circumstances, an investor is considered to control an organization if:

(1) The investor or an affiliate is a general partner of the organization; or

(2) The investor and its affiliates directly or indirectly own or control more than 50 percent of the equity of the organization.

(x) *Tier 1 capital* has the same meaning as provided under the Capital Adequacy Guidelines.

(y) *Well capitalized* means:

(1) In relation to a parent member or insured bank, that the standards set out in §208.43(b)(1) of Regulation H (12 CFR 208.43(b)(1)) are satisfied;

(2) In relation to a bank holding company, that the standards set out in §225.2(r)(1) of Regulation Y (12 CFR 225.2(r)(1)) are satisfied; and

(3) In relation to an Edge or agreement corporation, that it has tier 1 and total risk-based capital ratios of 6.0 and 10.0 percent, respectively, or greater.

(z) *Well managed* means that the Edge or agreement corporation, any parent insured bank, and the bank holding company received a composite rating of 1 or 2, and at least a satisfactory rating for management if such a rating is given, at their most recent examination or review.

§211.3 Foreign branches of U.S. banking organizations.

(a) *General*—(1) *Definition of banking organization*. For purposes of this section, a *banking organization* is defined as a member bank and its affiliates.

(2) A banking organization is considered to be operating a branch in a foreign country if it has an affiliate that is a member bank, Edge or agreement corporation, or foreign bank that operates an office (other than a representative office) in that country.

(3) For purposes of this subpart, a foreign office of an operating subsidiary of a member bank shall be treated as a foreign branch of the member bank and may engage only in activities permissible for a branch of a member bank.

(4) At any time upon notice, the Board may modify or suspend branching authority conferred by this section with respect to any banking organization.

(b) (1) *Establishment of foreign branches*. (i) Foreign branches may be established by any member bank having capital and surplus of $1,000,000 or more, an Edge corporation, an agreement corporation, any subsidiary the shares of which are held directly by the member bank, or any other subsidiary held pursuant to this subpart.

(ii) The Board grants its general consent under section 25 of the FRA (12 U.S.C. 601–604a) for a member bank to establish a branch in the Commonwealth of Puerto Rico and the overseas territories, dependencies, and insular possessions of the United States.

(2) *Prior notice*. Unless otherwise provided in this section, the establishment of a foreign branch requires 30 days' prior written notice to the Board.

(3) *Branching into additional foreign countries*. After giving the Board 12 business days prior written notice, a

banking organization that operates branches in two or more foreign countries may establish a branch in an additional foreign country.

(4) *Additional branches within a foreign country*. No prior notice is required to establish additional branches in any foreign country where the banking organization operates one or more branches.

(5) *Branching by nonbanking affiliates*. No prior notice is required for a nonbanking affiliate of a banking organization (*i.e.*, an organization that is not a member bank, an Edge or agreement corporation, or foreign bank) to establish branches within a foreign country or in additional foreign countries.

(6) *Expiration of branching authority*. Authority to establish branches, when granted following prior written notice to the Board, shall expire one year from the earliest date on which the authority could have been exercised, unless extended by the Board.

(c) *Reporting*. Any banking organization that opens, closes, or relocates a branch shall report such change in a manner prescribed by the Board.

(d) *Reserves of foreign branches of member banks*. Member banks shall maintain reserves against foreign branch deposits when required by Regulation D (12 CFR part 204).

(e) *Conditional approval; access to information*. The Board may impose such conditions on authority granted by it under this section as it deems necessary, and may require termination of any activities conducted under authority of this section if a member bank is unable to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

§ 211.4 Permissible activities and investments of foreign branches of member banks.

(a) *Permissible activities and investments*. In addition to its general banking powers, and to the extent consistent with its charter, a foreign branch of a member bank may engage in the following activities and make the following investments, so far as is usual in connection with the business of banking in the country where it transacts business:

(1) *Guarantees*. Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events (including, but not limited to, nonpayment of taxes, rentals, customs duties, or costs of transport, and loss or nonconformance of shipping documents) if the guarantee or agreement specifies a maximum monetary liability; however, except to the extent that the member bank is fully secured, it may not have liabilities outstanding for any person on account of such guarantees or agreements which, when aggregated with other unsecured obligations of the same person, exceed the limit contained in section 5200(a)(1) of the Revised Statutes (12 U.S.C. 84) for loans and extensions of credit;

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

(A) The national government of the country where the branch is located and any political subdivision of that country;

(B) An agency or instrumentality of the national government of the country where the branch is located where such obligations are supported by the taxing authority, guarantee, or full faith and credit of that government;

(C) The national government or political subdivision of any country, where such obligations are rated investment grade; and

(D) An agency or instrumentality of any national government where such obligations are rated investment grade and are supported by the taxing authority, guarantee or full faith and credit of that government.

(ii) No member bank, under authority of this paragraph (a)(2), may hold, or be under commitment with respect to, such obligations for its own account in relation to any one country in an amount exceeding the greater of:

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

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

(3) *Other investments*. (i) Invest in:

(A) The securities of the central bank, clearinghouses, governmental entities other than those authorized under paragraph (a)(2) of this section, and government-sponsored development banks of the country where the foreign branch is located;

(B) Other debt securities eligible to meet local reserve or similar requirements; and

(C) Shares of automated electronic-payments networks, professional societies, schools, and the like necessary to the business of the branch;

(ii) The total investments of a bank's branches in a country under this paragraph (a)(3) (exclusive of securities held as required by the law of that country or as authorized under section 5136 of the Revised Statutes (12 U.S.C. 24, Seventh)) may not exceed 1 percent of the total deposits of the bank's branches in that country on the preceding year-end call report date (or on the date of acquisition of the branch, in the case of a branch that has not been so reported);

(4) *Real estate loans.* Take liens or other encumbrances on foreign real estate in connection with its extensions of credit, whether or not of first priority and whether or not the real estate has been improved;

(5) *Insurance.* Act as insurance agent or broker;

(6) *Employee benefits program.* Pay to an employee of the branch, as part of an employee benefits program, a greater rate of interest than that paid to other depositors of the branch;

(7) *Repurchase agreements.* Engage in repurchase agreements involving securities and commodities that are the functional equivalents of extensions of credit;

(8) *Investment in subsidiaries.* With the Board's prior approval, acquire all of the shares of a company (except where local law requires other investors to hold directors' qualifying shares or similar types of instruments) that engages solely in activities:

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

(ii) That are incidental to the activities of the foreign branch.

(b) *Other activities.* With the Board's prior approval, engage in other activities that the Board determines are usual in connection with the transaction of the business of banking in the places where the member bank's branches transact business.

§211.5 Edge and agreement corporations.

(a) *Board Authority.* The Board shall have the authority to approve:

(1) The establishment of Edge corporations;

(2) Investments in agreement corporations; and

(3) A member bank's proposal to invest more than 10 percent of its capital and surplus in the aggregate amount of stock held in all Edge and agreement corporations.

(b) *Organization of an Edge corporation*—(1) *Permit.* A proposed Edge corporation shall become a body corporate when the Board issues a permit approving its proposed name, articles of association, and organization certificate.

(2) *Name.* The name of the Edge corporation shall include *international*, *foreign*, *overseas*, or a similar word, but may not resemble the name of another organization to an extent that might mislead or deceive the public.

(3) *Federal Register notice.* The Board shall publish in the FEDERAL REGISTER notice of any proposal to organize an Edge corporation and shall give interested persons an opportunity to express their views on the proposal.

(4) *Factors considered by Board.* The factors considered by the Board in acting on a proposal to organize an Edge corporation include:

(i) The financial condition and history of the applicant;

(ii) The general character of its management;

(iii) The convenience and needs of the community to be served with respect to international banking and financing services; and

(iv) The effects of the proposal on competition.

(5) *Authority to commence business.* After the Board issues a permit, the Edge corporation may elect officers and otherwise complete its organization, invest in obligations of the U.S. government, and maintain deposits with depository institutions, but it may not exercise any other powers

until at least 25 percent of the authorized capital stock specified in the articles of association has been paid in cash, and each shareholder has paid in cash at least 25 percent of that shareholder's stock subscription.

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

(c) *Other provisions regarding Edge corporations*—(1) *Amendments to articles of association.* No amendment to the articles of association shall become effective until approved by the Board.

(2) *Shareholders' meeting.* An Edge corporation shall provide in its bylaws that:

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

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

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

(3) *Nature and ownership of shares*—(i) *Shares.* Shares of stock in an Edge corporation may not include no-par-value shares and shall be issued and transferred only on its books and in compliance with section 25A of the FRA (12 U.S.C. 611 *et seq.*) and this subpart.

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

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

(B) Conspicuously set forth the substance of:

(*1*) Any limitations on the rights of ownership and transfer of shares imposed by section 25A of the FRA (12 U.S.C. 611 *et seq.*); and

(*2*) Any rules that the Edge corporation prescribes in its bylaws to ensure compliance with this paragraph (c).

(4) *Change in status of shareholder.* Any change in status of a shareholder that causes a violation of section 25A of the FRA (12 U.S.C. 611 *et seq.*) shall be reported to the Board as soon as possible, and the Edge corporation shall take such action as the Board may direct.

(d) *Ownership of Edge corporations by foreign institutions*—(1) *Prior Board approval.* One or more foreign or foreign-controlled domestic institutions referred to in section 25A(11) of the FRA (12 U.S.C. 619) may apply for the Board's prior approval to acquire, directly or indirectly, a majority of the shares of the capital stock of an Edge corporation.

(2) *Conditions and requirements.* Such an institution shall:

(i) Provide the Board with information related to its financial condition and activities and such other information as the Board may require;

(ii) Ensure that any transaction by an Edge corporation with an affiliate[2] is on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions by the Edge corporation with nonaffiliated persons, and does not involve more than the normal risk of repayment or present other unfavorable features;

(iii) Ensure that the Edge corporation will not provide funding on a continual or substantial basis to any affiliate or office of the foreign institution through transactions that would be inconsistent with the international and foreign business purposes for which Edge corporations are organized; and

(iv) Comply with the limitation on aggregate investments in all Edge and agreement corporations set forth in paragraph (h) of this section.

(3) *Foreign institutions not subject to the BHC Act.* In the case of a foreign institution not subject to section 4 of the BHC Act (12 U.S.C. 1843), that institution shall:

[2] For purposes of this paragraph (d)(2), *affiliate* means any organization that would be an affiliate under section 23A of the FRA (12 U.S.C. 371c) if the Edge corporation were a member bank.

(i) Comply with any conditions that the Board may impose that are necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices in the United States; and

(ii) Give the Board 30 days' prior written notice before engaging in any nonbanking activity in the United States, or making any initial or additional investments in another organization, that would require prior Board approval or notice by an organization subject to section 4 of the BHC Act (12 U.S.C. 1843); in connection with such notice, the Board may impose conditions necessary to prevent adverse effects that may result from such activity or investment.

(e) *Change in control of an Edge corporation*—(1) *Prior notice.* (i) Any person shall give the Board 60 days' prior written notice before acquiring, directly or indirectly, 25 percent or more of the voting shares, or otherwise acquiring control, of an Edge corporation.

(ii) The Board may extend the 60-day period for an additional 30 days by notifying the acquiring party.

(iii) A notice under this paragraph (e) need not be filed where a change in control is effected through a transaction requiring the Board's approval under section 3 of the BHC Act (12 U.S.C. 1842).

(2) *Board review.* In reviewing a notice filed under this paragraph (e), the Board shall consider the factors set forth in paragraph (b)(4) of this section, and may disapprove a notice or impose any conditions that it finds necessary to assure the safe and sound operation of the Edge corporation, to assure the international character of its operation, and to prevent adverse effects, such as decreased or unfair competition, conflicts of interest, or undue concentration of resources.

(f) *Domestic branching by Edge corporations*—(1) *Prior notice.* (i) An Edge corporation may establish branches in the United States 30 days after the Edge corporation has given written notice of its intention to do so to its Reserve Bank, unless the Edge corporation is notified to the contrary within that time.

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

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

(2) *Factors considered.* The factors considered in acting upon a proposal to establish a branch are enumerated in paragraph (b)(4) of this section.

(3) *Expiration of authority.* Authority to establish a branch under prior notice shall expire one year from the earliest date on which that authority could have been exercised, unless the Board extends the period.

(g) *Agreement corporations*—(1) *General.* With the prior approval of the Board, a member bank or bank holding company may invest in a federally or state-chartered corporation that has entered into an agreement or undertaking with the Board that it will not exercise any power that is impermissible for an Edge corporation under this subpart.

(2) *Factors considered by Board.* The factors considered in acting upon a proposal to establish an agreement corporation are enumerated in paragraph (b)(4) of this section.

(h) (1) *Limitation on investment in Edge and agreement corporations.* A member bank may invest up to 10 percent of its capital and surplus in the capital stock of Edge and agreement corporations or, with the prior approval of the Board, up to 20 percent of its capital and surplus in such stock.

(2) *Factors considered by Board.* The factors considered by the Board in acting on a proposal under paragraph (h)(1) of this section shall include:

(i) The composition of the assets of the bank's Edge and agreement corporations;

(ii) The total capital invested by the bank in its Edge and agreement corporations when combined with retained earnings of the Edge and agreement

corporations (including amounts invested in and retained earnings of any foreign bank subsidiaries) as a percentage of the bank's capital;

(iii) Whether the bank, bank holding company, and Edge and agreement corporations are well-capitalized and well-managed;

(iv) Whether the bank is adequately capitalized after deconsolidating and deducting the aggregate investment in and assets of all Edge or agreement corporations and all foreign bank subsidiaries; and

(v) Any other factor the Board deems relevant to the safety and soundness of the member bank.

(i) *Reserve requirements and interest rate limitations.* The deposits of an Edge or agreement corporation are subject to Regulations D and Q (12 CFR parts 204 and 217) in the same manner and to the same extent as if the Edge or agreement corporation were a member bank.

(j) *Liquid funds.* Funds of an Edge or agreement corporation that are not currently employed in its international or foreign business, if held or invested in the United States, shall be in the form of:

(1) Cash;

(2) Deposits with depository institutions, as described in Regulation D (12 CFR part 204), and other Edge and agreement corporations;

(3) Money-market instruments (including repurchase agreements with respect to such instruments), such as bankers' acceptances, federal funds sold, and commercial paper; and

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

(k) *Reports by Edge and agreement corporations of crimes and suspected crimes.* An Edge or agreement corporation, or any branch or subsidiary thereof, shall file a suspicious-activity report in accordance with the provisions of § 208.62 of Regulation H (12 CFR 208.62).

(l) *Protection of customer information.* An Edge or agreement corporation shall comply with the Interagency Guidelines Establishing Standards for Safeguarding Customer Information prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805), set forth in appendix D–2 to part 208 of this chapter.

[66 FR 54374, Oct. 26, 2001, as amended at 66 FR 58655, Nov. 23, 2001]

§ 211.6 Permissible activities of Edge and agreement corporations in the United States.

(a) *Activities incidental to international or foreign business.* An Edge or agreement corporation may engage, directly or indirectly, in activities in the United States that are permitted by section 25A(6) of the FRA (12 U.S.C. 615) and are incidental to international or foreign business, and in such other activities as the Board determines are incidental to international or foreign business. The following activities will ordinarily be considered incidental to an Edge or agreement corporation's international or foreign business:

(1) *Deposit-taking activities*—(i) *Deposits from foreign governments and foreign persons.* An Edge or agreement corporation may receive in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposits) from foreign governments and their agencies and instrumentalities, and from foreign persons.

(ii) *Deposits from other persons.* An Edge or agreement corporation may receive from any other person in the United States transaction accounts, savings, and time deposits (including issuing negotiable certificates of deposit) if such deposits:

(A) Are to be transmitted abroad;

(B) Consist of funds to be used for payment of obligations to the Edge or agreement corporation or collateral securing such obligations;

(C) Consist of the proceeds of collections abroad that are to be used to pay for exported or imported goods or for other costs of exporting or importing or that are to be periodically transferred to the depositor's account at another financial institution;

(D) Consist of the proceeds of extensions of credit by the Edge or agreement corporation;

(E) Represent compensation to the Edge or agreement corporation for extensions of credit or services to the customer;

(F) Are received from Edge or agreement corporations, foreign banks, and other depository institutions (as described in Regulation D (12 CFR part 204)); or

(G) Are received from an organization that by its charter, license, or enabling law is limited to business that is of an international character, including foreign sales corporations, as defined in 26 U.S.C. 922; transportation organizations engaged exclusively in the international transportation of passengers or in the movement of goods, wares, commodities, or merchandise in international or foreign commerce; and export trading companies established under subpart C of this part.

(2) *Borrowings.* An Edge or agreement corporation may:

(i) Borrow from offices of other Edge and agreement corporations, foreign banks, and depository institutions (as described in Regulation D (12 CFR part 204));

(ii) Issue obligations to the United States or any of its agencies or instrumentalities;

(iii) Incur indebtedness from a transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency or instrumentality thereof that the Edge or agreement corporation is obligated to repurchase; and

(iv) Issue long-term subordinated debt that does not qualify as a *deposit* under Regulation D (12 CFR part 204).

(3) *Credit activities.* An Edge or agreement corporation may:

(i) Finance the following:

(A) Contracts, projects, or activities performed substantially abroad;

(B) The importation into or exportation from the United States of goods, whether direct or through brokers or other intermediaries;

(C) The domestic shipment or temporary storage of goods being imported or exported (or accumulated for export); and

(D) The assembly or repackaging of goods imported or to be exported;

(ii) Finance the costs of production of goods and services for which export orders have been received or which are identifiable as being directly for export;

(iii) Assume or acquire participations in extensions of credit, or acquire obligations arising from transactions the Edge or agreement corporation could have financed, including acquisition of obligations of foreign governments;

(iv) Guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events (including, but not limited to, nonpayment of taxes, rentals, customs duties, or cost of transport, and loss or nonconformance of shipping documents), so long as the guarantee or agreement specifies the maximum monetary liability thereunder and is related to a type of transaction described in paragraphs (a)(3)(i) and (ii) of this section; and

(v) Provide credit and other banking services for domestic and foreign purposes to foreign governments and their agencies and instrumentalities, foreign persons, and organizations of the type described in paragraph (a)(1)(ii)(G) of this section.

(4) *Payments and collections.* An Edge or agreement corporation may receive checks, bills, drafts, acceptances, notes, bonds, coupons, and other instruments for collection abroad, and collect such instruments in the United States for a customer abroad; and may transmit and receive wire transfers of funds and securities for depositors.

(5) *Foreign exchange.* An Edge or agreement corporation may engage in foreign exchange activities.

(6) *Fiduciary and investment advisory activities.* An Edge or agreement corporation may:

(i) Hold securities in safekeeping for, or buy and sell securities upon the order and for the account and risk of, a person, provided such services for U.S. persons are with respect to foreign securities only;

(ii) Act as paying agent for securities issued by foreign governments or other entities organized under foreign law;

(iii) Act as trustee, registrar, conversion agent, or paying agent with respect to any class of securities issued to finance foreign activities and distributed solely outside the United States;

(iv) Make private placements of participations in its investments and extensions of credit; however, except to the extent permissible for member banks under section 5136 of the Revised Statutes (12 U.S.C. 24(Seventh)), no Edge or agreement corporation otherwise may engage in the business of underwriting, distributing, or buying or selling securities in the United States;

(v) Act as investment or financial adviser by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real-property interests, and other investment assets,[3] and by providing advice on mergers and acquisitions, provided such services for U.S. persons are with respect to foreign assets only; and

(vi) Provide general economic information and advice, general economic statistical forecasting services, and industry studies, provided such services for U.S. persons shall be with respect to foreign economies and industries only.

(7) *Banking services for employees.* Provide banking services, including deposit services, to the officers and employees of the Edge or agreement corporation and its affiliates; however, extensions of credit to such persons shall be subject to the restrictions of Regulation O (12 CFR part 215) as if the Edge or agreement corporation were a member bank.

(b) *Other activities.* With the Board's prior approval, an Edge or agreement corporation may engage, directly or indirectly, in other activities in the United States that the Board determines are incidental to their international or foreign business.

§ 211.7 Voluntary liquidation of Edge and agreement corporations.

(a) *Prior notice.* An Edge or agreement corporation desiring voluntarily to discontinue normal business and dissolve, shall provide the Board with 45 days' prior written notice of its intent to do so.

(b) *Waiver of notice period.* The Board may waive the 45-day period if it finds that immediate action is required by the circumstances presented.

§ 211.8 Investments and activities abroad.

(a) *General policy.* Activities abroad, whether conducted directly or indirectly, shall be confined to activities of a banking or financial nature and those that are necessary to carry on such activities. In doing so, investors[4] shall at all times act in accordance with high standards of banking or financial prudence, having due regard for diversification of risks, suitable liquidity, and adequacy of capital. Subject to these considerations and the other provisions of this section, it is the Board's policy to allow activities abroad to be organized and operated as best meets corporate policies.

(b) *Direct investments by member banks.* A member bank's direct investments under section 25 of the FRA (12 U.S.C. 601 *et seq.*) shall be limited to:

(1) Foreign banks;

(2) Domestic or foreign organizations formed for the sole purpose of holding shares of a foreign bank;

(3) Foreign organizations formed for the sole purpose of performing nominee, fiduciary, or other banking services incidental to the activities of a foreign branch or foreign bank affiliate of the member bank; and

(4) Subsidiaries established pursuant to § 211.4(a)(8) of this part.

(c) *Eligible investments.* Subject to the limitations set out in paragraphs (b) and (d) of this section, an investor may, directly or indirectly:

(1) *Investment in subsidiary.* Invest in a subsidiary that engages solely in activities listed in § 211.10 of this part, or in such other activities as the Board has determined in the circumstances of a particular case are permissible; provided that, in the case of an acquisition of a going concern, existing activities that are not otherwise permissible for a subsidiary may account for not more

[3] For purposes of this section, management of an investment portfolio does not include operational management of real property, or industrial or commercial assets.

[4] For purposes of this section and §§ 211.9 and 211.10 of this part, a direct subsidiary of a member bank is deemed to be an investor.

than 5 percent of either the consolidated assets or consolidated revenues of the acquired organization;

(2) *Investment in joint venture.* Invest in a joint venture; provided that, unless otherwise permitted by the Board, not more than 10 percent of the joint venture's consolidated assets or consolidated revenues are attributable to activities not listed in §211.10 of this part; and

(3) *Portfolio investments.* Make portfolio investments in an organization, provided that:

(i) *Individual investment limits.* The total direct and indirect portfolio investments by the investor and its affiliates in an organization engaged in activities that are not permissible for joint ventures, when combined with all other shares in the organization held under any other authority, do not exceed:

(A) 40 percent of the total equity of the organization; or

(B) 19.9 percent of the organization's voting shares.

(ii) *Aggregate Investment Limit.* Portfolio investments made under authority of this subpart shall be subject to the aggregate equity limit of §211.10(a)(15)(iii).

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

(iv) *Protecting shareholder rights.* Nothing in this paragraph (c)(3) shall prohibit an investor from otherwise exercising rights it may have as shareholder to protect the value of its investment, so long as the exercise of such rights does not result in the investor's direct or indirect control of the organization.

(d) *Investment limit.* In calculating the amount that may be invested in any organization under this section and §§211.9 and 211.10 of this part, there shall be included any unpaid amount for which the investor is liable and any investments in the same organization held by affiliates under any authority.

(e) *Divestiture.* An investor shall dispose of an investment promptly (unless the Board authorizes retention) if:

(1) The organization invested in:

(i) Engages in impermissible activities to an extent not permitted under paragraph (c) of this section; or

(ii) Engages directly or indirectly in other business in the United States that is not permitted to an Edge corporation in the United States; provided that an investor may:

(A) Retain portfolio investments in companies that derive no more than 10 percent of their total revenue from activities in the United States; and

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

(2) After notice and opportunity for hearing, the investor is advised by the Board that such investment is inappropriate under the FRA, the BHC Act, or this subpart.

(f) *Debts previously contracted.* Shares or other ownership interests acquired to prevent a loss upon a debt previously contracted in good faith are not subject to the limitations or procedures of this section; provided that such interests shall be disposed of promptly but in no event later than two years after their acquisition, unless the Board authorizes retention for a longer period.

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

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

from the government of the eligible country or from its agencies or instrumentalities.

(ii) *Private-sector companies.* A bank holding company may acquire up to and including 40 percent of the shares, including voting shares, of (or other ownership interests in) any other foreign company located in an eligible country subject to the following conditions:

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

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

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

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

(3) *Divestiture*—(i) *Time limits for divestiture.* A bank holding company shall divest the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (g) within the longer of:

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

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

(ii) *Maximum retention period.* Notwithstanding the provisions of paragraph (g)(3)(i) of this section:

(A) Divestiture shall occur within 15 years of the date of acquisition of the shares of, or other ownership interests in, any company acquired pursuant to this paragraph (g); and

(B) A bank holding company may retain such shares or ownership interests if such retention is otherwise permissible at the time required for divestiture.

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

(iv) *Other conditions requiring divestiture.* All investments made pursuant to this paragraph (g) are subject to paragraph (e) of this section requiring prompt divestiture (unless the Board upon application authorizes retention), if the company invested in engages in impermissible business in the United States that exceeds in the aggregate 10 percent of the company's consolidated assets or revenues calculated on an annual basis; provided that such company may not engage in activities in the United States that consist of banking or financial operations (as defined in § 211.23(f)(5)(iii)(B)) of this part, or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)), except under regulations of the Board or with the prior approval of the Board.

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

(ii) All other investments shall be made in accordance with the procedures of § 211.9(f) and (g) of this part, requiring prior notice or specific consent.

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

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

[66 FR 54374, Oct. 26, 2001, as amended at 66 FR 58655, Nov. 23, 2001]

§211.9 Investment procedures.

(a) *General provisions*.[5] Direct and indirect investments shall be made in accordance with the general consent, limited general consent, prior notice, or specific consent procedures contained in this section.

(1) *Minimum capital adequacy standards*. Except as the Board may otherwise determine, in order for an investor to make investments pursuant to the procedures set out in this section, the investor, the bank holding company, and the member bank shall be in compliance with applicable minimum standards for capital adequacy set out in the Capital Adequacy Guidelines; provided that, if the investor is an Edge or agreement corporation, the minimum capital required is total and tier 1 capital ratios of 8 percent and 4 percent, respectively.

(2) *Composite rating*. Except as the Board may otherwise determine, in order for an investor to make investments under the general consent or limited general consent procedures of paragraphs (b) and (c) of this section, the investor and any parent insured bank must have received a composite rating of at least 2 at the most recent examination.

(3) *Board's authority to modify or suspend procedures*. The Board, at any time upon notice, may modify or suspend the procedures contained in this section with respect to any investor or with respect to the acquisition of shares of organizations engaged in particular kinds of activities.

(4) *Long-range investment plan*. Any investor may submit to the Board for its specific consent a long-range investment plan. Any plan so approved shall be subject to the other procedures of this section only to the extent determined necessary by the Board to assure safety and soundness of the operations of the investor and its affiliates.

(5) *Prior specific consent for initial investment*. An investor shall apply for and receive the prior specific consent of the Board for its initial investment under this subpart in its first subsidiary or joint venture, unless an affiliate previously has received approval to make such an investment.

(6) *Expiration of investment authority*. Authority to make investments granted under prior notice or specific consent procedures shall expire one year from the earliest date on which the authority could have been exercised, unless the Board determines a longer period shall apply.

(7) *Conditional approval; Access to information*. The Board may impose such conditions on authority granted by it under this section as it deems necessary, and may require termination of any activities conducted under authority of this subpart if an investor is unable to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

(b) *General consent*. The Board grants its general consent for a well capitalized and well managed investor to make investments, subject to the following:

(1) *Well capitalized and well managed investor*. In order to qualify for making investments under authority of this paragraph (b), both before and immediately after the proposed investment, the investor, any parent insured bank, and any parent bank holding company shall be well capitalized and well managed.

(2) *Individual limit for investment in subsidiary*. In the case of an investment

[5] When necessary, the provisions of this section relating to general consent and prior notice constitute the Board's approval under section 25A(8) of the FRA (12 U.S.C. 615) for investments in excess of the limitations therein based on capital and surplus.

in a subsidiary, the total amount invested directly or indirectly in such subsidiary (in one transaction or a series of transactions) does not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 2 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 2 percent of the tier 1 capital of any parent insured bank or 10 percent of the investor's tier 1 capital, for any other investor.

(3) *Individual limit for investment in joint venture.* In the case of an investment in a joint venture, the total amount invested directly or indirectly in such joint venture (in one transaction or a series of transactions) does not exceed:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company; or

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of the tier 1 capital of any parent insured bank or 5 percent of the investor's tier 1 capital, for any other investor.

(4) *Individual limit for portfolio investment.* In the case of a portfolio investment, the total amount invested directly or indirectly in such company (in one transaction or a series of transactions) does not exceed the lesser of $25 million, or

(i) 5 percent of the investor's tier 1 capital in the case of a bank holding company or its subsidiary, or Edge corporation engaged in banking; or

(ii) 25 percent of the investor's tier 1 capital in the case of an Edge corporation not engaged in banking.

(5) *Investment in a general partnership or unlimited liability company.* An investment in a general partnership or unlimited liability company may be made under authority of paragraph (b) of this section, subject to the limits set out in paragraph (c) of this section.

(6) *Aggregate investment limits*—(i) *Investment limits.* All investments made, directly or indirectly, during the previous 12-month period under authority of this section, when aggregated with the proposed investment, shall not exceed:

(A) 20 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(B) 10 percent of the investor's tier 1 capital, where the investor is a member bank; or

(C) The lesser of 10 percent of the tier 1 capital of any parent insured bank or 50 percent of the tier 1 capital of the investor, for any other investor.

(ii) *Downstream investments.* In determining compliance with the aggregate limits set out in this paragraph (b), an investment by an investor in a subsidiary shall be counted only once, notwithstanding that such subsidiary may, within 12 months of the date of making the investment, downstream all or any part of such investment to another subsidiary.

(7) *Application of limits.* In determining compliance with the limits set out in this paragraph (b), an investor is not required to combine the value of all shares of an organization held in trading or dealing accounts under § 211.10(a)(15) of this part with investments in the same organization.

(c) *Limited general consent*—(1) *Individual limit.* The Board grants its general consent for an investor that is not well capitalized and well managed to make an investment in a subsidiary or joint venture, or to make a portfolio investment, if the total amount invested directly or indirectly (in one transaction or in a series of transactions) does not exceed the lesser of $25 million or:

(i) 5 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 1 percent of the investor's tier 1 capital, where the investor is a member bank; or

(iii) The lesser of 1 percent of any parent insured bank's tier 1 capital or 5 percent of the investor's tier 1 capital, for any other investor.

(2) *Aggregate limit.* The amount of general consent investments made by any investor directly or indirectly under authority of this paragraph (c) during the previous 12-month period, when aggregated with the proposed investment, shall not exceed:

(i) 10 percent of the investor's tier 1 capital, where the investor is a bank holding company;

(ii) 5 percent of the investor's tier 1 capital, where the investor is a member bank; and

(iii) The lesser of 5 percent of any parent insured bank's tier 1 capital or 25 percent of the investor's tier 1 capital, for any other investor.

(3) *Application of limits.* In calculating compliance with the limits of this paragraph (c), the rules set forth in paragraphs (b)(6)(ii) and (b)(7) of this section shall apply.

(d) *Other eligible investments under general consent.* In addition to the authority granted under paragraphs (b) and (c) of this section, the Board grants its general consent for any investor to make the following investments:

(1) *Investment in organization equal to cash dividends.* Any investment in an organization in an amount equal to cash dividends received from that organization during the preceding 12 calendar months; and

(2) *Investment acquired from affiliate.* Any investment that is acquired from an affiliate at net asset value or through a contribution of shares.

(e) *Investments ineligible for general consent.* An investment in a foreign bank may not be made under authority of paragraphs (b) or (c) of this section if:

(1) After the investment, the foreign bank would be an affiliate of a member bank; and

(2) The foreign bank is located in a country in which the member bank and its affiliates have no existing banking presence.

(f) *Prior notice.* An investment that does not qualify for general consent under paragraph (b), (c), or (d) of this section may be made after the investor has given the Board 30 days' prior written notice, such notice period to commence at the time the notice is received, provided that:

(1) The Board may waive the 30-day period if it finds the full period is not required for consideration of the proposed investment, or that immediate action is required by the circumstances presented; and

(2) The Board may suspend the 30-day period or act on the investment under the Board's specific consent procedures.

(g) *Specific consent.* Any investment that does not qualify for either the general consent or the prior notice procedure may not be consummated without the specific consent of the Board.

[66 FR 54374, Oct. 26, 2001, as amended at 66 FR 58655, Nov. 23, 2001]

§ 211.10 Permissible activities abroad.

(a) *Activities usual in connection with banking.* The Board has determined that the following activities are usual in connection with the transaction of banking or other financial operations abroad:

(1) Commercial and other banking activities;

(2) Financing, including commercial financing, consumer financing, mortgage banking, and factoring;

(3) Leasing real or personal property, or acting as agent, broker, or advisor in leasing real or personal property consistent with the provisions of Regulation Y (12 CFR part 225);

(4) Acting as fiduciary;

(5) Underwriting credit life insurance and credit accident and health insurance;

(6) Performing services for other direct or indirect operations of a U.S. banking organization, including representative functions, sale of long-term debt, name-saving, holding assets acquired to prevent loss on a debt previously contracted in good faith, and other activities that are permissible domestically for a bank holding company under sections 4(a)(2)(A) and 4(c)(1)(C) of the BHC Act (12 U.S.C. 1843(a)(2)(A), (c)(1)(C));

(7) Holding the premises of a branch of an Edge or agreement corporation or member bank or the premises of a direct or indirect subsidiary, or holding or leasing the residence of an officer or employee of a branch or subsidiary;

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

(9) General insurance agency and brokerage;

(10) Data processing;

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

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

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

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

(i) *Limits for well-capitalized and well-managed investor*—(A) *General.* After providing 30 days' prior written notice to the Board, an investor that is well capitalized and well managed may underwrite equity securities, provided that commitments by an investor and its subsidiaries for the shares of a single organization do not, in the aggregate, exceed:

(*1*) 15 percent of the bank holding company's tier 1 capital, where the investor is a bank holding company;

(*2*) 3 percent of the investor's tier 1 capital, where the investor is a member bank; or

(*3*) The lesser of 3 percent of any parent insured bank's tier 1 capital or 15 percent of the investor's tier 1 capital, for any other investor;

(B) *Qualifying criteria.* An investor will be considered well-capitalized and well-managed for purposes of paragraph (a)(14)(i) of this section only if each of the bank holding company, member bank, and Edge or agreement corporation qualify as well-capitalized and well-managed.

(ii) *Limits for investor that is not well capitalized and well managed.* After providing 30 days' prior written notice to the Board, an investor that is not well capitalized and well managed may underwrite equity securities, provided that commitments by the investor and its subsidiaries for the shares of an organization do not, in the aggregate, exceed $60 million; and

(iii) *Application of limits.* For purposes of determining compliance with the limitations of this paragraph (a)(14), the investor may subtract portions of an underwriting that are covered by binding commitments obtained by the investor or its affiliates from sub-underwriters or other purchasers;

(15) Dealing in equity securities outside the United States as follows:

(i) *Grandfathered authority.* By an investor, or an affiliate, that had commenced such activities prior to March 27, 1991, and subject to the limitations in effect at that time (See 12 CFR part 211, revised January 1, 1991); or

(ii) *Limit on shares of a single issuer.* After providing 30 days' prior written notice to the Board, an investor may deal in the shares of an organization where the shares held in the trading or dealing accounts of an investor and its affiliates under authority of this paragraph (a)(15) do not in the aggregate exceed the lesser of:

(A) $40 million; or

(B) 10 percent of the investor's tier 1 capital;

(iii) *Aggregate equity limit.* The total shares held directly and indirectly by the investor and its affiliates under authority of this paragraph (a)(15) and § 211.8(c)(3) of this part in organizations engaged in activities that are not permissible for joint ventures do not exceed:

(A) 25 percent of the bank holding company's tier 1 capital, where the investor is a bank holding company;

(B) 20 percent of the investor's tier 1 capital, where the investor is a member bank;[6] and

(C) The lesser of 20 percent of any parent insured bank's tier 1 capital or 100 percent of the investor's tier 1 capital, for any other investor;

(iv) *Determining compliance with limits*—(A) *General.* For purposes of determining compliance with all limits set out in this paragraph (a)(15):

(*1*) Long and short positions in the same security may be netted; and

(*2*) Except as provided in paragraph (a)(15)(iv)(B)(*4*) of this section, equity securities held in order to hedge bank permissible equity derivatives contracts shall not be included.

(B) *Use of internal hedging models.* After providing 30 days' prior written notice to the Board the investor may use an internal hedging model that:

(*1*) Nets long and short positions in the same security and offsets positions in a security by futures, forwards, options, and other similar instruments referenced to the same security, for

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

purposes of determining compliance with the single issuer limits of paragraph (a)(15)(ii) of this section;[7] and

(*2*) Offsets its long positions in equity securities by futures, forwards, options, and similar instruments, on a portfolio basis, and for purposes of determining compliance with the aggregate equity limits of paragraph (a)(15)(iii) of this section.

(*3*) With respect to all equity securities held under authority of paragraph (a)(15) of this section, no net long position in a security shall be deemed to have been reduced by more than 75 percent through use of internal hedging models under this paragraph (a)(15)(iv)(B); and

(*4*) With respect to equity securities acquired to hedge bank permissible equity derivatives contracts under authority of paragraph (a)(1) of this section, any residual position that remains in the securities of a single issuer after netting and offsetting of positions relating to the security under the investor's internal hedging models shall be included in calculating compliance with the limits of this paragraph (a)(15)(ii) and (iii).

(C) *Underwriting commitments*. Any shares acquired pursuant to an underwriting commitment that are held for longer than 90 days after the payment date for such underwriting shall be subject to the limits set out in paragraph (a)(15) of this section and the investment provisions of §§ 211.8 and 211.9 of this part.

(v) *Authority to deal in shares of U.S. organization*. The authority to deal in shares under paragraph (a)(15) of this section includes the authority to deal in the shares of a U.S. organization:

(A) With respect to foreign persons only; and

(B) Subject to the limitations on owning or controlling shares of a company in section 4(c)(6) of the BHC Act (12 U.S.C. 1843(c)(6)) and Regulation Y (12 CFR part 225).

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

(16) Operating a travel agency, but only in connection with financial services offered abroad by the investor or others;

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

(i) Investments in, and loans and extensions of credit (other than loans and extensions of credit fully secured in accordance with the requirements of section 23A of the FRA (12 U.S.C. 371c), or with such other standards as the Board may require) to, the company by the investor or its affiliates are deducted from the capital of the investor (with 50 percent of such capital deduction to be taken from tier 1 capital); and

(ii) Activities conducted directly or indirectly by a subsidiary of a U.S. insured bank are excluded from the authority of this paragraph (a)(17), unless authorized by the Board;

(18) Providing futures commission merchant services (including clearing without executing and executing without clearing) for nonaffiliated persons with respect to futures and options on futures contracts for financial and nonfinancial commodities; provided that prior notice under § 211.9(f) of this part shall be provided to the Board before any subsidiaries of a member bank operating pursuant to this subpart may join a mutual exchange or clearinghouse, unless the potential liability of the investor to the exchange, clearinghouse, or other members of the exchange, as the case may be, is legally limited by the rules of the exchange or clearinghouse to an amount that does not exceed applicable general consent limits under § 211.9 of this part;

(19) Acting as principal or agent in commodity-swap transactions in relation to:

(i) Swaps on a cash-settled basis for any commodity, provided that the investor's portfolio of swaps contracts is hedged in a manner consistent with safe and sound banking practices; and

(ii) Contracts that require physical delivery of a commodity, provided that:

[7] A basket of stocks, specifically segregated as an offset to a position in a stock index derivative product, as computed by the investor's internal model, may be offset against the stock index.

(A) Such contracts are entered into solely for the purpose of hedging the investor's positions in the underlying commodity or derivative contracts based on the commodity;

(B) The contract allows for assignment, termination or offset prior to expiration; and

(C) Reasonable efforts are made to avoid delivery.

(b) *Regulation Y activities.* An investor may engage in activities that the Board has determined in § 225.28(b) of Regulation Y (12 CFR 225.28(b)) are closely related to banking under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)).

(c) *Specific approval.* With the Board's specific approval, an investor may engage in other activities that the Board determines are usual in connection with the transaction of the business of banking or other financial operations abroad and are consistent with the FRA or the BHC Act.

§ 211.11 Advisory opinions under Regulation K.

(a) *Request for advisory opinion.* Any person may submit a request to the Board for an advisory opinion regarding the scope of activities permissible under any subpart of this part.

(b) *Form and content of the request.* Any request for an advisory opinion under this section shall be:

(1) Submitted in writing to the Board;

(2) Contain a clear description of the proposed parameters of the activity, or the service or product, at issue; and

(3) Contain a concise explanation of the grounds on which the submitter contends the activity is or should be considered by the Board to be permissible under this part.

(c) *Response to request.* In response to a request received under this section, the Board shall:

(1) Direct the submitter to provide such additional information as the Board may deem necessary to complete the record for a full consideration of the issue presented; and

(2) Provide an advisory opinion within 45 days after the record on the request has been determined to be complete.

§ 211.12 Lending limits and capital requirements.

(a) *Acceptances of Edge corporations.* (1) Limitations. An Edge corporation shall be and remain fully secured for acceptances of the types described in section 13(7) of the FRA (12 U.S.C. 372), as follows:

(i) All acceptances outstanding in excess of 200 percent of its tier 1 capital; and

(ii) All acceptances outstanding for any one person in excess of 10 percent of its tier 1 capital.

(2) *Exceptions.* These limitations do not apply if the excess represents the international shipment of goods, and the Edge corporation is:

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

(ii) Covered by participation agreements from other banks, as described in 12 CFR 250.165.

(b) *Loans and extensions of credit to one person*—(1) *Loans and extensions of credit defined. Loans and extensions of credit* has the meaning set forth in § 211.2(q) of this part[8] and, for purposes of this paragraph (b), also include:

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

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

(iii) Investments in the securities of another organization other than a subsidiary; and

(iv) Any underwriting commitments to an issuer of securities, where no binding commitments have been secured from subunderwriters or other purchasers.

(2) *Limitations.* Except as the Board may otherwise specify:

[8] In the case of a foreign government, these includes loans and extensions of credit to the foreign government's departments or agencies deriving their current funds principally from general tax revenues. In the case of a partnership or firm, these include loans and extensions of credit to its members and, in the case of a corporation, these include loans and extensions of credit to the corporation's affiliates, where the affiliate incurs the liability for the benefit of the corporation.

(i) The total loans and extensions of credit outstanding to any person by an Edge corporation engaged in banking, and its direct or indirect subsidiaries, may not exceed 15 percent of the Edge corporation's tier 1 capital;[9] and

(ii) The total loans and extensions of credit to any person by a foreign bank or Edge corporation subsidiary of a member bank, and by majority-owned subsidiaries of a foreign bank or Edge corporation, when combined with the total loans and extensions of credit to the same person by the member bank and its majority-owned subsidiaries, may not exceed the member bank's limitation on loans and extensions of credit to one person.

(3) *Exceptions*. The limitations of paragraph (b)(2) of this section do not apply to:

(i) Deposits with banks and federal funds sold;

(ii) Bills or drafts drawn in good faith against actual goods and on which two or more unrelated parties are liable;

(iii) Any banker's acceptance, of the kind described in section 13(7) of the FRA (12 U.S.C. 372), that is issued and outstanding;

(iv) Obligations to the extent secured by cash collateral or by bonds, notes, certificates of indebtedness, or Treasury bills of the United States;

(v) Loans and extensions of credit that are covered by bona fide participation agreements; and

(vi) Obligations to the extent supported by the full faith and credit of the following:

(A) The United States or any of its departments, agencies, establishments, or wholly owned corporations (including obligations, to the extent insured against foreign political and credit risks by the Export-Import Bank of the United States or the Foreign Credit Insurance Association), the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, or the European Bank for Reconstruction and Development;

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

(c) *Capitalization*. (1) An Edge corporation shall at all times be capitalized in an amount that is adequate in relation to the scope and character of its activities.

(2) In the case of an Edge corporation engaged in banking, the minimum ratio of qualifying total capital to risk-weighted assets, as determined under the Capital Adequacy Guidelines, shall not be less than 10 percent, of which at least 50 percent shall consist of tier 1 capital.

(3) For purposes of this paragraph (c), no limitation shall apply on the inclusion of subordinated debt that qualifies as tier 2 capital under the Capital Adequacy Guidelines.

§ 211.13 Supervision and reporting.

(a) *Supervision*. (1) *Foreign branches and subsidiaries*. U.S. banking organizations conducting international operations under this subpart shall supervise and administer their foreign branches and subsidiaries in such a manner as to ensure that their operations conform to high standards of banking and financial prudence.

(i) Effective systems of records, controls, and reports shall be maintained to keep management informed of their activities and condition.

(ii) Such systems shall provide, in particular, information on risk assets, exposure to market risk, liquidity management, operations, internal controls, legal and operational risk, and conformance to management policies.

(iii) Reports on risk assets shall be sufficient to permit an appraisal of

[9] For purposes of this pargraph (b), *subsidiaries* includes subsidiaries controlled by the Edge corporation, but does not include companies otherwise controlled by affiliates of the Edge corporation.

credit quality and assessment of exposure to loss, and, for this purpose, provide full information on the condition of material borrowers.

(iv) Reports on operations and controls shall include internal and external audits of the branch or subsidiary.

(2) *Joint ventures.* Investors shall maintain sufficient information with respect to joint ventures to keep informed of their activities and condition.

(i) Such information shall include audits and other reports on financial performance, risk exposure, management policies, operations, and controls.

(ii) Complete information shall be maintained on all transactions with the joint venture by the investor and its affiliates.

(3) *Availability of reports and information to examiners.* The reports specified in paragraphs (a)(1) and (2) of this section and any other information deemed necessary to determine compliance with U.S. banking law shall be made available to examiners of the appropriate bank supervisory agencies.

(b) *Examinations.* Examiners appointed by the Board shall examine each Edge corporation once a year. An Edge or agreement corporation shall make available to examiners information sufficient to assess its condition and operations and the condition and activities of any organization whose shares it holds.

(c) *Reports*—(1) *Reports of condition.* Each Edge or agreement corporation shall make reports of condition to the Board at such times and in such form as the Board may prescribe. The Board may require that statements of condition or other reports be published or made available for public inspection.

(2) *Foreign operations.* Edge and agreement corporations, member banks, and bank holding companies shall file such reports on their foreign operations as the Board may require.

(3) *Acquisition or disposition of shares.* Member banks, Edge and agreement corporations, and bank holding companies shall report, in a manner prescribed by the Board, any acquisition or disposition of shares.

(d) *Filing and processing procedures*—(1) *Place of filing.* Unless otherwise directed by the Board, applications, notices, and reports required by this part shall be filed with the Federal Reserve Bank of the District in which the parent bank or bank holding company is located or, if none, the Reserve Bank of the District in which the applying or reporting institution is located. Instructions and forms for applications, notices, and reports are available from the Reserve Banks.

(2) *Timing.* The Board shall act on an application under this subpart within 60 calendar days after the Reserve Bank has received the application, unless the Board notifies the investor that the 60-day period is being extended and states the reasons for the extension.

Subpart B—Foreign Banking Organizations

SOURCE: 66 FR 53474, Oct. 26, 2001, unless otherwise noted.

§ 211.20 Authority, purpose, and scope.

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

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

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

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

(3) Board approval of the establishment of an office of a foreign bank in the United States under sections 7(d) and 10(a) of the IBA (12 U.S.C. 3105(d), 3107(a));

(4) The termination by the Board of a foreign bank's representative office, state branch, state agency, or commercial lending company subsidiary under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(e), 3107(b)), and the transmission of a recommendation to the

Comptroller to terminate a federal branch or federal agency under section 7(e)(5) of the IBA (12 U.S.C. 3105(e)(5));

(5) The examination of an office or affiliate of a foreign bank in the United States as provided in sections 7(c) and 10(c) of the IBA (12 U.S.C. 3105(c), 3107(c));

(6) The disclosure of supervisory information to a foreign supervisor under section 15 of the IBA (12 U.S.C. 3109);

(7) The limitations on loans to one borrower by state branches and state agencies of a foreign bank under section 7(h)(2) of the IBA (12 U.S.C. 3105(h)(2));

(8) The limitation of a state branch and a state agency to conducting only activities that are permissible for a federal branch under section (7)(h)(1) of the IBA (12 U.S.C. 3105(h)(1)); and

(9) The deposit insurance requirement for retail deposit taking by a foreign bank under section 6 of the IBA (12 U.S.C. 3104).

(10) The management of shell branches (12 U.S.C. 3105(k)).

(c) *Additional requirements.* Compliance by a foreign bank with the requirements of this subpart and the laws administered and enforced by the Board does not relieve the foreign bank of responsibility to comply with the laws and regulations administered by the licensing authority.

§ 211.21 Definitions.

The definitions contained in §§ 211.1 and 211.2 apply to this subpart, except as a term is otherwise defined in this section:

(a) *Affiliate* of a foreign bank or of a parent of a foreign bank means any company that controls, is controlled by, or is under common control with, the foreign bank or the parent of the foreign bank.

(b) *Agency* means any place of business of a foreign bank, located in any state, at which credit balances are maintained, checks are paid, money is lent, or, to the extent not prohibited by state or federal law, deposits are accepted from a person or entity that is not a citizen or resident of the United States. Obligations shall not be considered credit balances unless they are:

(1) Incidental to, or arise out of the exercise of, other lawful banking powers;

(2) To serve a specific purpose;

(3) Not solicited from the general public;

(4) Not used to pay routine operating expenses in the United States such as salaries, rent, or taxes;

(5) Withdrawn within a reasonable period of time after the specific purpose for which they were placed has been accomplished; and

(6) Drawn upon in a manner reasonable in relation to the size and nature of the account.

(c)(1) *Appropriate Federal Reserve Bank* means, unless the Board designates a different Federal Reserve Bank:

(i) For a foreign banking organization, the Reserve Bank assigned to the foreign banking organization in § 225.3(b)(2) of Regulation Y (12 CFR 225.3(b)(2));

(ii) For a foreign bank that is not a foreign banking organization and proposes to establish an office, an Edge corporation, or an agreement corporation, the Reserve Bank of the Federal Reserve District in which the foreign bank proposes to establish such office or corporation; and

(iii) In all other cases, the Reserve Bank designated by the Board.

(2) The appropriate Federal Reserve Bank need not be the Reserve Bank of the Federal Reserve District in which the foreign bank's home state is located.

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

(e) *Branch* means any place of business of a foreign bank, located in any state, at which deposits are received, and that is not an agency, as that term is defined in paragraph (b) of this section.

(f) *Change the status* of an office means to convert a representative office into a branch or agency, or an agency or limited branch into a branch, but does not include renewal of the license of an existing office.

(g) *Commercial lending company* means any organization, other than a bank or

an organization operating under section 25 of the Federal Reserve Act (FRA) (12 U.S.C. 601–604a), organized under the laws of any state, that maintains credit balances permissible for an agency, and engages in the business of making commercial loans. *Commercial lending company* includes any company chartered under article XII of the banking law of the State of New York.

(h) *Comptroller* means the Office of the Comptroller of the Currency.

(i) *Control* has the same meaning as in section 2(a) of the BHC Act (12 U.S.C. 1841(a)), and the terms *controlled* and *controlling* shall be construed consistently with the term *control*.

(j) *Domestic branch* means any place of business of a foreign bank, located in any state, that may accept domestic deposits and deposits that are incidental to or for the purpose of carrying out transactions in foreign countries.

(k) A foreign bank *engages directly in the business of banking outside the United States* if the foreign bank engages directly in banking activities usual in connection with the business of banking in the countries where it is organized or operating.

(l) To *establish* means:

(1) To open and conduct business through an office;

(2) To acquire directly, through merger, consolidation, or similar transaction with another foreign bank, the operations of an office that is open and conducting business;

(3) To acquire an office through the acquisition of a foreign bank subsidiary that will cease to operate in the same corporate form following the acquisition;

(4) To change the status of an office; or

(5) To relocate an office from one state to another.

(m) *Federal agency*, *federal branch*, *state agency*, and *state branch* have the same meanings as in section 1 of the IBA (12 U.S.C. 3101).

(n) *Foreign bank* means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States. The term *foreign bank* does not include a central bank of a foreign country that does not engage or seek to engage in a commercial banking business in the United States through an office.

(o) *Foreign banking organization* means:

(1) A foreign bank, as defined in section 1(b)(7) of the IBA (12 U.S.C. 3101(7)), that:

(i) Operates a branch, agency, or commercial lending company subsidiary in the United States;

(ii) Controls a bank in the United States; or

(iii) Controls an Edge corporation acquired after March 5, 1987; and

(2) Any company of which the foreign bank is a subsidiary.

(p) *Home country*, with respect to a foreign bank, means the country in which the foreign bank is chartered or incorporated.

(q) *Home country supervisor*, with respect to a foreign bank, means the governmental entity or entities in the foreign bank's home country with responsibility for the supervision and regulation of the foreign bank.

(r) *Licensing authority* means:

(1) The relevant state supervisor, with respect to an application to establish a state branch, state agency, commercial lending company, or representative office of a foreign bank; or

(2) The Comptroller, with respect to an application to establish a federal branch or federal agency.

(s) *Limited branch* means a branch of a foreign bank that receives only such deposits as would be permitted for a corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611–631).

(t) *Office* or *office of a foreign bank* means any branch, agency, representative office, or commercial lending company subsidiary of a foreign bank in the United States.

(u) A *parent* of a foreign bank means a company of which the foreign bank is a subsidiary. An *immediate parent* of a foreign bank is a company of which the foreign bank is a direct subsidiary. An *ultimate parent* of a foreign bank is a parent of the foreign bank that is not the subsidiary of any other company.

(v) *Regional administrative office* means a representative office that:

(1) Is established by a foreign bank that operates two or more branches,

agencies, commercial lending companies, or banks in the United States;

(2) Is located in the same city as one or more of the foreign bank's branches, agencies, commercial lending companies, or banks in the United States;

(3) Manages, supervises, or coordinates the operations of the foreign bank or its affiliates, if any, in a particular geographic area that includes the United States or a region thereof, including by exercising credit approval authority in that area pursuant to written standards, credit policies, and procedures established by the foreign bank; and

(4) Does not solicit business from actual or potential customers of the foreign bank or its affiliates.

(w) *Relevant state supervisor* means the state entity that is authorized to supervise and regulate a state branch, state agency, commercial lending company, or representative office.

(x) *Representative office* means any office of a foreign bank which is located in any state and is not a Federal branch, Federal agency, State branch, State agency, or commercial lending company subsidiary.

(y) *State* means any state of the United States or the District of Columbia.

(z) *Subsidiary* means any organization that:

(1) Has 25 percent or more of its voting shares directly or indirectly owned, controlled, or held with the power to vote by a company, including a foreign bank or foreign banking organization; or

(2) Is otherwise controlled, or capable of being controlled, by a foreign bank or foreign banking organization.

§ 211.22 Interstate banking operations of foreign banking organizations.

(a) *Determination of home state.* (1) A foreign bank that, as of December 10, 1997, had declared a home state or had a home state determined pursuant to the law and regulations in effect prior to that date shall have that state as its home state.

(2) A foreign bank that has any branches, agencies, commercial lending company subsidiaries, or subsidiary banks in one state, and has no such offices or subsidiaries in any other states, shall have as its home state the state in which such offices or subsidiaries are located.

(b) *Change of home state*—(1) *Prior notice.* A foreign bank may change its home state once, if it files 30 days' prior notice of the proposed change with the Board.

(2) *Application to change home state.* (i) A foreign bank, in addition to changing its home state by filing prior notice under paragraph (b)(1) of this section, may apply to the Board to change its home state, upon showing that a national bank or state-chartered bank with the same home state as the foreign bank would be permitted to change its home state to the new home state proposed by the foreign bank.

(ii) A foreign bank may apply to the Board for such permission one or more times.

(iii) In determining whether to grant the request of a foreign bank to change its home state, the Board shall consider whether the proposed change is consistent with competitive equity between foreign and domestic banks.

(3) *Effect of change in home state.* The home state of a foreign bank and any change in its home state by a foreign bank shall not affect which Federal Reserve Bank or Reserve Banks supervise the operations of the foreign bank, and shall not affect the obligation of the foreign bank to file required reports and applications with the appropriate Federal Reserve Bank.

(4) *Conforming branches to new home state.* Upon any change in home state by a foreign bank under paragraph (b)(1) or (b)(2) of this section, the domestic branches of the foreign bank established in reliance on any previous home state of the foreign bank shall be conformed to those which a foreign bank with the new home state could permissibly establish or operate as of the date of such change.

(c) *Prohibition against interstate deposit production offices.* A covered interstate branch of a foreign bank may not be used as a deposit production office in accordance with the provisions in § 208.7 of Regulation H (12 CFR 208.7).

§ 211.23 Nonbanking activities of foreign banking organizations.

(a) *Qualifying foreign banking organizations.* Unless specifically made eligible for the exemptions by the Board, a foreign banking organization shall qualify for the exemptions afforded by this section only if, disregarding its United States banking, more than half of its worldwide business is banking; and more than half of its banking business is outside the United States.[10] In order to qualify, a foreign banking organization shall:

(1) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed total worldwide nonbanking assets;

(ii) Revenues derived from the business of banking outside the United States exceed total revenues derived from its worldwide nonbanking business; or

(iii) Net income derived from the business of banking outside the United States exceeds total net income derived from its worldwide nonbanking business; and

(2) Meet at least two of the following requirements:

(i) Banking assets held outside the United States exceed banking assets held in the United States;

(ii) Revenues derived from the business of banking outside the United States exceed revenues derived from the business of banking in the United States; or

(iii) Net income derived from the business of banking outside the United States exceeds net income derived from the business of banking in the United States.

(b) *Determining assets, revenues, and net income.* (1)(i) For purposes of paragraph (a) of this section, the total assets, revenues, and net income of an organization may be determined on a consolidated or combined basis.

(ii) The foreign banking organization shall include assets, revenues, and net income of companies in which it owns 50 percent or more of the voting shares when determining total assets, revenues, and net income.

(iii) The foreign banking organization may include assets, revenues, and net income of companies in which it owns 25 percent or more of the voting shares, if all such companies within the organization are included.

(2) Assets devoted to, or revenues or net income derived from, activities listed in § 211.10(a) shall be considered banking assets, or revenues or net income derived from the banking business, when conducted within the foreign banking organization by a foreign bank or its subsidiaries.

(c) *Limited exemptions available to foreign banking organizations in certain circumstances.* The following shall apply where a foreign bank meets the requirements of paragraph (a) of this section but its ultimate parent does not:

(1) Such foreign bank shall be entitled to the exemptions available to a qualifying foreign banking organization if its ultimate parent meets the requirements set forth in paragraph (a)(2) of this section and could meet the requirements in paragraph (a)(1) of this section but for the requirement in paragraph (b)(2) of this section that activities must be conducted by the foreign bank or its subsidiaries in order to be considered derived from the banking business;

(2) An ultimate parent as described in paragraph (c)(1) of this section shall be eligible for the exemptions available to a qualifying foreign banking organization except for those provided in § 211.23(f)(5)(iii).

(d) *Loss of eligibility for exemptions*—(1) *Failure to meet qualifying test.* A foreign banking organization that qualified under paragraph (a) or (c) of this section shall cease to be eligible for the exemptions of this section if it fails to meet the requirements of paragraphs (a) or (c) of this section for two consecutive years, as reflected in its annual reports (FR Y–7) filed with the Board.

[10] None of the assets, revenues, or net income, whether held or derived directly or indirectly, of a subsidiary bank, branch, agency, commercial lending company, or other company engaged in the business of banking in the United States (including any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands) shall be considered held or derived from the business of banking ''outside the United States''.

(2) *Continuing activities and investments*. (i) A foreign banking organization that ceases to be eligible for the exemptions of this section may continue to engage in activities or retain investments commenced or acquired prior to the end of the first fiscal year for which its annual report reflects nonconformance with paragraph (a) or (c) of this section.

(ii) *Termination or divestiture*. Activities commenced or investments made after that date shall be terminated or divested within three months of the filing of the second annual report, or at such time as the Board may determine upon request by the foreign banking organization to extend the period, unless the Board grants consent to continue the activity or retain the investment under paragraph (e) of this section.

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

(ii) The Board may grant consent for the foreign banking organization or its affiliate to make investments under paragraph (f)(5) of this section.

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

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

(2) *Factors considered by Board*. In determining whether eligibility for the exemptions would be consistent with the purposes of the BHC Act and in the public interest, the Board shall consider:

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

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

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

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

(v) The extent to which the foreign banking organization is subject to comprehensive supervision or regulation on a consolidated basis or the foreign organization is subject to oversight by regulatory authorities in its home country.

(3) *Conditions and limitations*. The Board may impose any conditions and limitations on a determination of eligibility, including requirements to cease activities or dispose of investments.

(4) *Eligibility not granted*. Determinations of eligibility generally would not be granted where a majority of the business of the foreign organization or foreign banking organization derives from commercial or industrial activities.

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

(1) Engage in activities of any kind outside the United States;

(2) Engage directly in activities in the United States that are incidental to its activities outside the United States;

(3) Own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the United States, other than those that are incidental to the international or foreign business of such company;

(4) Own or control voting shares of any company in a fiduciary capacity under circumstances that would entitle such shareholding to an exemption under section 4(c)(4) of the BHC Act (12 U.S.C. 1843(c)(4)) if the shares were held or acquired by a bank;

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

(i) More than 50 percent of the foreign company's consolidated assets shall be located, and consolidated revenues derived from, outside the United States; provided that, if the foreign company fails to meet the requirements of this paragraph (f)(5)(i) for two consecutive years (as reflected in annual reports (FR Y–7) filed with the Board by the foreign banking organization), the foreign company shall be divested or its activities terminated within one year of the filing of the second consecutive annual report that reflects nonconformance with the requirements of this paragraph (f)(5)(i), unless the Board grants consent to retain the investment under paragraph (g) of this section;

(ii) The foreign company shall not directly underwrite, sell, or distribute, nor own or control more than 10 percent of the voting shares of a company that underwrites, sells, or distributes securities in the United States, except to the extent permitted bank holding companies;

(iii) If the foreign company is a subsidiary of the foreign banking organization, the foreign company must be, or must control, an operating company, and its direct or indirect activities in the United States shall be subject to the following limitations:

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

(B) The foreign company may engage in activities in the United States that consist of banking, securities, insurance, or other financial operations, or types of activities permitted by regulation or order under section 4(c)(8) of the BHC Act (12 U.S.C. 1843(c)(8)), only under regulations of the Board or with the prior approval of the Board, subject to the following;

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

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

(g) *Exemptions under section 4(c)(9) of the BHC Act*. A foreign banking organization that is of the opinion that other activities or investments may, in particular circumstances, meet the conditions for an exemption under section 4(c)(9) of the BHC Act (12 U.S.C. 1843(c)(9)) may apply to the Board for such a determination by submitting to the appropriate Federal Reserve Bank a letter setting forth the basis for that opinion.

(h) *Reports*. The foreign banking organization shall report in a manner prescribed by the Board any direct activities in the United States by a foreign subsidiary of the foreign banking organization and the acquisition of all

shares of companies engaged, directly or indirectly, in activities in the United States that were acquired under the authority of this section.

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

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

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

§ 211.24 Approval of offices of foreign banks; procedures for applications; standards for approval; representative office activities and standards for approval; preservation of existing authority.

(a) *Board approval of offices of foreign banks*—(1) *Prior Board approval of branches, agencies, commercial lending companies, or representative offices of foreign banks.* (i) Except as otherwise provided in paragraphs (a)(2) and (a)(3) of this section, a foreign bank shall obtain the approval of the Board before it:

(A) Establishes a branch, agency, commercial lending company subsidiary, or representative office in the United States; or

(B) Acquires ownership or control of a commercial lending company subsidiary.

(2) *Prior notice for certain offices.* (i) After providing 45 days' prior written notice to the Board, a foreign bank may establish:

(A) An additional office (other than a domestic branch outside the home state of the foreign bank established pursuant to section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3))), provided that the Board has previously determined the foreign bank to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor (*comprehensive consolidated supervision* or *CCS*); or

(B) A representative office, if:

(*1*) The Board has not yet determined the foreign bank to be subject to consolidated comprehensive supervision, but the foreign bank is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a)); or

(*2*) The Board previously has approved an application by the foreign bank to establish a branch or agency pursuant to the standard set forth in paragraph (c)(1)(iii) of this section; or

(*3*) The Board previously has approved an application by the foreign bank to establish a representative office.

(ii) The Board may waive the 45-day notice period if it finds that immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is received by the appropriate Federal Reserve Bank. The Board may suspend the period or require Board approval prior to the establishment of such office if the notification raises significant policy or supervisory concerns.

(3) *General consent for certain representative offices.* (i) The Board grants its general consent for a foreign bank that is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 U.S.C. 3106(a)), to establish:

(A) A representative office, but only if the Board has previously determined that the foreign bank proposing to establish a representative office is subject to consolidated comprehensive supervision;

(B) A regional administrative office; or

(C) An office that solely engages in limited administrative functions (such as separately maintaining back-office support systems) that:

(*1*) Are clearly defined;

(*2*) Are performed in connection with the U.S. banking activities of the foreign bank; and

(*3*) Do not involve contact or liaison with customers or potential customers, beyond incidental contact with existing customers relating to administrative matters (such as verification or correction of account information).

(4) *Suspension of general consent or prior notice procedures.* The Board may, at any time, upon notice, modify or suspend the prior notice and general consent procedures in paragraphs (a)(2) and (3) of this section for any foreign bank with respect to the establishment by such foreign bank of any U.S. office of such foreign bank.

(5) *Temporary offices.* The Board may, in its discretion, determine that a foreign bank has not established an office if the foreign bank temporarily operates at one or more additional locations in the same city of an existing branch or agency due to renovations, an expansion of activities, a merger or consolidation of the operations of affiliated foreign banks or companies, or other similar circumstances. The foreign bank must provide reasonable advance notice of its intent temporarily to utilize additional locations, and the Board may impose such conditions in connection with its determination as it deems necessary.

(6) *After-the-fact Board approval.* Where a foreign bank proposes to establish an office in the United States through the acquisition of, or merger or consolidation with, another foreign bank with an office in the United States, the Board may, in its discretion, allow the acquisition, merger, or consolidation to proceed before an application to establish the office has been filed or acted upon under this section if:

(i) The foreign bank or banks resulting from the acquisition, merger, or consolidation, will not directly or indirectly own or control more than 5 percent of any class of the voting securities of, or control, a U.S. bank;

(ii) The Board is given reasonable advance notice of the proposed acquisition, merger, or consolidation; and

(iii) Prior to consummation of the acquisition, merger, or consolidation, each foreign bank, as appropriate, commits in writing either:

(A) To comply with the procedures for an application under this section within a reasonable period of time; to engage in no new lines of business, or otherwise to expand its U.S. activities until the disposition of the application; and to abide by the Board's decision on the application, including, if necessary, a decision to terminate the activities of any such U.S. office, as the Board or the Comptroller may require; or

(B) Promptly to wind-down and close any office, the establishment of which would have required an application under this section; and to engage in no new lines of business or otherwise to expand its U.S. activities prior to the closure of such office.

(7) *Notice of change in ownership or control or conversion of existing office or establishment of representative office under general-consent authority.* A foreign bank with a U.S. office shall notify the Board in writing within 10 days of the occurrence of any of the following events:

(i) A change in the foreign bank's ownership or control, where the foreign bank is acquired or controlled by another foreign bank or company and the acquired foreign bank with a U.S. office continues to operate in the same corporate form as prior to the change in ownership or control;

(ii) The conversion of a branch to an agency or representative office; an agency to a representative office; or a branch or agency from a federal to a state license, or a state to a federal license; or

(iii) The establishment of a representative office under general-consent authority.

(8) *Transactions subject to approval under Regulation Y.* Subpart B of Regulation Y (12 CFR 225.11–225.17) governs the acquisition by a foreign banking organization of direct or indirect ownership or control of any voting securities of a bank or bank holding company in the United States if the acquisition results in the foreign banking organization's ownership or control of more than 5 percent of any class of voting securities of a U.S. bank or bank holding company, including through acquisition of a foreign bank or foreign banking organization that owns or controls more than 5 percent of any class of the voting securities of a U.S. bank or bank holding company.

(b) *Procedures for application*—(1) *Filing application.* An application for the Board's approval pursuant to this section shall be filed in the manner prescribed by the Board.

(2) *Publication requirement*—(i) *Newspaper notice.* Except with respect to a proposed transaction where more extensive notice is required by statute or as otherwise provided in paragraphs (b)(2)(ii) and (iii) of this section, an applicant under this section shall publish a notice in a newspaper of general circulation in the community in which the applicant proposes to engage in business.

(ii) *Contents of notice.* The newspaper notice shall:

(A) State that an application is being filed as of the date of the newspaper notice; and

(B) Provide the name of the applicant, the subject matter of the application, the place where comments should be sent, and the date by which comments are due, pursuant to paragraph (b)(3) of this section.

(iii) *Copy of notice with application.* The applicant shall furnish with its application to the Board a copy of the newspaper notice, the date of its publication, and the name and address of the newspaper in which it was published.

(iv) *Exception.* The Board may modify the publication requirement of paragraphs (b)(2)(i) and (ii) of this section in appropriate circumstances.

(v) *Federal branch or federal agency.* In the case of an application to establish a federal branch or federal agency, compliance with the publication procedures of the Comptroller shall satisfy the publication requirement of this section. Comments regarding the application should be sent to the Board and the Comptroller.

(3) *Written comments.* (i) Within 30 days after publication, as required in paragraph (b)(2) of this section, any person may submit to the Board written comments and data on an application.

(ii) The Board may extend the 30-day comment period if the Board determines that additional relevant information is likely to be provided by interested persons, or if other extenuating circumstances exist.

(4) *Board action on application.* (i) *Time limits.* (A) The Board shall act on an application from a foreign bank to establish a branch, agency, or commercial lending company subsidiary within 180 calendar days after the receipt of the application.

(B) The Board may extend for an additional 180 calendar days the period within which to take final action, after providing notice of and reasons for the extension to the applicant and the licensing authority.

(C) The time periods set forth in this paragraph (b)(4)(i) may be waived by the applicant.

(ii) *Additional information.* The Board may request any information in addition to that supplied in the application when the Board believes that the information is necessary for its decision, and may deny an application if it does not receive the information requested from the applicant or its home country supervisor in sufficient time to permit adequate evaluation of the information within the time periods set forth in paragraph (b)(4)(i) of this section.

(5) *Coordination with other regulators.* Upon receipt of an application by a foreign bank under this section, the Board shall promptly notify, consult with, and consider the views of the licensing authority.

(c) *Standards for approval of U.S. offices of foreign banks*— (1) *Mandatory standards*—(i) *General.* As specified in section 7(d) of the IBA (12 U.S.C. 3105(d)), the Board may not approve an application to establish a branch or an agency, or to establish or acquire ownership or control of a commercial lending company, unless it determines that:

(A) Each of the foreign bank and any parent foreign bank engages directly in the business of banking outside the United States and, except as provided in paragraph (c)(1)(iii) of this section, is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor; and

(B) The foreign bank has furnished to the Board the information that the Board requires in order to assess the application adequately.

(ii) *Basis for determining comprehensive consolidated supervision.* In determining whether a foreign bank and any parent foreign bank is subject to comprehensive consolidated supervision, the Board shall determine whether the foreign bank is supervised or regulated in such a manner that its home country

supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. In making such a determination, the Board shall assess, among other factors, the extent to which the home country supervisor:

(A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;

(B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;

(C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;

(D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;

(E) Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

(iii) *Determination of comprehensive consolidated supervision not required in certain circumstances.* (A) If the Board is unable to find, under paragraph (c)(1)(i) of this section, that a foreign bank is subject to comprehensive consolidated supervision, the Board may, nevertheless, approve an application by the foreign bank if:

(*1*) The home country supervisor is actively working to establish arrangements for the consolidated supervision of such bank; and

(*2*) All other factors are consistent with approval.

(B) In deciding whether to use its discretion under this paragraph (c)(1)(iii), the Board also shall consider whether the foreign bank has adopted and implemented procedures to combat money laundering. The Board also may take into account whether the home country supervisor is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering. In approving an application under this paragraph (c)(1)(iii), the Board, after requesting and taking into consideration the views of the licensing authority, may impose any conditions or restrictions relating to the activities or business operations of the proposed branch, agency, or commercial lending company subsidiary, including restrictions on sources of funding. The Board shall coordinate with the licensing authority in the implementation of such conditions or restrictions.

(2) *Additional standards.* In acting on any application under this subpart, the Board may take into account:

(i) *Consent of home country supervisor.* Whether the home country supervisor of the foreign bank has consented to the proposed establishment of the branch, agency, or commercial lending company subsidiary;

(ii) *Financial resources.* The financial resources of the foreign bank (including the foreign bank's capital position, projected capital position, profitability, level of indebtedness, and future prospects) and the condition of any U.S. office of the foreign bank;

(iii) *Managerial resources.* The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors; the integrity of its principal shareholders; management's experience and capacity to engage in international banking; and the record of the foreign bank and its management of complying with laws and regulations, and of fulfilling any commitments to, and any conditions imposed by, the Board in connection with any prior application;

(iv) *Sharing information with supervisors.* Whether the foreign bank's home country supervisor and the home country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(v) *Assurances to Board.* (A) Whether the foreign bank has provided the Board with adequate assurances that information will be made available to the Board on the operations or activities of the foreign bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the BHC Act, and

other applicable federal banking statutes.

(B) These assurances shall include a statement from the foreign bank describing the laws that would restrict the foreign bank or any of its parents from providing information to the Board;

(vi) *Measures for prevention of money laundering*. Whether the foreign bank has adopted and implemented procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering;

(vii) *Compliance with U.S. law*. Whether the foreign bank and its U.S. affiliates are in compliance with applicable U.S. law, and whether the applicant has established adequate controls and procedures in each of its offices to ensure continuing compliance with U.S. law, including controls directed to detection of money laundering and other unsafe or unsound banking practices; and (viii) The needs of the community and the history of operation of the foreign bank and its relative size in its home country, provided that the size of the foreign bank is not the sole factor in determining whether an office of a foreign bank should be approved.

(3) *Additional standards for certain interstate applications*. (i) As specified in section 5(a)(3) of the IBA (12 U.S.C. 3103(a)(3)), the Board may not approve an application by a foreign bank to establish a branch, other than a limited branch, outside the home state of the foreign bank under section 5(a)(1) or (2) of the IBA (12 U.S.C. 3103(a)(1), (2)) unless the Board:

(A) Determines that the foreign bank's financial resources, including the capital level of the bank, are equivalent to those required for a domestic bank to be approved for branching under section 5155 of the Revised Statutes (12 U.S.C. 36) and section 44 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. 1831u);

(B) Consults with the Department of the Treasury regarding capital equivalency;

(C) Applies the standards specified in section 7(d) of the IBA (12 U.S.C. 3105(d)) and this paragraph (c); and

(D) Applies the same requirements and conditions to which an application by a domestic bank for an interstate merger is subject under section 44(b)(1), (3), and (4) of the FDIA (12 U.S.C. 1831u(b)(1), (3), (4)); and

(ii) As specified in section 5(a)(7) of the IBA (12 U.S.C. 3103(a)(7)), the Board may not approve an application to establish a branch through a change in status of an agency or limited branch outside the foreign bank's home state unless:

(A) The establishment and operation of such branch is permitted by such state; and

(B) Such agency or branch has been in operation in such state for a period of time that meets the state's minimum age requirement permitted under section 44(a)(5) of the Federal Deposit Insurance Act (12 U.S.C. 183u(a)(5)).

(4) *Board conditions on approval*. The Board may impose any conditions on its approval as it deems necessary, including a condition which may permit future termination by the Board of any activities or, in the case of a federal branch or a federal agency, by the Comptroller, based on the inability of the foreign bank to provide information on its activities or those of its affiliates that the Board deems necessary to determine and enforce compliance with U.S. banking laws.

(d) *Representative offices*—(1) *Permissible activities*. A representative office may engage in:

(i) *Representational and administrative functions*. Representational and administrative functions in connection with the banking activities of the foreign bank, which may include soliciting new business for the foreign bank; conducting research; acting as liaison between the foreign bank's head office and customers in the United States; performing preliminary and servicing steps in connection with lending;[11] or performing back-office functions; but shall not include contracting for any deposit or deposit-like liability, lending money, or engaging in any other banking activity for the foreign bank;

[11] *See* 12 CFR 250.141(h) for activities that constitute preliminary and servicing steps.

(ii) *Credit approvals under certain circumstances*. Making credit decisions if the foreign bank also operates one or more branches or agencies in the United States, the loans approved at the representative office are made by a U.S. office of the bank, and the loan proceeds are not disbursed in the representative office; and

(iii) *Other functions*. Other functions for or on behalf of the foreign bank or its affiliates, such as operating as a regional administrative office of the foreign bank, but only to the extent that these other functions are not banking activities and are not prohibited by applicable federal or state law, or by ruling or order of the Board.

(2) *Standards for approval of representative offices*. As specified in section 10(a)(2) of the IBA (12 U.S.C. 3107(a)(2)), in acting on the application of a foreign bank to establish a representative office, the Board shall take into account, to the extent it deems appropriate, the standards for approval set out in paragraph (c) of this section. The standard regarding supervision by the foreign bank's home country supervisor (as set out in paragraph (c)(1)(i)(A) of this section) will be met, in the case of a representative office application, if the Board makes a finding that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities and the operating record of the applicant.

(3) *Special-purpose foreign government-owned banks*. A foreign government-owned organization engaged in banking activities in its home country that are not commercial in nature may apply to the Board for a determination that the organization is not a foreign bank for purposes of this section. A written request setting forth the basis for such a determination may be submitted to the Reserve Bank of the District in which the foreign organization's representative office is located in the United States, or to the Board, in the case of a proposed establishment of a representative office. The Board shall review and act upon each request on a case-by-case basis.

(4) *Additional requirements*. The Board may impose any additional requirements that it determines to be necessary to carry out the purposes of the IBA.

(e) *Preservation of existing authority*. Nothing in this subpart shall be construed to relieve any foreign bank or foreign banking organization from any otherwise applicable requirement of federal or state law, including any applicable licensing requirement.

(f) *Reports of crimes and suspected crimes*. Except for a federal branch or a federal agency or a state branch that is insured by the Federal Deposit Insurance Corporation (FDIC), a branch, agency, or representative office of a foreign bank operating in the United States shall file a suspicious activity report in accordance with the provisions of § 208.62 of Regulation H (12 CFR 208.62).

(g) *Management of shell branches*. (1) A state-licensed branch or agency shall not manage, through an office of the foreign bank which is located outside the United States and is managed or controlled by such state-licensed branch or agency, any type of activity that a bank organized under the laws of the United States or any state is not permitted to manage at any branch or subsidiary of such bank which is located outside the United States.

(2) For purposes of this paragraph (g), an office of a foreign bank located outside the United States is ''managed or controlled'' by a state-licensed branch or agency if a majority of the responsibility for business decisions, including but not limited to decisions with regard to lending or asset management or funding or liability management, or the responsibility for recordkeeping in respect of assets or liabilities for that non-U.S. office, resides at the state-licensed branch or agency.

(3) The types of activities that a state-licensed branch or agency may manage through an office located outside the United States that it manage or controls include the types of activities authorized to a U.S. bank by state or federal charters, regulations issued by chartering or regulatory authorities, and other U.S. banking laws, including the Federal Reserve Act, and the implementing regulations, but U.S.

procedural or quantitative requirements that may be applicable to the conduct of such activities by U.S. banks shall not apply.

(h) *Government securities sales practices*. An uninsured state-licensed branch or agency of a foreign bank that is required to give notice to the Board under section 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5) and the Department of the Treasury rules under section 15C (17 CFR 400.1(d) and part 401) shall be subject to the provisions of 12 CFR 208.37 to the same extent as a state member bank that is required to give such notice.

(i) *Protection of customer information*. An uninsured state-licensed branch or agency of a foreign bank shall comply with the Interagency Guidelines Establishing Standards for Safeguarding Customer Information prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805), set forth in appendix D–2 to part 208 of this chapter.

§ 211.25 Termination of offices of foreign banks.

(a) *Grounds for termination*—(1) *General*. Under sections 7(e) and 10(b) of the IBA (12 U.S.C. 3105(d), 3107(b)), the Board may order a foreign bank to terminate the activities of its representative office, state branch, state agency, or commercial lending company subsidiary if the Board finds that:

(i) The foreign bank is not subject to comprehensive consolidated supervision in accordance with § 211.24(c)(1), and the home country supervisor is not making demonstrable progress in establishing arrangements for the consolidated supervision of the foreign bank; or

(ii) Both of the following criteria are met:

(A) There is reasonable cause to believe that the foreign bank, or any of its affiliates, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States; and

(B) As a result of such violation or practice, the continued operation of the foreign bank's representative office, state branch, state agency, or commercial lending company subsidiary would not be consistent with the public interest, or with the purposes of the IBA, the BHC Act, or the FDIA.

(2) *Additional ground*. The Board also may enforce any condition imposed in connection with an order issued under § 211.24.

(b) *Factor*. In making its findings under this section, the Board may take into account the needs of the community, the history of operation of the foreign bank, and its relative size in its home country, provided that the size of the foreign bank shall not be the sole determining factor in a decision to terminate an office.

(c) *Consultation with relevant state supervisor*. Except in the case of termination pursuant to the expedited procedure in paragraph (d)(3) of this section, the Board shall request and consider the views of the relevant state supervisor before issuing an order terminating the activities of a state branch, state agency, representative office, or commercial lending company subsidiary under this section.

(d) *Termination procedures*—(1) *Notice and hearing*. Except as otherwise provided in paragraph (d)(3) of this section, an order issued under paragraph (a)(1) of this section shall be issued only after notice to the relevant state supervisor and the foreign bank and after an opportunity for a hearing.

(2) *Procedures for hearing*. Hearings under this section shall be conducted pursuant to the Board's Rules of Practice for Hearings (12 CFR part 263).

(3) *Expedited procedure*. The Board may act without providing an opportunity for a hearing, if it determines that expeditious action is necessary in order to protect the public interest. When the Board finds that it is necessary to act without providing an opportunity for a hearing, the Board, solely in its discretion, may:

(i) Provide the foreign bank that is the subject of the termination order with notice of the intended termination order;

(ii) Grant the foreign bank an opportunity to present a written submission opposing issuance of the order; or

(iii) Take any other action designed to provide the foreign bank with notice

and an opportunity to present its views concerning the order.

(e) *Termination of federal branch or federal agency*. The Board may transmit to the Comptroller a recommendation that the license of a federal branch or federal agency be terminated if the Board has reasonable cause to believe that the foreign bank or any affiliate of the foreign bank has engaged in conduct for which the activities of a state branch or state agency may be terminated pursuant to this section.

(f) *Voluntary termination*. A foreign bank shall notify the Board at least 30 days prior to terminating the activities of any office. Notice pursuant to this paragraph (f) is in addition to, and does not satisfy, any other federal or state requirements relating to the termination of an office or the requirement for prior notice of the closing of a branch, pursuant to section 39 of the FDIA (12 U.S.C. 1831p).

§ 211.26 Examination of offices and affiliates of foreign banks.

(a) *Conduct of examinations*—(1) *Examination of branches, agencies, commercial lending companies, and affiliates*. The Board may examine:

(i) Any branch or agency of a foreign bank;

(ii) Any commercial lending company or bank controlled by one or more foreign banks, or one or more foreign companies that control a foreign bank; and

(iii) Any other office or affiliate of a foreign bank conducting business in any state.

(2) *Examination of representative offices*. The Board may examine any representative office in the manner and with the frequency it deems appropriate.

(b) *Coordination of examinations*. To the extent possible, the Board shall coordinate its examinations of the U.S. offices and U.S. affiliates of a foreign bank with the licensing authority and, in the case of an insured branch, the Federal Deposit Insurance Corporation (FDIC), including through simultaneous examinations of the U.S. offices and U.S. affiliates of a foreign bank.

(c) *Frequency of on-site examination*—(1) *General*. Each branch or agency of a foreign bank shall be examined on-site at least once during each 12-month period (beginning on the date the most recent examination of the office ended) by—

(i) The Board;

(ii) The FDIC, if the branch of the foreign bank accepts or maintains insured deposits;

(iii) The Comptroller, if the branch or agency of the foreign bank is licensed by the Comptroller; or

(iv) The state supervisor, if the office of the foreign bank is licensed or chartered by the state.

(2) *18-month cycle for certain small institutions*—(i) *Mandatory standards*. The Board may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as required in paragraph (c)(1) of this section, if the branch or agency—

(A) Has total assets of $250 million or less;

(B) Has received a composite ROCA supervisory rating (which rates risk management, operational controls, compliance, and asset quality) of 1 or 2 at its most recent examination;

(C) Satisfies the requirement of either the following paragraph (c)(2)(i)(C)(*1*) or (*2*):

(*1*) The foreign bank's most recently reported capital adequacy position consists of, or is equivalent to, tier 1 and total risk-based capital ratios of at least 6 percent and 10 percent, respectively, on a consolidated basis; or

(*2*) The branch or agency has maintained on a daily basis, over the past three quarters, eligible assets in an amount not less than 108 percent of the preceding quarter's average third-party liabilities (determined consistent with applicable federal and state law) and sufficient liquidity is currently available to meet its obligations to third parties;

(D) Is not subject to a formal enforcement action or order by the Board, FDIC, or OCC; and

(E) Has not experienced a change in control during the preceding 12-month period in which a full-scope, on-site examination would have been required but for this section.

(ii) *Discretionary standards*. In determining whether a branch or agency of

a foreign bank that meets the standards of paragraph (c)(2)(i) of this section should not be eligible for an 18-month examination cycle pursuant to this paragraph (c)(2), the Board may consider additional factors, including whether—

(A) Any of the individual components of the ROCA supervisory rating of a branch or agency of a foreign bank is rated ''3'' or worse;

(B) The results of any off-site surveillance indicate a deterioration in the condition of the office;

(C) The size, relative importance, and role of a particular office when reviewed in the context of the foreign bank's entire U.S. operations otherwise necessitate an annual examination; and

(D) The condition of the foreign bank gives rise to such a need.

(3) *Authority to conduct more frequent examinations.* Nothing in paragraphs (c)(1) and (2) of this section limits the authority of the Board to examine any U.S. branch or agency of a foreign bank as frequently as it deems necessary.

§ 211.27 Disclosure of supervisory information to foreign supervisors.

(a) *Disclosure by Board.* The Board may disclose information obtained in the course of exercising its supervisory or examination authority to a foreign bank regulatory or supervisory authority, if the Board determines that disclosure is appropriate for bank supervisory or regulatory purposes and will not prejudice the interests of the United States.

(b) *Confidentiality.* Before making any disclosure of information pursuant to paragraph (a) of this section, the Board shall obtain, to the extent necessary, the agreement of the foreign bank regulatory or supervisory authority to maintain the confidentiality of such information to the extent possible under applicable law.

§ 211.28 Provisions applicable to branches and agencies: limitation on loans to one borrower.

(a) *Limitation on loans to one borrower.* Except as provided in paragraph (b) of this section, the total loans and extensions of credit by all the state branches and state agencies of a foreign bank outstanding to a single borrower at one time shall be aggregated with the total loans and extensions of credit by all federal branches and federal agencies of the same foreign bank outstanding to such borrower at the time; and shall be subject to the limitations and other provisions of section 5200 of the Revised Statutes (12 U.S.C. 84), and the regulations promulgated thereunder, in the same manner that extensions of credit by a federal branch or federal agency are subject to section 4(b) of the IBA (12 U.S.C. 3102(b)) as if such state branches and state agencies were federal branches and federal agencies.

(b) *Preexisting loans and extensions of credit.* Any loans or extensions of credit to a single borrower that were originated prior to December 19, 1991, by a state branch or state agency of the same foreign bank and that, when aggregated with loans and extensions of credit by all other branches and agencies of the foreign bank, exceed the limits set forth in paragraph (a) of this section, may be brought into compliance with such limitations through routine repayment, provided that any new loans or extensions of credit (including renewals of existing unfunded credit lines, or extensions of the maturities of existing loans) to the same borrower shall comply with the limits set forth in paragraph (a) of this section.

§ 211.29 Applications by state branches and state agencies to conduct activities not permissible for federal branches.

(a) *Scope.* A state branch or state agency shall file with the Board a prior written application for permission to engage in or continue to engage in any type of activity that:

(1) Is not permissible for a federal branch, pursuant to statute, regulation, official bulletin or circular, or order or interpretation issued in writing by the Comptroller; or

(2) Is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction.

(b) *Exceptions.* No application shall be required by a state branch or state agency to conduct any activity that is

otherwise permissible under applicable state and federal law or regulation and that:

(1) Has been determined by the FDIC, pursuant to 12 CFR 362.4(c)(3)(i) through (c)(3)(ii)(A), not to present a significant risk to the affected deposit insurance fund;

(2) Is permissible for a federal branch, but the Comptroller imposes a quantitative limitation on the conduct of such activity by the federal branch;

(3) Is conducted as agent rather than as principal, provided that the activity is one that could be conducted by a state-chartered bank headquartered in the same state in which the branch or agency is licensed; or

(4) Any other activity that the Board has determined may be conducted by any state branch or state agency of a foreign bank without further application to the Board.

(c) *Contents of application.* An application submitted pursuant to paragraph (a) of this section shall be in letter form and shall contain the following information:

(1) A brief description of the activity, including the manner in which it will be conducted, and an estimate of the expected dollar volume associated with the activity;

(2) An analysis of the impact of the proposed activity on the condition of the U.S. operations of the foreign bank in general, and of the branch or agency in particular, including a copy, if available, of any feasibility study, management plan, financial projections, business plan, or similar document concerning the conduct of the activity;

(3) A resolution by the applicant's board of directors or, if a resolution is not required pursuant to the applicant's organizational documents, evidence of approval by senior management, authorizing the conduct of such activity and the filing of this application;

(4) If the activity is to be conducted by a state branch insured by the FDIC, statements by the applicant:

(i) Of whether or not it is in compliance with 12 CFR 346.19 (Pledge of Assets) and 12 CFR 346.20 (Asset Maintenance);

(ii) That it has complied with all requirements of the FDIC concerning an application to conduct the activity and the status of the application, including a copy of the FDIC's disposition of such application, if available; and

(iii) Explaining why the activity will pose no significant risk to the deposit insurance fund; and

(5) Any other information that the Reserve Bank deems appropriate.

(d) *Factors considered in determination.* (1) The Board shall consider the following factors in determining whether a proposed activity is consistent with sound banking practice:

(i) The types of risks, if any, the activity poses to the U.S. operations of the foreign banking organization in general, and the branch or agency in particular;

(ii) If the activity poses any such risks, the magnitude of each risk; and

(iii) If a risk is not de minimis, the actual or proposed procedures to control and minimize the risk.

(2) Each of the factors set forth in paragraph (d)(1) of this section shall be evaluated in light of the financial condition of the foreign bank in general and the branch or agency in particular and the volume of the activity.

(e) *Application procedures.* Applications pursuant to this section shall be filed with the appropriate Federal Reserve Bank. An application shall not be deemed complete until it contains all the information requested by the Reserve Bank and has been accepted. Approval of such an application may be conditioned on the applicant's agreement to conduct the activity subject to specific conditions or limitations.

(f) *Divestiture or cessation.* (1) If an application for permission to continue to conduct an activity is not approved by the Board or, if applicable, the FDIC, the applicant shall submit a detailed written plan of divestiture or cessation of the activity to the appropriate Federal Reserve Bank within 60 days of the disapproval.

(i) The divestiture or cessation plan shall describe in detail the manner in which the applicant will divest itself of or cease the activity, and shall include a projected timetable describing how long the divestiture or cessation is expected to take.

(ii) Divestiture or cessation shall be complete within one year from the date

of the disapproval, or within such shorter period of time as the Board shall direct.

(2) If a foreign bank operating a state branch or state agency chooses not to apply to the Board for permission to continue to conduct an activity that is not permissible for a federal branch, or which is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction, the foreign bank shall submit a written plan of divestiture or cessation, in conformance with paragraph (f)(1) of this section within 60 days of the effective date of this part or of such change or decision.

§ 211.30 Criteria for evaluating U.S. operations of foreign banks not subject to consolidated supervision.

(a) *Development and publication of criteria.* Pursuant to the Foreign Bank Supervision Enhancement Act, Pub. L. 102–242, 105 Stat. 2286 (1991), the Board shall develop and publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive consolidated supervision.

(b) *Criteria considered by Board.* Following a determination by the Board that, having taken into account the standards set forth in § 211.24(c)(1), a foreign bank is not subject to CCS, the Board shall consider the following criteria in determining whether the foreign bank's U.S. operations should be permitted to continue and, if so, whether any supervisory constraints should be placed upon the bank in connection with those operations:

(1) The proportion of the foreign bank's total assets and total liabilities that are located or booked in its home country, as well as the distribution and location of its assets and liabilities that are located or booked elsewhere;

(2) The extent to which the operations and assets of the foreign bank and any affiliates are subject to supervision by its home country supervisor;

(3) Whether the home country supervisor of such foreign bank is actively working to establish arrangements for comprehensive consolidated supervision of the bank, and whether demonstrable progress is being made;

(4) Whether the foreign bank has effective and reliable systems of internal controls and management information and reporting, which enable its management properly to oversee its worldwide operations;

(5) Whether the foreign bank's home country supervisor has any objection to the bank continuing to operate in the United States;

(6) Whether the foreign bank's home country supervisor and the home country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(7) The relationship of the U.S. operations to the other operations of the foreign bank, including whether the foreign bank maintains funds in its U.S. offices that are in excess of amounts due to its U.S. offices from the foreign bank's non-U.S. offices;

(8) The soundness of the foreign bank's overall financial condition;

(9) The managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors, and the integrity of its principal shareholders;

(10) The scope and frequency of external audits of the foreign bank;

(11) The operating record of the foreign bank generally and its role in the banking system in its home country;

(12) The foreign bank's record of compliance with relevant laws, as well as the adequacy of its anti-money-laundering controls and procedures, in respect of its worldwide operations;

(13) The operating record of the U.S. offices of the foreign bank;

(14) The views and recommendations of the Comptroller or the relevant state supervisors in those states in which the foreign bank has operations, as appropriate;

(15) Whether the foreign bank, if requested, has provided the Board with adequate assurances that such information will be made available on the operations or activities of the foreign bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the IBA,

the BHC Act, and other U.S. banking statutes; and

(16) Any other information relevant to the safety and soundness of the U.S. operations of the foreign bank.

(c) *Restrictions on U.S. operations*—(1) *Terms of agreement.* Any foreign bank that the Board determines is not subject to CCS may be required to enter into an agreement to conduct its U.S. operations subject to such restrictions as the Board, having considered the criteria set forth in paragraph (b) of this section, determines to be appropriate in order to ensure the safety and soundness of its U.S. operations.

(2) *Failure to enter into or comply with agreement.* A foreign bank that is required by the Board to enter into an agreement pursuant to paragraph (c)(1) of this section and either fails to do so, or fails to comply with the terms of such agreement, may be subject to:

(i) Enforcement action, in order to ensure safe and sound banking operations, under 12 U.S.C. 1818; or

(ii) Termination or a recommendation for termination of its U.S. operations, under § 211.25(a) and (e) and section (7)(e) of the IBA (12 U.S.C. 3105(e)).

Subpart C—Export Trading Companies

SOURCE: 66 FR 54374, Oct. 26, 2001, unless otherwise noted.

§ 211.31 Authority, purpose, and scope.

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

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

§ 211.32 Definitions.

The definitions in §§ 211.1 and 211.2 of subpart A apply to this subpart, subject to the following:

(a) *Appropriate Federal Reserve Bank* has the same meaning as in § 211.21(c).

(b) *Bank* has the same meaning as in section 2(c) of the BHC Act (12 U.S.C. 1841(c)).

(c) *Company* has the same meaning as in section 2(b) of the BHC Act (12 U.S.C. 1841(b)).

(d) *Eligible investors* means:

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

(2) Edge and agreement corporations that are subsidiaries of bank holding companies but are not subsidiaries of banks;

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

(4) Foreign banking organizations, as defined in § 211.21(o).

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

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

(2) More revenues in each four-year period from export activities as described in paragraph (e)(1) of this section than it derives from the import, or facilitating the import, into the United States of goods or services produced outside the United States. The four-year period within which to calculate revenues derived from its activities under this section shall be deemed to have commenced with the first fiscal year after the respective export trading company has been in operation for two years.

(f) *Revenues* shall include net sales revenues from exporting, importing, or third-party trade in goods by the export trading company for its own account and gross revenues derived from

all other activities of the export trading company.

(g) *Subsidiary* has the same meaning as in section 2(d) of the BHC Act (12 U.S.C. 1841(d)).

(h) *Well capitalized* has the same meaning as in § 225.2(r) of Regulation Y (12 CFR 225.2(r)).

(i) *Well managed* has the same meaning as in § 225.2(s) of Regulation Y (12 CFR 225.2(s)).

§ 211.33 Investments and extensions of credit.

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

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

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

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

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

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

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

§ 211.34 Procedures for filing and processing notices.

(a) *General policy.* Direct and indirect investments by eligible investors in export trading companies shall be made in accordance with the general consent or prior notice procedures contained in this section. The Board may at any time, upon notice, modify or suspend the general-consent procedures with respect to any eligible investor.

(b) *General consent*—(1) *Eligibility for general consent.* Subject to the other limitations of this subpart, the Board grants its general consent for any investment an export trading company:

(i) If the eligible investor is well capitalized and well managed;

(ii) In an amount equal to cash dividends received from that export trading company during the preceding 12 calendar months; or

(iii) That is acquired from an affiliate at net asset value or through a contribution of shares.

(2) *Post-investment notice.* By the end of the month following the month in which the investment is made, the investor shall provide the Board with the following information:

(i) The amount of the investment and the source of the funds with which the investment was made; and

(ii) In the case of an initial investment, a description of the activities in which the export trading company proposes to engage and projections for the export trading company for the first year following the investment.

(c) *Filing notice*—(1) *Prior notice.* An eligible investor shall give the Board 60 days' prior written notice of any investment in an export trading company that does not qualify under the general consent procedure.

(2) *Notice of change of activities.* (i) An eligible investor shall give the Board 60

days' prior written notice of changes in the activities of an export trading company that is a subsidiary of the investor if the export trading company expands its activities beyond those described in the initial notice to include:

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

(B) Product research and design;

(C) Product modification; or

(D) Activities not specifically covered by the list of activities contained in section 4(c)(14)(F)(ii) of the BHC Act (12 U.S.C. 1843(c)(14)(F)(ii)).

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

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

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

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

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

Subpart D—International Lending Supervision

SOURCE: 49 FR 5592, Feb. 13, 1984, unless otherwise noted.

§ 211.41 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (''Board'') under the authority of the International Lending Supervision Act of 1983 (Pub. L. 98–181, title IX, 97 Stat. 1153) (''International Lending Supervision Act''); the Federal Reserve Act (12 U.S.C. 221 *et seq.*) (''FRA''), and the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*) (''BHC Act'').

(b) *Purpose and scope.* This subpart is issued in furtherance of the purposes of the International Lending Supervision Act. It applies to State banks that are members of the Federal Reserve System (''State member banks''); corporations organized under section 25(a) of the FRA (12 U.S.C. 611 through 631) (''Edge Corporations''); corporations operating subject to an agreement with the Board under section 25 of the FRA (12 U.S.C. 601 through 604a) (''Agreement Corporations''); and bank holding companies (as defined in section 2 of the BHC Act (12 U.S.C. 1841(a)) but not including a bank holding company that is a foreign banking organization as defined in § 211.21(n) of this regulation.

[49 FR 5592, Feb. 13, 1984, as amended at 58 FR 46076, Sept. 1, 1993]

§ 211.42 Definitions.

For the purposes of this subpart:

(a) *Banking institution* means a State member bank; bank holding company; Edge Corporation and Agreement Corporation engaged in banking. *Banking institution* does not include a *foreign banking organization* as defined in § 211.21(n).

(b) *Federal banking agencies* means the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

(c) *International assets* means those assets required to be included in banking institutions' *Country Exposure Report* forms (FFIEC No. 009).

(d) *International loan* means a loan as defined in the instructions to the *Report of Condition and Income* for the respective banking institution (FFIEC Nos. 031, 032, 033 and 034) and made to a foreign government, or to an individual, a corporation, or other entity

not a citizen of, resident in, or organized or incorporated in the United States.

(e) *International syndicated loan* means a loan characterized by the formation of a group of *managing* banking institutions and, in the usual case, assumption by them of underwriting commitments and participation in the loan by other banking institutions.

(f) *Loan agreement* means the documents signed by all of the parties to a loan, containing the amount, terms and conditions of the loan, and the interest and fees to be paid by the borrower.

(g) *Restructed international loan* means a loan that meets the following criteria:

(1) The borrower is unable to service the existing loan according to its terms and is a resident of a foreign country in which there is a generalized inability of public and private sector obligors to meet their external debt obligations on a timely basis because of a lack of, or restraints on the availability of, needed foreign exchange in the country; and

(2) The terms of the existing loan are amended to reduce stated interest or extend the schedule of payments; or

(3) A new loan is made to, or for the benefit or, the borrower, enabling the borrower to service or refinance the existing debt.

(h) *Transfer risk* means the possibility that an asset cannot be serviced in the currency of payment because of a lack of, or restraints on the availability of, needed foreign exchange in the country of the obligor.

[49 FR 5592, Feb. 13, 1984, as amended at 49 FR 12197, Mar. 29, 1984; 58 FR 46076, Sept. 1, 1993]

§ 211.43 Allocated transfer risk reserve.

(a) *Establishment of Allocated Transfer Risk Reserve.* A banking institution shall establish an allocated transfer risk reserve (ATRR) for specified international assets when required by the Board in accordance with this section.

(b) *Procedures and standards*—(1) *Joint agency determination.* At least annually, the Federal banking agencies shall determine jointly, based on the standards set forth in paragraph (b)(2) of this section, the following:

(i) Which international assets subject to transfer risk warrant establishment of an ATRR;

(ii) The amount of the ATRR for the specified assets; and

(iii) Whether an ATRR established for specified assets may be reduced.

(2) *Standards for requiring ATRR*—(i) *Evaluation of assets.* The Federal banking agencies shall apply the following criteria in determining whether an ATRR is required for particular international assets:

(A) Whether the quality of a banking institution's assets has been impaired by a protracted inability of public or private obligors in a foreign country to make payments on their external indebtedness as indicated by such factors, among others, as whether:

(*1*) Such obligors have failed to make full interest payments on external indebtedness;

(*2*) Such obligors have failed to comply with the terms of any restructured indebtedness; or

(*3*) A foreign country has failed to comply with any International Monetary Fund or other suitable adjustment program; or

(B) Whether no definite prospects exist for the orderly restoration of debt service.

(ii) *Determination of amount of ATRR.* (A) In determining the amount of the ATRR, the Federal banking agencies shall consider:

(*1*) The length of time the quality of the asset has been impaired;

(*2*) Recent actions taken to restore debt service capability;

(*3*) Prospects for restored asset quality; and

(*4*) Such other factors as the Federal banking agencies may consider relevant to the quality of the asset.

(B) The initial year's provision for the ATRR shall be ten percent of the principal amount of each specified international asset, or such greater or lesser percentage determined by the Federal banking agencies. Additional provision, if any, for the ATRR in subsequent years shall be fifteen percent of the principal amount of each specified international asset, or such greater or lesser percentage determined by the Federal banking agencies.

(3) *Board notification.* Based on the joint agency determinations under paragraph (b)(1) of this section, the Board shall notify each banking institution holding assets subject to an ATRR:

(i) Of the amount of the ATRR to be established by the institution for specified international assets; and

(ii) That an ATRR established for specified assets may be reduced.

(c) *Accounting treatment of ATRR*—(1) *Charge to current income.* A banking institution shall establish an ATRR by a charge to current income and the amounts so charged shall not be included in the banking institution's capital or surplus.

(2) *Separate accounting.* A banking institution shall account for an ATRR separately from the Allowance for Possible Loan Losses, and shall deduct the ATRR from ''gross loans and leases'' to arrive at ''net loans and leases.'' The ATRR must be established for each asset subject to the ATRR in the percentage amount specified.

(3) *Consolidation.* A banking institution shall establish an ATRR, as required, on a consolidated basis. For banks, consolidation should be in accordance with the procedures and tests of significance set forth in the instructions for preparation of *Consolidated Reports of Condition and Income* (FFIEC Nos. 031, 032, 033 and 034). For bank holding companies, the consolidation shall be in accordance with the principles set forth in the ''Instructions to the Bank Holding Company Financial Supplement to Report F.R. Y–6'' (Form F.R. Y–9). Edge and Agreement corporations engaged in banking shall report in accordance with instructions for preparation of the Report of Condition for Edge and Agreement Corporations (Form F.R. 2886b).

(4) *Alternative accounting treatment.* A banking institution need not establish an ATRR if it writes down in the period in which the ATRR is required, or has written down in prior periods, the value of the specified international assets in the requisite amount for each such asset. For purposes of this paragraph, international assets may be written down by a charge to the Allowance for Possible Loan Losses or a reduction in the principal amount of the asset by application of interest payments or other collections on the asset. However, the Allowance for Possible Loan Losses must be replenished in such amount necessary to restore it to a level which adequately provides for the estimated losses inherent in the banking institutions's loan portfolio.

(5) *Reduction of ATRR.* A banking institution may reduce an ATRR when notified by the Board or, at any time, by writing down such amount of the international asset for which the ATRR was established.

§ 211.44 Reporting and disclosure of international assets.

(a) *Requirements.* (1) Pursuant to section 907(a) of the International Lending Supervision Act of 1983 (Title IX, Pub. L. 98–181, 97 Stat. 1153) (ILSA), a banking institution shall submit to the Board, at least quarterly, information regarding the amounts and composition of its holdings of international assets.

(2) Pursuant to section 907(b) of ILSA, a banking institution shall submit to the Board information regarding concentrations in its holdings of international assets that are material in relation to total assets and to capital of the institution, such information to be made publicly available by the Board on request.

(b) *Procedures.* The format, content and reporting and filing dates of the reports required under paragraph (a) of this section shall be determined jointly by the Federal banking agencies. The requirements to be prescribed by the agencies may include changes to existing reporting forms (such as the Country exposure Report, form FFIEC No. 009) or such other requirements as the agencies deem appropriate. The agencies also may determine to exempt from the requirements of paragraph (a) of this section banking institutions that, in the agencies' judgment, have *de minimis* holdings of international assets.

(c) *Reservation of authority.* Nothing contained in this rule shall preclude the Board from requiring from a banking institution such additional or more

frequent information on the institution's holding of international assets as the Board may consider necessary.

[49 FR 5587, Feb. 13, 1984]

§ 211.45 Accounting for fees on international loans.

(a) *Restrictions on fees for restructured international loans.* No banking institution shall charge any fee in connection with a restructured international loan unless all fees exceeding the banking institution's administrative costs, as described in paragraph (c)(2) of this section, are deferred and recognized over the term of the loan as an interest yield adjustment.

(b) *Amortizing fees.* Except as otherwise provided by this section, fees received on international loans shall be deferred and amortized over the term of the loan. The interest method should be used during the loan period to recognize the deferred fee revenue in relation to the outstanding loan balance. If it is not practicable to apply the interest method during the loan period, the straight-line method shall be used.

(c) *Accounting treatment of international loan or syndication administrative costs and corresponding fees.* (1) Administrative costs of originating, restructuring or syndicating an international loan shall be expensed as incurred. A portion of the fee income equal to the banking institution's administrative costs may be recognized as income in the same period such costs are expensed.

(2) The administrative costs of originating, restructuring, or syndicating an international loan include those costs which are specifically identified with negotiating, processing and consummating the loan. These costs include, but are not necessarily limited to: legal fees; costs of preparing and processing loan documents; and an allocable portion of salaries and related benefits of employees engaged in the international lending function and, where applicable, the syndication function. No portion of supervisory and administrative expenses or other indirect expenses such as occupancy and other similar overhead costs shall be included.

(d) *Fees received by managing banking institutions in an international syndicated loan.* Fees received on international syndicated loans representing an adjustment of the yield on the loan shall be recognized over the loan period using the interest method. If the interest yield portion of a fee received on an international syndicated loan by a managing banking institution is unstated or differs materially from the pro rata portion of fees paid other participants in the syndication, an amount necessary for an interest yield adjustment shall be recognized. This amount shall at least be equivalent (on a pro rata basis) to the largest fee received by a loan participant in the syndication that is not a managing banking institution. The remaining portion of the syndication fee may be recognized as income at the loan closing date to the extent that it is identified and documented as compensation for services in arranging the loan. Such documentation shall include the loan agreement. Otherwise, the fee shall be deemed an adjustment of yield.

(e) *Loan commitment fees.* (1) Fees which are based upon the unfunded portion of a credit for the period until it is drawn and represent compensation for a binding commitment to provide funds or for rendering a service in issuing the commitment shall be recognized as income over the term of the commitment period using the straight-line method of amortization. Such fees for revolving credit arrangements, where the fees are received periodically in arrears and are based on the amount of the unused loan commitment, may be recognized as income when received provided the income result would not be materially different.

(2) If it is not practicable to separate the commitment portion from other components of the fee, the entire fee shall be amortized over the term of the combined commitment and expected loan period. The straight-line method of amortization should be used during the commitment period to recognize the fee revenue. The interest method should be used during the loan period to recognize the remaining fee revenue in relation to the outstanding loan balance. If the loan is funded before the end of the commitment period, any unamortized commitment fees shall be recognized as revenue at that time.

(f) *Agency fees*. Fees paid to an agent banking institution for administrative services in an international syndicated loan shall be recognized at the time of the loan closing or as the service is performed, if later.

[49 FR 12197, Mar. 29, 1984]

INTERPRETATIONS

§ 211.601 Status of certain offices for purposes of the International Banking Act restrictions on interstate banking operations.

The Board has considered the question of whether a foreign bank's California office that may accept deposits from certain foreign sources (e.g., a United States citizen residing abroad) is a branch or an agency for the purposes of the grandfather provisions of section 5 of the International Banking Act of 1978 (12 U.S.C. 3103(b)). The question has arisen as a result of the definitions in the International Banking Act of *branch* and *agency*, and the limited deposit-taking capabilities of certain California offices of foreign banks.

The International Banking Act defines *agency* as ''any office * * * at which deposits may not be accepted from citizens or residents of the United States,'' and defines *branch* as ''any office * * * of a foreign bank * * * at which deposits are received'' (12 U.S.C. 3101(1) and (3)). Offices of foreign banks in California prior to the International Banking Act were generally prohibited from accepting deposits by the requirement of State law that such offices obtain Federal deposit insurance (Cal. Fin. Code 1756); until the passage of the International Banking Act an office of a foreign bank could not obtain such insurance. California law, however, permits offices of foreign banks, with the approval of the Banking Department, to accept deposits from any person that resides, is domiciled, and maintains its principal place of business in a foreign country (Cal. Fin. Code 1756.2). Thus, under a literal reading of the definitions of *branch* and *agency* contained in the International Banking Act, a foreign bank's California office that accepts deposits from certain foreign sources (e.g., a U.S. citizen residing abroad), is a branch rather than an agency.

Section 5 of the International Banking Act establishes certain limitations on the expansion of the domestic deposit-taking capabilities of a foreign bank outside its home State. It also grandfathers offices established or applied for prior to July 27, 1978, and permits a foreign bank to select its home State from among the States in which it operated branches and agencies on the grandfather date. If a foreign bank's office that was established or applied for prior to June 27, 1978, is a *branch* as defined in the International Banking Act, then it is grandfathered as a branch. Accordingly, a foreign bank could designate a State other than California as its home State and subsequently convert its California office to a full domestic deposit-taking facility by obtaining Federal deposit insurance. If, however, the office is determined to be an *agency*, then it is grandfathered as such and the foreign bank may may not expand its deposit-taking capabilities in California without declaring California its home State.

In the Board's view, it would be inconsistent with the purposes and the legislative history of the International Banking Act to enable a foreign bank to expand its domestic interstate deposit-taking capabilities by grandfathering these California offices as branches because of their ability to receive certain foreign source deposits. The Board also notes that such deposits are of the same general type that may be received by an Edge Corporation and, hence in accordance with section 5(a) of the International Banking Act, by branches established and operated outside a foreign bank's home State. It would be inconsistent with the structure of the interstate banking provisions of the International Banking Act to grandfather as full deposit-taking offices those facilities whose activities have been determined by Congress to be appropriate for a foreign bank's out-of-home State branches.

Accordingly, the Board, in administering the interstate banking provisions of the IBA, regards as agencies those offices of foreign banks that do not accept domestic deposits but that may accept deposits from any person

that resides, is domiciled, and maintains its principal place of business in a foreign country.

[45 FR 67309, Oct. 10, 1980]

§ 211.602 Investments by United States Banking Organizations in foreign companies that transact business in the United States.

Section 25(a) of the Federal Reserve Act (12 U.S.C. 611, the ''Edge Act'') provides for the establishment of corporations to engage in international or foreign banking or other international or foreign financial operations (''Edge Corporations''). Congress has declared that Edge Corporations are to serve the purpose of stimulating the provision of international banking and financing services throughout the United States and are to have powers sufficiently broad to enable them to compete effectively with foreign-owned institutions in the United States and abroad. The Board was directed by the International Banking Act of 1978 (12 U.S.C. 3101) to revise its regulations governing Edge Corporations in order to accomplish these and other objectives and was further directed to modify or eliminate any interpretations that impede the attainment of these purposes.

One of the powers of Edge Corporations is that of investing in foreign companies. Under the relevant statutes, however, an Edge Corporation is prohibited from investing in foreign companies that engage in the general business of buying or selling goods, wares, merchandise or commodities in the United States. In addition, an Edge Corporation may not invest in foreign companies that transact any business in the United States that is not, in the Board's judgment, ''incidental'' to its international or foreign business. The latter limitation also applies to investments by bank holding companies (12 U.S.C. 1843(c)(13)) and member banks (12 U.S.C. 601).

The Board has been asked to determine whether an Edge Corporation's minority investment (involving less than 25 percent of the voting shares) in a foreign company would continue to be permissible after the foreign company establishes or acquires a United States subsidiary that engages in domestic activities that are closely related to banking. The Board has also been asked to determine whether an Edge Corporation's minority investment in a foreign bank would continue to be permissible after the foreign bank establishes a branch in the United States that engages in domestic banking activities. In the latter case, the branch would be located outside the State in which the Edge Corporation and its parent bank are located.

In the past the Board, in exercising its discretionary authority to determine those activities that are permissible in the United States, has followed the policy that an Edge Corporation could not hold even a minority interest in a foreign company that engaged, directly or indirectly, in any purely domestic business in the United States. The United States activities considered permissible were those internationally related activities that Edge Corporations may engage in directly. If this policy were applied to the subject requests, the Edge Corporations would be required to divest their interests in the foreign companies notwithstanding the fact that, in each case, the Edge Corporation, as a minority investor, did not control the decision to undertake activities in the United States, and that even after the United States activities are undertaken the business of the foreign company will remain predominantly outside the United States.

International banking and finance have undergone considerable growth and change in recent years. It is increasingly common, for example, for United States institutions to have direct or indirect offices in foreign countries and to engage in activities at those offices that are domestically as well as internationally oriented. In this climate, United States banking organizations would be placed at a competitive disadvantage if their minority investments in foreign companies were limited to those companies that do no domestic business in the United States. Moreover, continued adherence to the existing policy would be contrary to the declaration in the International Banking Act of 1978 that Edge Corporations' powers are to be sufficiently broad to enable them to compete effectively in the United States and abroad. Furthermore, where the activities to

be conducted in the United States by the foreign company are banking or closely related to banking, it does not appear that any regulatory or supervisory purpose would be served by prohibiting a minority investment in the foreign firm by a United States banking organization.

In view of these considerations, the Board has reviewed its policy relating to the activities that may be engaged in in the United States by foreign companies (including foreign banks) in which Edge Corporations, member banks, and bank holding companies invest. As a result of that review, the Board has determined that it would be appropriate to interpret sections 25 and 25(a)of the Federal Reserve Act (12 U.S.C. 601, 611) and section 4(c)(13) of the Bank Holding Company Act (12 U.S.C. 1843(c)(13)) generally to allow United States banking organizations, with the prior consent of the Board, to acquire and hold investments in foreign companies that do business in the United States subject to the following conditions:

(1) The foreign company is engaged predominantly in business outside the United States or in internationally related activities in the United States;*

(2) The direct or indirect activities of the foreign company in the United States are either banking or closely related to banking; and

(3) The United States banking organization does not own 25 percent or more of the voting stock of, or otherwise control, the foreign company.

In considering whether to grant its consent for such investments, the Board would also review the proposals to ensure that they are consistent with the purposes of the Bank Holding Company Act and the Federal Reserve Act.

[46 FR 8437, Jan. 27, 1981]

*This condition would ordinarily not be met where a foreign company merely maintains a majority of its business in international activities. Each case will be scrutinized to ensure that the activities in the United States do not alter substantially the international orientation of the foreign company's business.

§ 211.603 Commodity swap transactions.

For text of interpretation relating to this subject, see § 208.128 of this chapter.

[56 FR 63408, Dec. 4, 1991]

§ 211.604 Data processing activities.

(a) *Introduction.* As a result of a recent proposal by a bank holding company to engage in data processing activities abroad, the Board has considered the scope of permissible data processing activities under Regulation K (12 CFR part 211). This question has arisen as a result of the fact that § 211.5(d)(10) of Regulation K does not specifically indicate the scope of data processing as a permissible activity abroad.

(b) *Scope of data processing activities.* (1) Prior to 1979, the Board authorized specific banking organizations to engage in data processing activities abroad with the expectation that such activity would be primarily related to financial activities. When Regulation K was issued in 1979, data processing was included as a permissible activity abroad. Although the regulation did not provide specific guidance on the scope of this authority, the Board has considered such authority to be coextensive with the authority granted in specific cases prior to the issuance of Regulation K, which relied on the fact that most of the activity would relate to financial data. Regulation K does not address related activities such as the manufacture of hardware or the provision of software or related or incidental services.

(2) In 1979, when the activity was included in Regulation K for the first time, the data processing authority in Regulation K was somewhat broader than that permissible in the United States under Regulation Y (12 CFR part 225) at that time, as the Regulation K authority permitted limited non-financial data processing. In 1979, Regulation Y authorized only financial data processing activities for third parties, with very limited exceptions. By 1997, however, the scope of data processing activities under Regulation Y was expanded such that bank holding companies are permitted to derive up

to 30 percent of their data processing revenues from processing data that is not financial, banking, or economic. Moreover, in other respects, the Regulation Y provision is broader than the data processing provision in Regulation K.

(3) In light of the fact that the permissible scope of data processing activities under Regulation Y is now equal to, and in some respects, broader than the activity originally authorized under Regulation K, the Board believes that §211.5(d)(10) should be read to encompass all of the activities permissible under §225.28(b)(14) of Regulation Y. In addition, the limitations of that section would also apply to §211.5(d)(10).

(c) *Applications*. If a U.S. banking organization wishes to engage abroad in data processing or data transmission activities beyond those described in Regulation Y, it must apply for the Board's prior consent under §211.5(d)(20) of Regulation K. In addition, if any investor has commenced activities beyond those permitted under §225.28(b)(14) of Regulation Y in reliance on Regulation K, it should consult with staff of the Board to determine whether such activities have been properly authorized under Regulation K.

[Reg. K, 64 FR 58781, Nov. 1, 1999]

PART 212—MANAGEMENT OFFICIAL INTERLOCKS

Sec.
212.1 Authority, purpose, and scope.
212.2 Definitions.
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212.4 Interlocking relationships permitted by statute.
212.5 Small market share exemption.
212.6 General exemption.
212.7 Change in circumstances.
212.8 Enforcement.
212.9 Effect of Interlocks Act on Clayton Act.

AUTHORITY: 12 U.S.C. 3201–3208; 15 U.S.C. 19.

SOURCE: 61 FR 40302, Aug. 2, 1996, unless otherwise noted.

§212.1 Authority, purpose, and scope.

(a) *Authority*. This part is issued under the provisions of the Depository Institution Management Interlocks Act (Interlocks Act) (12 U.S.C. 3201 *et seq.*), as amended.

(b) *Purpose*. The purpose of the Interlocks Act and this part is to foster competition by generally prohibiting a management official from serving two nonaffiliated depository organizations in situations where the management interlock likely would have an anticompetitive effect.

(c) *Scope*. This part applies to management officials of state member banks, bank holding companies, and their affiliates.

§212.2 Definitions.

For purposes of this part, the following definitions apply:

(a) *Affiliate*. (1) The term *affiliate* has the meaning given in section 202 of the Interlocks Act (12 U.S.C. 3201). For purposes of that section 202, shares held by an individual include shares held by members of his or her immediate family. ''Immediate family'' means spouse, mother, father, child, grandchild, sister, brother, or any of their spouses, whether or not any of their shares are held in trust.

(2) For purposes of section 202(3)(B) of the Interlocks Act (12 U.S.C. 3201(3)(B)), an affiliate relationship based on common ownership does not exist if the Board determines, after giving the affected persons the opportunity to respond, that the asserted affiliation was established in order to avoid the prohibitions of the Interlocks Act and does not represent a true commonality of interest between the depository organizations. In making this determination, the Board considers, among other things, whether a person, including members of his or her immediate family, whose shares are necessary to constitute the group owns a nominal percentage of the shares of one of the organizations and the percentage is substantially disproportionate to that person's ownership of shares in the other organization.

(b) *Area median income* means:

(1) The median family income for the metropolitan statistical area (MSA), if a depository organization is located in an MSA; or

(2) The statewide nonmetropolitan median family income, if a depository

organization is located outside an MSA.

(c) *Community* means a city, town, or village, and contiguous and adjacent cities, towns, or villages.

(d) *Contiguous or adjacent cities, towns, or villages* means cities, towns, or villages whose borders touch each other or whose borders are within 10 road miles of each other at their closest points. The property line of an office located in an unincorporated city, town, or village is the boundary line of that city, town, or village for the purpose of this definition.

(e) *Depository holding company* means a bank holding company or a savings and loan holding company (as more fully defined in section 202 of the Interlocks Act (12 U.S.C. 3201)) having its principal office located in the United States.

(f) *Depository institution* means a commercial bank (including a private bank), a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union, chartered under the laws of the United States and having a principal office located in the United States. Additionally, a United States office, including a branch or agency, of a foreign commercial bank is a depository institution.

(g) *Depository institution affiliate* means a depository institution that is an affiliate of a depository organization.

(h) *Depository organization* means a depository institution or a depository holding company.

(i) *Low- and moderate-income areas* means census tracts (or, if an area is not in a census tract, block numbering areas delineated by the United States Bureau of the Census) where the median family income is less than 100 percent of the area median income.

(j) *Management official.* (1) The term *management official* means:

(i) A director;

(ii) An advisory or honorary director of a depository institution with total assets of $100 million or more;

(iii) A senior executive officer as that term is defined in 12 CFR 225.71(a);

(iv) A branch manager;

(v) A trustee of a depository organization under the control of trustees; and

(vi) Any person who has a representative or nominee, as defined in paragraph (p) of this section, serving in any of the capacities in this paragraph (l)(1).

(2) The term *management official* does not include:

(i) A person whose management functions relate exclusively to the business of retail merchandising or manufacturing;

(ii) A person whose management functions relate principally to a foreign commercial bank's business outside the United States; or

(iii) A person described in the provisos of section 202(4) of the Interlocks Act (referring to an officer of a State-chartered savings bank, cooperative bank, or trust company that neither makes real estate mortgage loans nor accepts savings).

(k) *Office* means a principal or branch office of a depository institution located in the United States. *Office* does not include a representative office of a foreign commercial bank, an electronic terminal, a loan production office, or any office of a depository holding company.

(l) *Person* means a natural person, corporation, or other business entity.

(m) *Relevant metropolitan statistical area (RMSA)* means an MSA, a primary MSA, or a consolidated MSA that is not comprised of designated Primary MSAs to the extent that these terms are defined and applied by the Office of Management and Budget.

(n) *Representative or nominee* means a natural person who serves as a management official and has an obligation to act on behalf of another person with respect to management responsibilities. The Board will find that a person has an obligation to act on behalf of another person only if the first person has an agreement, express or implied, to act on behalf of the second person with respect to management responsibilities. The Board will determine, after giving the affected persons an opportunity to respond, whether a person is a *representative or nominee*.

(o) *Total assets*. (1) The term *total assets* means assets measured on a consolidated basis and reported in the most recent fiscal year-end Consolidated Report of Condition and Income.

(2) The term *total assets* does not include:

(i) Assets of a diversified savings and loan holding company as defined by section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) other than the assets of its depository institution affiliate;

(ii) Assets of a bank holding company that is exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956 pursuant to an order issued under section 4(d) of that Act (12 U.S.C. 1843(d)) other than the assets of its depository institution affiliate; or

(iii) Assets of offices of a foreign commercial bank other than the assets of its United States branch or agency.

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

[61 FR 40302, Aug. 2, 1996, as amended at 64 FR 51679, Sept. 24, 1999]

§ 212.3 Prohibitions.

(a) *Community*. A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same community.

(b) *RMSA*. A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same RMSA and, in the case of depository institutions, each depository organization has total assets of $20 million or more.

(c) *Major assets*. A management official of a depository organization with total assets exceeding $2.5 billion (or any affiliate of such an organization) may not serve at the same time as a management official of an unaffiliated depository organization with total assets exceeding $1.5 billion (or any affiliate of such an organization), regardless of the location of the two depository organizations. The Board will adjust these thresholds, as necessary, based on the year-to-year change in the average of the Consumer Price Index for the Urban Wage Earners and Clerical Workers, not seasonally adjusted, with rounding to the nearest $100 million. The Board will announce the revised thresholds by publishing a final rule without notice and comment in the FEDERAL REGISTER.

[61 FR 40302, Aug. 2, 1996, as amended at 64 FR 51679, Sept. 24, 1999]

§ 212.4 Interlocking relationships permitted by statute.

The prohibitions of § 212.3 do not apply in the case of any one or more of the following organizations or to a subsidiary thereof:

(a) A depository organization that has been placed formally in liquidation, or which is in the hands of a receiver, conservator, or other official exercising a similar function;

(b) A corporation operating under section 25 or section 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq*. and 12 U.S.C. 611 *et seq*., respectively) (Edge Corporations and Agreement Corporations);

(c) A credit union being served by a management official of another credit union;

(d) A depository organization that does not do business within the United States except as an incident to its activities outside the United States;

(e) A State-chartered savings and loan guaranty corporation;

(f) A Federal Home Loan Bank or any other bank organized solely to serve depository institutions (a bankers' bank) or solely for the purpose of providing securities clearing services and services related thereto for depository institutions and securities companies;

(g) A depository organization that is closed or is in danger of closing as determined by the appropriate Federal depository institution's regulatory agency and is acquired by another depository organization. This exemption lasts for five years, beginning on the date the depository organization is acquired; and

(h)(1) A diversified savings and loan holding company (as defined in section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) with respect to the service of a director of such company who also is a director of an unaffiliated depository organization if:

(i) Both the diversified savings and loan holding company and the unaffiliated depository organization notify their appropriate Federal depository institutions regulatory agency at least 60 days before the dual service is proposed to begin; and

(ii) The appropriate regulatory agency does not disapprove the dual service before the end of the 60-day period.

(2) The Board may disapprove a notice of proposed service if it finds that:

(i) The service cannot be structured or limited so as to preclude an anticompetitive effect in financial services in any part of the United States;

(ii) The service would lead to substantial conflicts of interest or unsafe or unsound practices; or

(iii) The notificant failed to furnish all the information required by the Board.

(3) The Board may require that any interlock permitted under this paragraph (h) be terminated if a change in circumstances occurs with respect to one of the interlocked depository organizations that would have provided a basis for disapproval of the interlock during the notice period.

§ 212.5 Small market share exemption.

(a) *Exemption*. A management interlock that is prohibited by § 212.3 is permissible, if:

(1) The interlock is not prohibited by § 212.3(c); and

(2) The depository organizations (and their depository institution affiliates) hold, in the aggregate, no more than 20 percent of the deposits in each RMSA or community in which both depository organizations (or their depository institution affiliates) have offices. The amount of deposits shall be determined by reference to the most recent annual Summary of Deposits published by the FDIC for the RMSA or community.

(b) *Confirmation and records*. Each depository organization must maintain records sufficient to support its determination of eligibility for the exemption under paragraph (a) of this section, and must reconfirm that determination on an annual basis.

[64 FR 51679, Sept. 24, 1999]

§ 212.6 General exemption.

(a) *Exemption*. The Board may, by agency order, exempt an interlock from the prohibitions in § 212.3, if the Board finds that the interlock would not result in a monopoly or substantial lessening of competition, and would not present safety and soundness concerns.

(b) *Presumptions*. In reviewing an application for an exemption under this section, the Board will apply a rebuttable presumption that an interlock will not result in a monopoly or substantial lessening of competition if the depository organization seeking to add a management official:

(1) Primarily serves low- and moderate-income areas;

(2) Is controlled or managed by persons who are members of a minority group, or women;

(3) Is a depository institution that has been chartered for less than two years; or

(4) Is deemed to be in ''troubled condition'' as defined in 12 CFR 225.71.

(c) *Duration*. Unless a shorter expiration period is provided in the Board approval, an exemption permitted by paragraph (a) of this section may continue so long as it does not result in a monopoly or substantial lessening of competition, or is unsafe or unsound. If the Board grants an interlock exemption in reliance upon a presumption under paragraph (b) of this section, the interlock may continue for three years, unless otherwise provided by the Board in writing.

[64 FR 51679, Sept. 24, 1999]

§ 212.7 Change in circumstances.

(a) *Termination*. A management official shall terminate his or her service or apply for an exemption if a change in circumstances causes the service to become prohibited. A change in circumstances may include an increase in asset size of an organization, a change in the delineation of the RMSA or community, the establishment of an office,

an increase in the aggregate deposits of the depository organization, or an acquisition, merger, consolidation, or reorganization of the ownership structure of a depository organization that causes a previously permissible interlock to become prohibited.

(b) *Transition period*. A management official described in paragraph (a) of this section may continue to serve the state member bank or bank holding company involved in the interlock for 15 months following the date of the change in circumstances. The Board may shorten this period under appropriate circumstances.

[61 FR 40302, Aug. 2, 1996, as amended at 64 FR 51679, Sept. 24, 1999]

§212.8 Enforcement.

Except as provided in this section, the Board administers and enforces the Interlocks Act with respect to state member banks, bank holding companies, and affiliates of either, and may refer any case of a prohibited interlocking relationship involving these entities to the Attorney General of the United States to enforce compliance with the Interlocks Act and this part. If an affiliate of a state member bank or a bank holding company is subject to the primary regulation of another Federal depository organization supervisory agency, then the Board does not administer and enforce the Interlocks Act with respect to that affiliate.

§212.9 Effect of Interlocks Act on Clayton Act.

The Board regards the provisions of the first three paragraphs of section 8 of the Clayton Act (15 U.S.C. 19) to have been supplanted by the revised and more comprehensive prohibitions on management official interlocks between depository organizations in the Interlocks Act.

PART 213—CONSUMER LEASING (REGULATION M)

Sec.

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SUPPLEMENT I TO PART 213—OFFICIAL STAFF COMMENTARY TO REGULATION M

AUTHORITY: 15 U.S.C. 1604; 1667f.

SOURCE: Reg. M, 61 FR 52258, Oct. 7, 1996, unless otherwise noted.

§213.1 Authority, scope, purpose, and enforcement.

(a) *Authority*. The regulation in this part, known as Regulation M, is issued by the Board of Governors of the Federal Reserve System to implement the consumer leasing provisions of the Truth in Lending Act, which is Title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 *et seq.*). Information collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 *et seq.* and have been assigned OMB control number 7100–0202.

(b) *Scope and purpose*. This part applies to all persons that are lessors of personal property under consumer leases as those terms are defined in §213.2(e)(1) and (h). The purpose of this part is:

(1) To ensure that lessees of personal property receive meaningful disclosures that enable them to compare lease terms with other leases and, where appropriate, with credit transactions;

(2) To limit the amount of balloon payments in consumer lease transactions; and

(3) To provide for the accurate disclosure of lease terms in advertising.

(c) *Enforcement and liability*. Section 108 of the act contains the administrative enforcement provisions. Sections 112, 130, 131, and 185 of the act contain the liability provisions for failing to comply with the requirements of the act and this part.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 62 FR 15367, Apr. 1, 1997]

§ 213.2 Definitions.

For the purposes of this part the following definitions apply:

(a) *Act* means the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Consumer Leasing Act is chapter 5 of the Truth in Lending Act.

(b) *Advertisement* means a commercial message in any medium that directly or indirectly promotes a consumer lease transaction.

(c) *Board* refers to the Board of Governors of the Federal Reserve System.

(d) *Closed-end lease* means a consumer lease other than an open-end lease as defined in this section.

(e)(1) *Consumer lease* means a contract in the form of a bailment or lease for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months and for a total contractual obligation not exceeding $25,000, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease. Unless the context indicates otherwise, in this part ''lease'' means ''consumer lease.''

(2) The term does not include a lease that meets the definition of a credit sale in Regulation Z (12 CFR 226.2(a)). It also does not include a lease for agricultural, business, or commercial purposes or a lease made to an organization.

(3) This part does not apply to a lease transaction of personal property which is incident to the lease of real property and which provides that:

(i) The lessee has no liability for the value of the personal property at the end of the lease term except for abnormal wear and tear; and

(ii) The lessee has no option to purchase the leased property.

(f) *Gross capitalized cost* means the amount agreed upon by the lessor and the lessee as the value of the leased property and any items that are capitalized or amortized during the lease term, including but not limited to taxes, insurance, service agreements, and any outstanding prior credit or lease balance. *Capitalized cost reduction* means the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost. The *adjusted capitalized cost* equals the gross capitalized cost less the capitalized cost reduction, and is the amount used by the lessor in calculating the base periodic payment.

(g) *Lessee* means a natural person who enters into or is offered a consumer lease.

(h) *Lessor* means a person who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who has leased, offered, or arranged to lease personal property more than five times in the preceding calendar year or more than five times in the current calendar year is subject to the act and this part.

(i) *Open-end lease* means a consumer lease in which the lessee's liability at the end of the lease term is based on the difference between the residual value of the leased property and its realized value.

(j) *Organization* means a corporation, trust, estate, partnership, cooperative, association, or government entity or instrumentality.

(k) *Person* means a natural person or an organization.

(l) *Personal property* means any property that is not real property under the law of the state where the property is located at the time it is offered or made available for lease.

(m) *Realized value* means:

(1) The price received by the lessor for the leased property at disposition;

(2) The highest offer for disposition of the leased property; or

(3) The fair market value of the leased property at the end of the lease term.

(n) *Residual value* means the value of the leased property at the end of the lease term, as estimated or assigned at consummation by the lessor, used in calculating the base periodic payment.

(o) *Security interest* and *security* mean any interest in property that secures the payment or performance of an obligation.

(p) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 62 FR 15367, Apr. 1, 1997]

§213.3 General disclosure requirements.

(a) *General requirements.* A lessor shall make the disclosures required by §213.4, as applicable. The disclosures shall be made clearly and conspicuously in writing in a form the consumer may keep, in accordance with this section.

(1) *Form of disclosures.* The disclosures required by §213.4 shall be given to the lessee together in a dated statement that identifies the lessor and the lessee; the disclosures may be made either in a separate statement that identifies the consumer lease transaction or in the contract or other document evidencing the lease. Alternatively, the disclosures required to be segregated from other information under paragraph (a)(2) of this section may be provided in a separate dated statement that identifies the lease, and the other required disclosures may be provided in the lease contract or other document evidencing the lease. In a lease of multiple items, the property description required by §213.4(a) may be given in a separate statement that is incorporated by reference in the disclosure statement required by this paragraph.

(2) *Segregation of certain disclosures.* The following disclosures shall be segregated from other information and shall contain only directly related information: §§213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1). The headings, content, and format for the disclosures referred to in this paragraph (a)(2) shall be provided in a manner substantially similar to the applicable model form in appendix A of this part.

(3) *Timing of disclosures.* A lessor shall provide the disclosures to the lessee prior to the consummation of a consumer lease.

(4) *Language of disclosures.* The disclosures required by §213.4 may be made in a language other than English provided that they are made available in English upon the lessee's request.

(5) *Electronic communication.* For rules governing the electronic delivery of disclosures, including a definition of electronic communication, see §213.6.

(b) *Additional information; nonsegregated disclosures.* Additional information may be provided with any disclosure not listed in paragraph (a)(2) of this section, but it shall not be stated, used, or placed so as to mislead or confuse the lessee or contradict, obscure, or detract attention from any disclosure required by this part.

(c) *Multiple lessors or lessees.* When a transaction involves more than one lessor, the disclosures required by this part may be made by one lessor on behalf of all the lessors. When a lease involves more than one lessee, the lessor may provide the disclosures to any lessee who is primarily liable on the lease.

(d) *Use of estimates.* If an amount or other item needed to comply with a required disclosure is unknown or unavailable after reasonable efforts have been made to ascertain the information, the lessor may use a reasonable estimate that is based on the best information available to the lessor, is clearly identified as an estimate, and is not used to circumvent or evade any disclosures required by this part.

(e) *Effect of subsequent occurrence.* If a required disclosure becomes inaccurate because of an event occurring after consummation, the inaccuracy is not a violation of this part.

(f) *Minor variations.* A lessor may disregard the effects of the following in making disclosures:

(1) That payments must be collected in whole cents;

(2) That dates of scheduled payments may be different because a scheduled date is not a business day;

(3) That months have different numbers of days; and

(4) That February 29 occurs in a leap year.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 66 FR 17328, Mar. 30, 2001]

§213.4 Content of disclosures.

For any consumer lease subject to this part, the lessor shall disclose the following information, as applicable:

(a) *Description of property.* A brief description of the leased property sufficient to identify the property to the lessee and lessor.

(b) *Amount due at lease signing or delivery.* The total amount to be paid prior to or at consummation or by delivery, if delivery occurs after consummation, using the term ''amount due at lease signing or delivery.'' The lessor shall itemize each component by

type and amount, including any refundable security deposit, advance monthly or other periodic payment, and capitalized cost reduction; and in motor-vehicle leases, shall itemize how the amount due will be paid, by type and amount, including any net trade-in allowance, rebates, noncash credits, and cash payments in a format substantially similar to the model forms in appendix A of this part.

(c) *Payment schedule and total amount of periodic payments.* The number, amount, and due dates or periods of payments scheduled under the lease, and the total amount of the periodic payments.

(d) *Other charges.* The total amount of other charges payable to the lessor, itemized by type and amount, that are not included in the periodic payments. Such charges include the amount of any liability the lease imposes upon the lessee at the end of the lease term; the potential difference between the residual and realized values referred to in paragraph (k) of this section is excluded.

(e) *Total of payments.* The total of payments, with a description such as ''the amount you will have paid by the end of the lease.'' This amount is the sum of the amount due at lease signing (less any refundable amounts), the total amount of periodic payments (less any portion of the periodic payment paid at lease signing), and other charges under paragraphs (b), (c), and (d) of this section. In an open-end lease, a description such as ''you will owe an additional amount if the actual value of the vehicle is less than the residual value'' shall accompany the disclosure.

(f) *Payment calculation.* In a motor-vehicle lease, a mathematical progression of how the scheduled periodic payment is derived, in a format substantially similar to the applicable model form in appendix A of this part, which shall contain the following:

(1) *Gross capitalized cost.* The gross capitalized cost, including a disclosure of the agreed upon value of the vehicle, a description such as ''the agreed upon value of the vehicle [state the amount] and any items you pay for over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance),'' and a statement of the lessee's option to receive a separate written itemization of the gross capitalized cost. If requested by the lessee, the itemization shall be provided before consummation.

(2) *Capitalized cost reduction.* The capitalized cost reduction, with a description such as ''the amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost.''

(3) *Adjusted capitalized cost.* The adjusted capitalized cost, with a description such as ''the amount used in calculating your base [periodic] payment.''

(4) *Residual value.* The residual value, with a description such as ''the value of the vehicle at the end of the lease used in calculating your base [periodic] payment.''

(5) *Depreciation and any amortized amounts.* The depreciation and any amortized amounts, which is the difference between the adjusted capitalized cost and the residual value, with a description such as ''the amount charged for the vehicle's decline in value through normal use and for any other items paid over the lease term.''

(6) *Rent charge.* The rent charge, with a description such as ''the amount charged in addition to the depreciation and any amortized amounts.'' This amount is the difference between the total of the base periodic payments over the lease term minus the depreciation and any amortized amounts.

(7) *Total of base periodic payments.* The total of base periodic payments with a description such as ''depreciation and any amortized amounts plus the rent charge.''

(8) *Lease payments.* The lease payments with a description such as ''the number of payments in your lease.''

(9) *Base periodic payment.* The total of the base periodic payments divided by the number of payment periods in the lease.

(10) *Itemization of other charges.* An itemization of any other charges that are part of the periodic payment.

(11) *Total periodic payment.* The sum of the base periodic payment and any other charges that are part of the periodic payment.

(g) *Early termination*—(1) *Conditions and disclosure of charges.* A statement

of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term; and the amount or a description of the method for determining the amount of any penalty or other charge for early termination, which must be reasonable.

(2) *Early-termination notice.* In a motor-vehicle lease, a notice substantially similar to the following: ''Early Termination. You may have to pay a substantial charge if you end this lease early. *The charge may be up to several thousand dollars.* The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.''

(h) *Maintenance responsibilities.* The following provisions are required:

(1) *Statement of responsibilities.* A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility;

(2) *Wear and use standard.* A statement of the lessor's standards for wear and use (if any), which must be reasonable; and

(3) *Notice of wear and use standard.* In a motor-vehicle lease, a notice regarding wear and use substantially similar to the following: ''Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use.'' The notice shall also specify the amount or method for determining any charge for excess mileage.

(i) *Purchase option.* A statement of whether or not the lessee has the option to purchase the leased property, and:

(1) *End of lease term.* If at the end of the lease term, the purchase price; and

(2) *During lease term.* If prior to the end of the lease term, the purchase price or the method for determining the price and when the lessee may exercise this option.

(j) *Statement referencing nonsegregated disclosures.* A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interests, if applicable.

(k) *Liability between residual and realized values.* A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value.

(l) *Right of appraisal.* If the lessee's liability at early termination or at the end of the lease term is based on the realized value of the leased property, a statement that the lessee may obtain, at the lessee's expense, a professional appraisal by an independent third party (agreed to by the lessee and the lessor) of the value that could be realized at sale of the leased property. The appraisal shall be final and binding on the parties.

(m) *Liability at end of lease term based on residual value.* If the lessee is liable at the end of the lease term for the difference between the residual value of the leased property and its realized value:

(1) *Rent and other charges.* The rent and other charges, paid by the lessee and required by the lessor as an incident to the lease transaction, with a description such as ''the total amount of rent and other charges imposed in connection with your lease [state the amount].''

(2) *Excess liability.* A statement about a rebuttable presumption that, at the end of the lease term, the residual value of the leased property is unreasonable and not in good faith to the extent that the residual value exceeds the realized value by more than three times the base monthly payment (or more than three times the average payment allocable to a monthly period, if the lease calls for periodic payments other than monthly); and that the lessor cannot collect the excess amount unless the lessor brings a successful court action and pays the lessee's reasonable attorney's fees, or unless the excess of the residual value over the realized value is due to unreasonable or excessive wear or use of the leased property (in which case the rebuttable presumption does not apply).

(3) *Mutually agreeable final adjustment.* A statement that the lessee and lessor are permitted, after termination of the lease, to make any mutually

agreeable final adjustment regarding excess liability.

(n) *Fees and taxes.* The total dollar amount for all official and license fees, registration, title, or taxes required to be paid in connection with the lease.

(o) *Insurance.* A brief identification of insurance in connection with the lease including:

(1) *Through the lessor.* If the insurance is provided by or paid through the lessor, the types and amounts of coverage and the cost to the lessee; or

(2) *Through a third party.* If the lessee must obtain the insurance, the types and amounts of coverage required of the lessee.

(p) *Warranties or guarantees.* A statement identifying all express warranties and guarantees from the manufacturer or lessor with respect to the leased property that apply to the lessee.

(q) *Penalties and other charges for delinquency.* The amount or the method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable.

(r) *Security interest.* A description of any security interest, other than a security deposit disclosed under paragraph (b) of this section, held or to be retained by the lessor; and a clear identification of the property to which the security interest relates.

(s) *Limitations on rate information.* If a lessor provides a percentage rate in an advertisement or in documents evidencing the lease transaction, a notice stating that ''this percentage may not measure the overall cost of financing this lease'' shall accompany the rate disclosure. The lessor shall not use the term ''annual percentage rate,'' ''annual lease rate,'' or any equivalent term.

(t) *Non-motor vehicle open-end leases.* Non-motor vehicle open-end leases remain subject to section 182(10) of the act regarding end of term liability.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 62 FR 15367, Apr. 1, 1997; 63 FR 52109, Sept. 29, 1998]

§ 213.5 Renegotiations, extensions, and assumptions.

(a) *Renegotiation.* A renegotiation occurs when a consumer lease subject to this part is satisfied and replaced by a new lease undertaken by the same consumer. A renegotiation requires new disclosures, except as provided in paragraph (d) of this section.

(b) *Extension.* An extension is a continuation, agreed to by the lessor and the lessee, of an existing consumer lease beyond the originally scheduled end of the lease term, except when the continuation is the result of a renegotiation. An extension that exceeds six months requires new disclosures, except as provided in paragraph (d) of this section.

(c) *Assumption.* New disclosures are not required when a consumer lease is assumed by another person, whether or not the lessor charges an assumption fee.

(d) *Exceptions.* New disclosures are not required for the following, even if they meet the definition of a renegotiation or an extension:

(1) A reduction in the rent charge;

(2) The deferment of one or more payments, whether or not a fee is charged;

(3) The extension of a lease for not more than six months on a month-to-month basis or otherwise;

(4) A substitution of leased property with property that has a substantially equivalent or greater economic value, provided no other lease terms are changed;

(5) The addition, deletion, or substitution of leased property in a multiple-item lease, provided the average periodic payment does not change by more than 25 percent; or

(6) An agreement resulting from a court proceeding.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 62 FR 15367, Apr. 1, 1997]

§ 213.6 Electronic communication.

(a) *Definition.* ''Electronic communication'' means a message transmitted electronically between a lessor and a lessee in a format that allows visual text to be displayed on equipment, for example, a personal computer monitor.

(b) *General rule.* In accordance with the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) (15 U.S.C. 7001 *et seq.*) and the rules of this part, a lessor may provide

by electronic communication any disclosure required by this part to be in writing.

(c) *When consent is required.* Under the E-Sign Act, a lessor is required to obtain a lessee's affirmative consent when providing disclosures related to a transaction. For purposes of this requirement, the disclosures required under §213.7 are deemed not to be related to a transaction.

(d) *Address or location to receive electronic communication.* A lessor that uses electronic communication to provide disclosures required by this part shall:

(1) Send the disclosure to the consumer's electronic address; or

(2) Make the disclosure available at another location such as a web site; and

(i) Alert the lessee of the disclosure's availability by sending a notice to the consumer's electronic address (or to a postal address, at the lessor's option). The notice shall identify the transaction involved and the address of the Internet web site or other location where the disclosure is available; and

(ii) Make the disclosure available for at least 90 days from the date the disclosure first becomes available or from the date of the notice alerting the lessee of the disclosure, whichever comes later.

(3) *Exceptions.* A lessor need not comply with paragraph (d)(2)(i) and (ii) of this section for the disclosures required under §213.7.

(e) *Redelivery.* When a disclosure provided by electronic communication is returned to a lessor undelivered, the lessor shall take reasonable steps to attempt redelivery using information in its files.

[Reg. M, 66 FR 17328, Mar. 30, 2001]

§213.7 Advertising.

(a) *General rule.* An advertisement for a consumer lease may state that a specific lease of property at specific amounts or terms is available only if the lessor usually and customarily leases or will lease the property at those amounts or terms.

(b) *Clear and conspicuous standard.* Disclosures required by this section shall be made clearly and conspicuously.

(1) *Amount due at lease signing or delivery.* Except for the statement of a periodic payment, any affirmative or negative reference to a charge that is a part of the disclosure required under paragraph (d)(2)(ii) of this section shall not be more prominent than that disclosure.

(2) *Advertisement of a lease rate.* If a lessor provides a percentage rate in an advertisement, the rate shall not be more prominent than any of the disclosures in §213.4, with the exception of the notice in §213.4(s) required to accompany the rate; and the lessor shall not use the term ''annual percentage rate,'' ''annual lease rate,'' or equivalent term.

(c) *Catalogs and multipage advertisements.* A catalog or other multipage advertisement that provides a table or schedule of the required disclosures shall be considered a single advertisement if, for lease terms that appear without all the required disclosures, the advertisement refers to the page or pages on which the table or schedule appears.

(d) *Advertisement of terms that require additional disclosure*—(1) *Triggering terms.* An advertisement that states any of the following items shall contain the disclosures required by paragraph (d)(2) of this section, except as provided in paragraphs (e) and (f) of this section:

(i) The amount of any payment; or

(ii) A statement of any capitalized cost reduction or other payment (or that no payment is required) prior to or at consummation or by delivery, if delivery occurs after consummation.

(2) *Additional terms.* An advertisement stating any item listed in paragraph (d)(1) of this section shall also state the following items:

(i) That the transaction advertised is a lease;

(ii) The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation;

(iii) The number, amounts, and due dates or periods of scheduled payments under the lease;

(iv) A statement of whether or not a security deposit is required; and

(v) A statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if

any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term.

(e) *Alternative disclosures—merchandise tags*. A merchandise tag stating any item listed in paragraph (d)(1) of this section may comply with paragraph (d)(2) of this section by referring to a sign or display prominently posted in the lessor's place of business that contains a table or schedule of the required disclosures.

(f) *Alternative disclosures—television or radio advertisements*.—(1) *Toll-free number or print advertisement*. An advertisement made through television or radio stating any item listed in paragraph (d)(1) of this section complies with paragraph (d)(2) of this section if the advertisement states the items listed in paragraphs (d)(2)(i) through (iii) of this section, and:

(i) Lists a toll-free telephone number along with a reference that such number may be used by consumers to obtain the information required by paragraph (d)(2) of this section; or

(ii) Directs the consumer to a written advertisement in a publication of general circulation in the community served by the media station, including the name and the date of the publication, with a statement that information required by paragraph (d)(2) of this section is included in the advertisement. The written advertisement shall be published beginning at least three days before and ending at least ten days after the broadcast.

(2) *Establishment of toll-free number*. (i) The toll-free telephone number shall be available for no fewer than ten days, beginning on the date of the broadcast.

(ii) The lessor shall provide the information required by paragraph (d)(2) of this section orally, or in writing upon request.

[Reg. M, 61 FR 52258, Oct. 7, 1996, as amended at 62 FR 15368, Apr. 1, 1997; 63 FR 52109, Sept. 29, 1998]

§ 213.8 Record retention.

A lessor shall retain evidence of compliance with the requirements imposed by this part, other than the advertising requirements under § 213.7, for a period of not less than two years after the date the disclosures are required to be made or an action is required to be taken.

§ 213.9 Relation to state laws.

(a) *Inconsistent state law*. A state law that is inconsistent with the requirements of the act and this part is preempted to the extent of the inconsistency. If a lessor cannot comply with a state law without violating a provision of this part, the state law is inconsistent within the meaning of section 186(a) of the act and is preempted, unless the state law gives greater protection and benefit to the consumer. A state, through an official having primary enforcement or interpretative responsibilities for the state consumer leasing law, may apply to the Board for a preemption determination.

(b) *Exemptions*.—(1) *Application*. A state may apply to the Board for an exemption from the requirements of the act and this part for any class of lease transactions within the state. The Board will grant such an exemption if the Board determines that:

(i) The class of leasing transactions is subject to state law requirements substantially similar to the act and this part or that lessees are afforded greater protection under state law; and

(ii) There is adequate provision for state enforcement.

(2) *Enforcement and liability*. After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by federal law) will constitute the requirements of the act and this part. No exemption will extend to the civil liability provisions of sections 130, 131, and 185 of the act.

APPENDIX A TO PART 213—MODEL FORMS

A–1 Model Open-End or Finance Vehicle Lease Disclosures
A–2 Model Closed-End or Net Vehicle Lease Disclosures
A–3 Model Furniture Lease Disclosures

Appendix A-1 Model Open-End or Finance Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Amount Due at Lease Signing or Delivery (Itemized below)* $ _____	**Monthly Payments** Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	**Other Charges** (not part of your monthly payment) Disposition fee (if you do not purchase the vehicle) $ _____ _____ _____ Total $ _____	**Total of Payments** (The amount you will have paid by the end of the lease) $ _____ You will owe an additional amount if the actual value of the vehicle is less than the residual value.

*** Itemization of Amount Due at Lease Signing or Delivery**

Amount Due At Lease Signing or Delivery:		**How the Amount Due at Lease Signing or Delivery will be paid:**	
Capitalized cost reduction	$ _____	Net trade-in allowance	$ _____
First monthly payment	_____	Rebates and noncash credits	_____
Refundable security deposit	_____	Amount to be paid in cash	_____
Title fees	_____	_____	_____
Registration fees	_____		
_____	_____		
Total	$ _____	Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($ _____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... – _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... – _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease payments. The number of payments in your lease ..... ÷ _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Rent and other charges. The total amount of rent and other charges imposed in connection with your lease $ _____ .

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Description of Leased Property				
Year	Make	Model	Body Style	Vehicle ID #

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____.

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

End of Term Liability. (a) The residual value ($ _____) of the vehicle is based on a reasonable, good faith estimate of the value of the vehicle at the end of the lease term. If the actual value of the vehicle at that time is greater than the residual value, you will have no further liability under this lease, except for other charges already incurred [and are entitled to a credit or refund of any surplus.] If the actual value of the vehicle is less than the residual value, you will be liable for any difference up to $ _____ (3 times the monthly payment). For any difference in excess of that amount, you will be liable only if:
1. Excessive use or damage [as described in paragraph ____] [representing more than normal wear and use] resulted in an unusually low value at the end of the term.
2. The matter is not otherwise resolved and we win a lawsuit against you seeking a higher payment.
3. You voluntarily agree with us after the end of the lease term to make a higher payment.
Should we bring a lawsuit against you, we must prove that our original estimate of the value of the leased property at the end of the lease term was reasonable and was made in good faith. For example, we might prove that the actual value was less than the original estimated value, although the original estimate was reasonable, because of an unanticipated decline in value for that type of vehicle. We must also pay your attorney's fees.
(b) If you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____ .

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____ .

Late Payments. The charge for late payments is: _____ .

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

[Reg. M, 63 FR 52110, Sept. 29, 1998]

Appendix A-2 Model Closed-End or Net Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Amount Due at Lease Signing or Delivery (Itemized below)* $ _____	**Monthly Payments** Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	**Other Charges** (not part of your monthly payment) Disposition fee (if you do not purchase the vehicle) $ _____ _____ _____ Total $ _____	**Total of Payments** (The amount you will have paid by the end of the lease) $ _____

*** Itemization of Amount Due at Lease Signing or Delivery**

Amount Due At Lease Signing or Delivery:		**How the Amount Due at Lease Signing or Delivery will be paid:**	
Capitalized cost reduction	$ _____	Net trade-in allowance	$ _____
First monthly payment	_____	Rebates and noncash credits	_____
Refundable security deposit	_____	Amount to be paid in cash	_____
Title fees	_____	_____	_____
Registration fees	_____		
_____	_____		
Total	$ _____	Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($ _____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... – _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... – _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease payments. The number of payments in your lease ..... ÷ _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Description of Leased Property				
Year	Make	Model	Body Style	Vehicle ID #

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____.

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____

Late Payments. The charge for late payments is: _____

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

[Reg. M, 63 FR 52112, Sept. 29, 1998]

Appendix A-3 Model Furniture Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Description of Leased Property

Item	Color	Stock #	Mfg.	Quantity

Amount Due at Lease Signing or Delivery	**Monthly Payments**	**Other Charges** (not part of your monthly payment)	**Total of Payments** (The amount you will have paid by the end of the lease)
First monthly payment $ _____ Refundable security deposit $ _____ Delivery/Installation fee $ _____ _____ $ _____ Total $ _____	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Pick-up fee $ _____ _____ $ _____ Total $ _____	$ _____

Purchase Option at End of Lease Term. [You have an option to purchase the leased property at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the leased property at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official fees, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease: _____
_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____ .

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased property:
_____

Maintenance.

[You are responsible for the following maintenance and servicing of the leased property:
_____.]

[We are responsible for the following maintenance and servicing of the leased property:
_____.]

Warranties. The leased property is subject to the following express warranties:
_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:
_____ .

The charge for such early termination is: _____ .

(b) We may terminate this lease before the end of the lease term under the following conditions: _____ .

Upon such termination we shall be entitled to the following charge(s) for: _____ .

Appendix A-3 Model Furniture Lease Disclosures Page 2 of 2

Early Termination and Default. (continued)

(c) To the extent these charges take into account the value of the leased property at termination, if you disagree with the value we assign to the property, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the property which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease: _____.

Late Payments. The charge for late payments is: _____.

Purchase Option Prior to the End of the Lease Term.

[You have an option to purchase the leased property prior to the end of the term. The price will be [$ _____]/the method of determining the price].]

[You do not have an option to purchase the leased property.]

[Reg. M, 63 FR 52114, Sept. 29, 1998]

APPENDIX B TO PART 213—FEDERAL ENFORCEMENT AGENCIES

The following list indicates which federal agency enforces Regulation M (12 CFR Part 213) for particular classes of business. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

1. *National banks and federal branches and federal agencies of foreign banks*
   District office of the Office of the Comptroller of the Currency for the district in which the institution is located.
2. *State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act*
   Federal Reserve Bank serving the District in which the institution is located.
3. *Nonmember insured banks and insured state branches of foreign banks*
   Federal Deposit Insurance Corporation Regional Director for the region in which the institution is located.
4. *Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund)*
   Office of Thrift Supervision regional director for the region in which the institution is located.
5. *Federal credit unions*
   Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.
6. *Air carriers*
   Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, S.W., Washington, DC 20590
7. *Those subject to Packers and Stockyards Act*
   Nearest Packers and Stockyards Administration area supervisor.
8. *Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations*
   Farm Credit Administration, 490 L'Enfant Plaza, S.W., Washington, DC 20578
9. *All other lessors (lessors operating on a local or regional basis should use the address of the FTC regional office in which they operate)*
   Division of Credit Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, DC 20580

APPENDIX C TO PART 213—ISSUANCE OF STAFF INTERPRETATIONS

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this Regulation M (12 CFR Part 213). These interpretations provide the formal protection afforded under section 130(f) of the act. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official commentary to Regulation M (Supplement I of this part), which will be amended periodically. No staff interpretations will be issued approving lessor's forms, statements, or calculation tools or methods.

SUPPLEMENT I TO PART 213—OFFICIAL STAFF COMMENTARY TO REGULATION M

Introduction

1. *Official status.* The commentary in Supplement I is the vehicle by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official

staff interpretations of Regulation M (12 CFR part 213). Good faith compliance with this commentary affords protection from liability under section 130(f) of the Truth in Lending Act (15 U.S.C. 1640(f)). Section 130(f) protects lessors from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System.

2. *Procedures for requesting interpretations.* Under appendix C of Regulation M, anyone may request an official staff interpretation. Interpretations that are adopted will be incorporated in this commentary following publication in the FEDERAL REGISTER. No official staff interpretations are expected to be issued other than by means of this commentary.

3. *Comment designations.* Each comment in the commentary is identified by a number and the regulatory section or paragraph that it interprets. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. For example, some of the comments to § 213.4(f) are further divided by subparagraph, such as comment 4(f)(1)–1 and comment 4(f)(2)–1. In other cases, comments have more general application and are designated, for example, as comment 4(a)–1. This introduction may be cited as comments I–1 through I–4. An appendix may be cited as comment app. A–1.

4. *Illustrations.* Lists that appear in the commentary may be exhaustive or illustrative; the appropriate construction should be clear from the context. Illustrative lists are introduced by phrases such as ''including,'' ''such as,'' ''to illustrate,'' and ''for example.''

Section 213.1—Authority, Scope, Purpose, and Enforcement

1. *Foreign applicability.* Regulation M applies to all persons (including branches of foreign banks or leasing companies located in the United States) that offer consumer leases to residents of any state (including foreign nationals) as defined in § 213.2(p). The regulation does not apply to a foreign branch of a U.S. bank or to a leasing company leasing to a U.S. citizen residing or visiting abroad or to a foreign national abroad.

Section 213.2—Definitions

2(b) Advertisement

1. *Coverage.* The term advertisement includes messages inviting, offering, or otherwise generally announcing to prospective customers the availability of consumer leases, whether in visual, oral, print or electronic media. Examples include:

i. Messages in newspapers, magazines, leaflets, catalogs, and fliers.

ii. Messages on radio, television, and public address systems.

iii. Direct mail literature.

iv. Printed material on any interior or exterior sign or display, in any window display, in any point-of-transaction literature or price tag that is delivered or made available to a lessee or prospective lessee in any manner whatsoever.

v. Telephone solicitations.

vi. On-line messages, such as those on the Internet.

2. *Exclusions.* The term does not apply to the following:

i. Direct personal contacts, including follow-up letters, cost estimates for individual lessees, or oral or written communications relating to the negotiation of a specific transaction.

ii. Informational material distributed only to businesses.

iii. Notices required by federal or state law, if the law mandates that specific information be displayed and only the mandated information is included in the notice.

iv. News articles controlled by the news medium.

v. Market research or educational materials that do not solicit business.

3. *Persons covered.* See the commentary to § 213.7(a).

2(d) Closed-End Lease

1. *General.* In closed-end leases, sometimes referred to as ''walk-away'' leases, the lessee is not responsible for the residual value of the leased property at the end of the lease term.

2(e) Consumer lease

1. *Primary purposes.* A lessor must determine in each case if the leased property will be used primarily for personal, family, or household purposes. If a question exists as to the primary purpose for a lease, the fact that a lessor gives disclosures is not controlling on the question of whether the transaction is covered. The primary purpose of a lease is determined before or at consummation and a lessor need not provide Regulation M disclosures where there is a subsequent change in the primary use.

2. *Period of time.* To be a consumer lease, the initial term of the lease must be more than four months. Thus, a lease of personal property for four months, three months or on a month-to-month or week-to-week basis (even though the lease actually extends beyond four months) is not a consumer lease and is not subject to the disclosure requirements of the regulation. However, a lease that imposes a penalty for not continuing the lease beyond four months is considered to have a term of more than four months. To illustrate:

i. A three-month lease extended on a month-to-month basis and terminated after one year is not subject to the regulation.

ii. A month-to-month lease with a penalty, such as the forfeiture of a security deposit for terminating before one year, is subject to the regulation.

3. *Total contractual obligation*. The total contractual obligation is not necessarily the same as the total of payments disclosed under §213.4(e). The total contractual obligation includes nonrefundable amounts a lessee is contractually obligated to pay to the lessor, but excludes items such as:

i. Residual value amounts or purchase-option prices;

ii. Amounts collected by the lessor but paid to a third party, such as taxes, licenses, and registration fees.

4. *Credit sale*. The regulation does not cover a lease that meets the definition of a credit sale in Regulation Z, 12 CFR 226.2(a)(16), which is defined, in part, as a bailment or lease (unless terminable without penalty at any time by the consumer) under which the consumer:

i. Agrees to pay as compensation for use a sum substantially equivalent to, or in excess of, the total value of the property and services involved; and

ii. Will become (or has the option to become), for no additional consideration or for nominal consideration, the owner of the property upon compliance with the agreement.

5. *Agricultural purpose*. Agricultural purpose means a purpose related to the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products, including but not limited to the acquisition of personal property and services used primarily in farming. Agricultural products include horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any products thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof.

6. *Organization or other entity*. A consumer lease does not include a lease made to an organization such as a corporation or a government agency or instrumentality. Such a lease is not covered by the regulation even if the leased property is used (by an employee, for example) primarily for personal, family or household purposes, or is guaranteed by or subsequently assigned to a natural person.

7. *Leases of personal property incidental to a service*. The following leases of personal property are deemed incidental to a service and thus are not subject to the regulation:

i. Home entertainment systems requiring the consumer to lease equipment that enables a television to receive the transmitted programming.

ii. Security alarm systems requiring the installation of leased equipment intended to monitor unlawful entries into a home and in some cases to provide fire protection.

iii. Propane gas service where the consumer must lease a propane tank to receive the service.

8. *Safe deposit boxes*. The lease of a safe deposit box is not a consumer lease under §213.2(e).

2(g) Lessee

1. *Guarantors*. Guarantors are not lessees for purposes of the regulation.

2(h) Lessor

1. *Arranger of a lease*. To ''arrange'' for the lease of personal property means to provide or offer to provide a lease that is or will be extended by another person under a business or other relationship pursuant to which the person arranging the lease (a) receives or will receive a fee, compensation, or other consideration for the service or (b) has knowledge of the lease terms and participates in the preparation of the contract documents required in connection with the lease. To illustrate:

i. An automobile dealer who, pursuant to a business relationship, completes the necessary lease agreement before forwarding it for execution to the leasing company (to whom the obligation is payable on its face) is ''arranging'' for the lease.

ii. An automobile dealer who, without receiving a fee for the service, refers a customer to a leasing company that will prepare all relevant contract documents is not ''arranging'' for the lease.

2. *Consideration*. The term ''other consideration'' as used in comment 2(h)–1 refers to an actual payment corresponding to a fee or similar compensation and not to intangible benefits, such as the advantage of increased business, which may flow from the relationship between the parties.

3. *Assignees*. An assignee may be a lessor for purposes of the regulation in circumstances where the assignee has substantial involvement in the lease transaction. See cf. *Ford Motor Credit Co.* v. *Cenance*, 452 U.S. 155 (1981) (held that an assignee was a creditor for purposes of the pre-1980 Truth in Lending Act and Regulation Z because of its substantial involvement in the credit transaction).

4. *Multiple lessors*. See the commentary to §213.3(c).

2(j) Organization

1. *Coverage*. The term ''organization'' includes joint ventures and persons operating under a business name.

2(l) Personal Property

1. *Coverage*. Whether property is personal property depends on state or other applicable law. For example, a mobile home or houseboat may be considered personal property in one state but real property in another.

2(m) Realized Value

1. *General*. Realized value refers to either the retail or wholesale value of the leased property at early termination or at the end of the lease term. It is not a required disclosure. Realized value is relevant only to leases in which the lessee's liability at early termination or at the end of the lease term typically is based on the difference between the residual value (or the adjusted lease balance) of the leased property and its realized value.

2. *Options*. Subject to the contract and to state or other applicable law, the lessor may calculate the realized value in determining the lessee's liability at the end of the lease term or at early termination in one of the three ways stated in §213.2(m). If the lessor sells the property prior to making the determination about liability, the price received for the property (or the fair market value) is the realized value. If the lessor does not sell the property prior to making that determination, the highest offer or the fair market value is the realized value.

3. *Determination of realized value*. Disposition charges are not subtracted in determining the realized value but amounts attributable to taxes may be subtracted.

4. *Offers*. In determining the highest offer for disposition, the lessor may disregard offers that an offeror has withdrawn or is unable or unwilling to perform.

5. *Lessor's appraisal*. See commentary to §213.4(l).

2(o) Security Interest and Security

1. *Disclosable interests*. For purposes of disclosure, a security interest is an interest taken by the lessor to secure performance of the lessee's obligation. For example, if a bank that is not a lessor makes a loan to a leasing company and takes assignments of consumer leases generated by that company to secure the loan, the bank's security interest in the lessor's receivables is not a security interest for purposes of this regulation.

2. *General coverage*. An interest the lessor may have in leased property must be disclosed only if it is considered a security interest under state or other applicable law. The term includes, but is not limited to, security interests under the Uniform Commercial Code; real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded; mechanic's, materialman's, artisan's, and other similar liens; vendor's liens in both real and personal property; liens on property arising by operation of law; and any interest in a lease when used to secure payment or performance of an obligation.

3. *Insurance exception*. The lessor's right to insurance proceeds or unearned insurance premiums is not a security interest for purposes of this regulation.

Section 213.3—General Disclosure Requirements

3(a) General Requirements

1. *Basis of disclosures*. Disclosures must reflect the terms of the legal obligation between the parties. For example:

i. In a three-year lease with no penalty for termination after a one-year minimum term, disclosures are based on the full three-year term of the lease. The one-year minimum term is only relevant to the early termination provisions of §§213.4 (g)(1), (k) and (l).

2. *Clear and conspicuous standard*. The clear and conspicuous standard requires that disclosures be reasonably understandable. For example, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other; appendix A of this part contains model forms that meet this standard. In addition, although no minimum typesize is required, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

3. *Multipurpose disclosure forms*. A lessor may use a multipurpose disclosure form provided the lessor is able to designate the specific disclosures applicable to a given transaction, consistent with the requirement that disclosures be clearly and conspicuously provided.

4. *Number of transactions*. Lessors have flexibility in handling lease transactions that may be viewed as multiple transactions. For example:

i. When a lessor leases two items to the same lessee on the same day, the lessor may disclose the leases as either one or two lease transactions.

ii. When a lessor sells insurance or other incidental services in connection with a lease, the lessor may disclose in one of two ways: as a single lease transaction (in which case Regulation M, not Regulation Z, disclosures are required) or as a lease transaction and a credit transaction.

iii. When a lessor includes an outstanding lease or credit balance in a lease transaction, the lessor may disclose the outstanding balance as part of a single lease transaction (in which case Regulation M, not Regulation Z, disclosures are required) or as a lease transaction and a credit transaction.

3(a)(1) Form of Disclosures

1. *Cross-references*. Lessors may include in the nonsegregated disclosures a cross-reference to items in the segregated disclosures rather than repeat those items. A lessor may

include in the segregated disclosures numeric or alphabetic designations as cross-references to related information so long as such references do not obscure or detract from the segregated disclosures.

2. *Identification of parties*. While disclosures must be made clearly and conspicuously, lessors are not required to use the word ''lessor'' and ''lessee'' to identify the parties to the lease transaction.

3. *Lessor's address*. The lessor must be identified by name; an address (and telephone number) may be provided.

4. *Multiple lessors and lessees*. In transactions involving multiple lessors and multiple lessees, a single lessor may make all the disclosures to a single lessee as long as the disclosure statement identifies all the lessors and lessees.

5. *Lessee's signature*. The regulation does not require that the lessee sign the disclosure statement, whether disclosures are separately provided or are part of the lease contract. Nevertheless, to provide evidence that disclosures are given before a lessee becomes obligated on the lease transaction, the lessor may, for example, ask the lessee to sign the disclosure statement or an acknowledgement of receipt, may place disclosures that are included in the lease documents above the lessee's signature, or include instructions alerting a lessee to read the disclosures prior to signing the lease.

3(a)(2) Segregation of Certain Disclosures

1. *Location*. The segregated disclosures referred to in §213.3(a)(2) may be provided on a separate document and the other required disclosures may be provided in the lease contract, so long as all disclosures are given at the same time. Alternatively, all disclosures may be provided in a separate document or in the lease contract.

2. *Additional information among segregated disclosures*. The disclosures required to be segregated may contain only the information required or permitted to be included among the segregated disclosures.

3. *Substantially similar*. See commentary to appendix A of this part.

3(a)(3) Timing of Disclosures

1. *Consummation*. When a contractual relationship is created between the lessor and the lessee is a matter to be determined under state or other applicable law.

3(b) Additional Information; Nonsegregated Disclosures

1. *State law disclosures*. A lessor may include in the nonsegregated disclosures any state law disclosures that are not inconsistent with the act and regulation under §213.9 as long as, in accordance with the standard set forth in §213.3(b) for additional information, the state law disclosures are not used or placed to mislead or confuse or detract from any disclosure required by the regulation.

3(c) Multiple Lessors or Lessees

1. *Multiple lessors*. If a single lessor provides disclosures to a lessee on behalf of several lessors, all disclosures for the transaction must be given, even if the lessor making the disclosures would not otherwise have been obligated to make a particular disclosure.

3(d) Use of Estimates

3(d)(1) Standard

1. *Time of estimated disclosure*. The lessor may, after making a reasonable effort to obtain information, use estimates to make disclosures if necessary information is unknown or unavailable at the time the disclosures are made.

2. *Basis of estimates*. Estimates must be made on the basis of the best information reasonably available at the time disclosures are made. The ''reasonably available'' standard requires that the lessor, acting in good faith, exercise due diligence in obtaining information. The lessor may rely on the representations of other parties. For example, the lessor might look to the consumer to determine the purpose for which leased property will be used, to insurance companies for the cost of insurance, or to an automobile manufacturer or dealer for the date of delivery. See commentary to §213.4(n) for estimating official fees and taxes.

3. *Residual value of leased property at termination*. In an open-end lease where the lessee's liability at the end of the lease term is based on the residual value of the leased property as determined at consummation, the estimate of the residual value must be reasonable and based on the best information reasonably available to the lessor (see §213.4(m)). A lessor should generally use an accepted trade publication listing estimated current or future market prices for the leased property unless other information or a reasonable belief based on its experience provides the better information. For example:

i. An automobile lessor offering a three-year open-end lease assigns a wholesale value to the vehicle at the end of the lease term. The lessor may disclose as an estimate a wholesale value derived from a generally accepted trade publication listing current wholesale values.

ii. Same facts as above, except that the lessor discloses an estimated value derived by adjusting the residual value quoted in the trade publication because, in its experience, the trade publication values either understate or overstate the prices actually received in local used-vehicle markets. The lessor may adjust estimated values quoted in trade publications if the lessor reasonably

believes based on its experience that the values are understated or overstated.

4. *Retail or wholesale value.* The lessor may choose either a retail or a wholesale value in estimating the value of leased property at termination of an open-end lease provided the choice is consistent with the lessor's general practice when determining the value of the property at the end of the lease term. The lessor should indicate whether the value disclosed is a retail or wholesale value.

5. *Labelling estimates.* Generally, only the disclosure for which the exact information is unknown is labelled as an estimate. Nevertheless, when several disclosures are affected because of the unknown information, the lessor has the option of labelling as an estimate every affected disclosure or only the disclosure primarily affected.

3(e) Effect of Subsequent Occurrence

1. *Subsequent occurrences.* Examples of subsequent occurrences include:

i. An agreement between the lessee and lessor to change from a monthly to a weekly payment schedule.

ii. An increase in official fees or taxes.

iii. An increase in insurance premiums or coverage caused by a change in the law.

iv. Late delivery of an automobile caused by a strike.

2. *Redisclosure.* When a disclosure becomes inaccurate because of a subsequent occurrence, the lessor need not make new disclosures unless new disclosures are required under §213.5.

3. *Lessee's failure to perform.* The lessor does not violate the regulation if a previously given disclosure becomes inaccurate when a lessee fails to perform obligations under the contract and a lessor takes actions that are necessary and proper in such circumstances to protect its interest. For example, the addition of insurance or a security interest by the lessor because the lessee has not performed obligations contracted for in the lease is not a violation of the regulation.

Section 213.4—Content of Disclosures

4(a) Description of Property

1. *Placement of description.* Although the description of leased property may not be included among the segregated disclosures, a lessor may choose to place the description directly above the segregated disclosures.

4(b) Amount Due at Lease Signing or Delivery

1. *Consummation.* See commentary to §213.3(a)(3).

2. *Capitalized cost reduction.* A capitalized cost reduction is a payment in the nature of a downpayment on the leased property that reduces the amount to be capitalized over the term of the lease. This amount does not include any amounts included in a periodic payment paid at lease signing or delivery.

3. *''Negative'' equity trade-in allowance.* If an amount owed on a prior lease or credit balance exceeds the agreed upon value of a trade-in, the difference is not reflected as a negative trade-in allowance under §213.4(b). The lessor may disclose the trade-in allowance as zero or not applicable, or may leave a blank line.

4. *Rebates.* Only rebates applied toward an amount due at lease signing or delivery are required to be disclosed under §213.4(b).

5. *Balance sheet approach.* In motor-vehicle leases, the total for the column labeled ''total amount due at lease signing or delivery'' must equal the total for the column labeled ''how the amount due at lease signing or delivery will be paid.''

6. *Amounts to be paid in cash.* The term cash is intended to include payments by check or other payment methods in addition to currency; however, a lessor may add a line item under the column ''how the amount due at lease signing or delivery will be paid'' for non-currency payments such as credit cards.

4(c) Payment Schedule and Total Amount of Periodic Payments

1. *Periodic payments.* The phrase ''number, amount, and due dates or periods of payments'' requires the disclosure of all payments that are made at regular or irregular intervals and generally derived from rent, capitalized or amortized amounts such as depreciation, and other amounts that are collected by the lessor at the same interval(s), including, for example, taxes, maintenance, and insurance charges. Other periodic payments may, but need not, be disclosed under §213.4(c).

4(d) Other charges

1. *Coverage.* Section 213.4(d) requires the disclosure of charges that are anticipated by the parties incident to the normal operation of the lease agreement. If a lessor is unsure whether a particular fee is an ''other charge,'' the lessor may disclose the fee as such without violating §213.4(d) or the segregation rule under §213.3(a)(2).

2. *Excluded charges.* This section does not require disclosure of charges that are imposed when the lessee terminates early, fails to abide by, or modifies the terms of the existing lease agreement, such as charges for:

i. Late payment.

ii. Default.

iii. Early termination.

iv. Deferral of payments.

v. Extension of the lease.

3. *Third-party fees and charges.* Third-party fees or charges collected by the lessor on behalf of third parties, such as taxes, are not disclosed under §213.4(d).

4. *Relationship to other provisions*. The other charges mentioned in this paragraph are charges that are not required to be disclosed under some other provision of §213.4. To illustrate:

i. The price of a mechanical breakdown protection (MBP) contract is sometimes disclosed as an ''other charge.'' Nevertheless, the price of MBP is sometimes reflected in the periodic payment disclosure under §213.4(c) or in states where MBP is regarded as insurance, the cost is be disclosed in accordance with §213.4(o).

5. *Lessee's liabilities at the end of the lease term*. Liabilities that the lessor imposes upon the lessee at the end of the scheduled lease term and that must be disclosed under §213.4(d) include disposition and ''pick-up'' charges.

6. *Optional ''disposition'' charges*. Disposition and similar charges that are anticipated by the parties as an incident to the normal operation of the lease agreement must be disclosed under §213.4(d). If, under a lease agreement, a lessee may return leased property to various locations, and the lessor charges a disposition fee depending upon the location chosen, under §213.4(d), the lessor must disclose the highest amount charged. In such circumstances, the lessor may also include a brief explanation of the fee structure in the segregated disclosure. For example, if no fee or a lower fee is imposed for returning a leased vehicle to the originating dealer as opposed to another location, that fact may be disclosed. By contrast, if the terms of the lease treat the return of the leased property to a location outside the lessor's service area as a default, the fee imposed is not disclosed as an ''other charge,'' although it may be required to be disclosed under §213.4(q).

4(e) Total of payments

1. *Open-end lease*. The additional statement is required under §213.4(e) for open-end leases because, with some limitations, a lessee is liable at the end of the lease term for the difference between the residual and realized values of the leased property.

4(f) Payment Calculation

1. *Motor-vehicle lease*. Whether leased property is a motor vehicle is determined by state or other applicable law.

2. *Multiple-items*. If a lease transaction involves multiple items of leased property, one of which is not a motor vehicle under state law, at their option, lessors may include all items in the disclosures required under §213.4(f). See comment 3(a)–4 regarding disclosure of multiple transactions.

4(f)(1) Gross Capitalized Cost

1. *Agreed upon value of the vehicle*. The agreed upon value of a motor vehicle includes the amount of capitalized items such as charges for vehicle accessories and options, and delivery or destination charges. The lessor may also include taxes and fees for title, licenses, and registration that are capitalized. Charges for service or maintenance contracts, insurance products, guaranteed automobile protection, or an outstanding balance on a prior lease or credit transaction are not included in the agreed upon value.

2. *Itemization of the gross capitalized cost*. The lessor may choose to provide the itemization of the gross capitalized cost only on request or may provide the itemization as a matter of course. In the latter case, the lessor need not provide a statement of the lessee's option to receive an itemization. The gross capitalized cost must be itemized by type and amount. The lessor may include in the itemization an identification of the items and amounts of some or all of the items contained in the agreed upon value of the vehicle. The itemization must be provided at the same time as the other disclosures required by §213.4, but it may not be included among the segregated disclosures.

4(f)(7) Total of Base Periodic Payment

1. *Accuracy of disclosure*. If the periodic payment calculation under §213.4(f) has been calculated correctly, the amount disclosed under §213.4(f)(7)—the total of base periodic payments—is correct for disclosure purposes even if that amount differs from the base periodic payment disclosed under §213.4(f)(9) multiplied by the number of lease payments disclosed under §213.4(f)(8), when the difference is due to rounding.

4(f)(8) Lease Payment

1. *Lease Term*. The lease term may be disclosed among the segregated disclosures.

4(g) Early Termination

4(g)(1) Conditions and Disclosure of Charges

1. *Reasonableness of charges*. See the commentary to §213.4(q).

2. *Description of the method*. Section 213.4(g)(1) requires a full description of the method of determining an early termination charge. The lessor should attempt to provide consumers with clear and understandable descriptions of its early termination charges. Descriptions that are full, accurate, and not intended to be misleading will comply with §213.4(g)(1), even if the descriptions are complex. In providing a full description of an early termination method, a lessor may use the name of a generally accepted method of computing the unamortized cost portion (also known as the ''adjusted lease balance'') of its early termination charges. For example, a lessor may state that the ''constant yield'' method will be utilized in obtaining

the adjusted lease balance, but must specify how that figure, and any other term or figure, is used in computing the total early termination charge imposed upon the consumer. Additionally, if a lessor refers to a named method in this manner, the lessor must provide a written explanation of that method if requested by the consumer. The lessor has the option of providing the explanation as a matter of course in the lease documents or on a separate document.

3. *Timing of written explanation of a named method*. While a lessor may provide an address or telephone number for the consumer to request a written explanation of the named method used to calculate the adjusted leased balance, if at consummation a consumer requests such an explanation, the lessor must provide a written explanation at that time. If a consumer requests an explanation after consummation, the lessor must provide a written explanation within a reasonable time after the request is made.

4. *Default*. When default is a condition for early termination of a lease, default charges must be disclosed under §213.4(g)(1). See the commentary to §213.4(q).

5. *Lessee's liability at early termination*. When the lessee is liable for the difference between the unamortized cost and the realized value at early termination, the method of determining the amount of the difference must be disclosed under §213.4(g)(1).

4(h) Maintenance Responsibilities

1. *Standards for wear and use*. No disclosure is required if a lessor does not set standards or impose charges for wear and use (such as excess mileage).

4(i) Purchase Option

1. *Mandatory disclosure of no purchase option*. Generally the lessor need only make the specific required disclosures that apply to a transaction. In the case of a purchase option disclosure, however, a lessor must disclose affirmatively that the lessee has no option to purchase the leased property if the purchase option is inapplicable.

2. *Existence of purchase option*. Whether a purchase option exists under the lease is determined by state or other applicable law. The lessee's right to submit a bid to purchase property at termination of the lease is not an option to purchase under §213.4(i) if the lessor is not required to accept the lessee's bid and the lessee does not receive preferential treatment.

3. *Purchase-option fee*. A purchase-option fee is disclosed under §213.4(i), not §213.4(d). The fee may be separately itemized or disclosed as part of the purchase-option price.

4. *Official fees and taxes*. Official fees such as those for taxes, licenses, and registration charged in connection with the exercise of a purchase option may be disclosed under §213.4(i) as part of the purchase-option price (with or without a reference to their inclusion in that price) or may be separately disclosed and itemized by category. Alternatively, a lessor may provide a statement indicating that the purchase-option price does not include fees for tags, taxes, and registration.

5. *Purchase-option price*. Lessors must disclose the purchase-option price as a sum certain or as a sum certain to be determined at a future date by reference to a readily available independent source. The reference should provide sufficient information so that the lessee will be able to determine the actual price when the option becomes available. Statements of a purchase price as the ''negotiated price'' or the ''fair market value'' do not comply with the requirements of §213.4(i).

4(j) Statement referencing nonsegregated disclosures

1. *Content*. A lessor may delete inapplicable items from the disclosure. For example, if a lease contract does not include a security interest, the reference to a security interest may be omitted.

4(l) Right of appraisal

1. *Disclosure inapplicable*. The lessee does not have the right to an independent appraisal merely because the lessee is liable at the end of the lease term or at early termination for unreasonable wear or use. Thus, the disclosure under §213.4(l) does not apply. For example:

i. The automobile lessor might expect a lessee to return an undented car with four good tires at the end of the lease term. Even though it may hold the lessee liable for the difference between a dented car with bald tires and the value of a car in reasonably good repair, the disclosure under §213.4(l) is not required.

2. *Lessor's appraisal*. If the lessor obtains an appraisal of the leased property to determine its realized value, that appraisal does not suffice for purposes of section 183(c) of the act; the lessor must disclose the lessee's right to an independent appraisal under §213.4(l).

3. *Retail or wholesale*. In providing the disclosures in §213.4(l), a lessor must indicate whether the wholesale or retail appraisal value will be used.

4. *Time restriction on appraisal*. The regulation does not specify a time period in which the lessee must exercise the appraisal right. The lessor may require a lessee to obtain the appraisal within a reasonable time after termination of the lease.

4(m) Liability at end of Lease Term Based on Residual Value

1. *Open-end leases.* Section 213.4(m) applies only to open-end leases.

2. *Lessor's payment of attorney's fees.* Section 183(a) of the act requires that the lessor pay the lessee's attorney's fees in all actions under §213.4(m), whether successful or not.

4(m)(1) Rent and other charges

1. *General.* This disclosure is intended to represent the cost of financing an open-end lease based on charges and fees that the lessor requires the lessee to pay. Examples of disclosable charges, in addition to the rent charge, include acquisition, disposition, or assignment fees. Charges imposed by a third party whose services are not required by the lessor (such as official fees and voluntary insurance) are not included in the §213.4(m)(1) disclosure.

4(m)(2) Excess liability

1. *Coverage.* The disclosure limiting the lessee's liability for the value of the leased property does not apply in the case of early termination.

2. *Leases with a minimum term.* If a lease has an alternative minimum term, the disclosures governing the liability limitation are not applicable for the minimum term.

3. *Charges not subject to rebuttable presumption.* The limitation on liability applies only to liability at the end of the lease term that is based on the difference between the residual value of the leased property and its realized value. The regulation does not preclude a lessor from recovering other charges from the lessee at the end of the lease term. Examples of such charges include:

i. Disposition charges.

ii. Excess mileage charges.

iii. Late payment and default charges.

iv. In simple-interest accounting leases, amount by which the unamortized cost exceeds the residual value because the lessee has not made timely payments.

4(n) Fees and taxes

1. *Treatment of certain taxes.* Taxes paid in connection with the lease are generally disclosed under §213.4(n), but there are exceptions. To illustrate:

i. Taxes paid by lease signing or delivery are disclosed under §213.4(b) and §213.4(n).

ii. Taxes that are part of the scheduled payments are reflected in the disclosure under §213.4(c), (f), and (n).

iii. A tax payable by the lessor that is passed on to the consumer and is reflected in the lease documentation must be disclosed under §213.4(n). A tax payable by the lessor and absorbed as a cost of doing business need not be disclosed.

iv. Taxes charged in connection with the exercise of a purchase option are disclosed under §213.4(i), not §213.4(n).

2. *Estimates.* In disclosing the total amount of fees and taxes under §213.4(n), lessors may need to base the disclosure on estimated tax rates or amounts and are afforded great flexibility in doing so. Where a rate is applied to the future value of leased property, lessors have flexibility in estimating that value, including, but not limited to, using the mathematical average of the agreed upon value and the residual value or published valuation guides; or a lessor could prepare estimates using the agreed upon value and disclose a reasonable estimate of the total fees and taxes. Lessors may include a statement that the actual total of fees and taxes may be higher or lower depending on the tax rates in effect or the value of the leased property at the time a fee or tax is assessed.

4(o) Insurance

1. *Coverage.* If insurance is obtained through the lessor, information on the type and amount of insurance coverage (whether voluntary or required) as well as the cost, must be disclosed.

2. *Lessor's insurance.* Insurance purchased by the lessor primarily for its own benefit, and absorbed as a business expense and not separately charged to the lessee, need not be disclosed under §213.4(o) even if it provides an incidental benefit to the lessee.

3. *Mechanical breakdown protection and other products.* Whether products purchased in conjunction with a lease, such as mechanical breakdown protection (MBP) or guaranteed automobile protection (GAP), should be treated as insurance is determined by state or other applicable law. In states that do not treat MBP or GAP as insurance, §213.4(o) disclosures are not required. In such cases the lessor may, however, disclose this information in accordance with the additional information provision in §213.3(b). For MBP insurance contracts not capped by a dollar amount, lessors may describe coverage by referring to a limitation by mileage or time period, for example, by indicating that the mechanical breakdown contract insures parts of the automobile for up to 100,000 miles.

4(p) Warranties or Guarantees

1. *Brief identification.* The statement identifying warranties may be brief and need not describe or list all warranties applicable to specific parts such as for air conditioning, radio, or tires in an automobile. For example, manufacturer's warranties may be identified simply by a reference to the standard manufacturer's warranty. If a lessor provides a comprehensive list of warranties that may not all apply, to comply with §213.4(p) the

lessor must indicate which warranties apply or, alternatively, which warranties do not apply.

2. *Warranty disclaimers*. Although a disclaimer of warranties is not required by the regulation, the lessor may give a disclaimer as additional information in accordance with §213.3(b).

3. *State law*. Whether an express warranty or guaranty exists is determined by state or other law.

4(q) Penalties and Other Charges for Delinquency

1. *Collection costs*. The automatic imposition of collection costs or attorney fees upon default must be disclosed under §213.4(q). Collection costs or attorney fees that are not imposed automatically, but are contingent upon expenditures in conjunction with a collection proceeding or upon the employment of an attorney to effect collection, need not be disclosed.

2. *Charges for early termination*. When default is a condition for early termination of a lease, default charges must also be disclosed under §213.4(g)(1). The §213.4(q) and (g)(1) disclosures may, but need not, be combined. Examples of combined disclosures are provided in the model lease disclosure forms in appendix A.

3. *Simple-interest leases*. In a simple-interest accounting lease, the additional rent charge that accrues on the lease balance when a periodic payment is made after the due date does not constitute a penalty or other charge for late payment. Similarly, continued accrual of the rent charge after termination of the lease because the lessee fails to return the leased property does not constitute a default charge. But in either case, if the additional charge accrues at a rate higher than the normal rent charge, the lessor must disclose the amount of or the method of determining the additional charge under §213.4(q).

4. *Extension charges*. Extension charges that exceed the rent charge in a simple-interest accounting lease or that are added separately are disclosed under §213.4(q).

5. *Reasonableness of charges*. Pursuant to section 183(b) of the act, penalties or other charges for delinquency, default, or early termination may be specified in the lease but only in an amount that is reasonable in light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

4(r) Security Interest

1. *Disclosable security interests*. See §213.2(o) and accompanying commentary to determine what security interests must be disclosed.

4(s) Limitations on Rate Information

1. *Segregated disclosures*. A lease rate may not be included among the segregated disclosures referenced in §213.3(a)(2).

Section 213.5—Renegotiations, Extensions and Assumptions

1. *Coverage*. Section 213.5 applies only to existing leases that are covered by the regulation. It does not apply to the renegotiation or extension of leases with an initial term of four months or less, because such leases are not covered by the definition of consumer lease in.

§213.2(e). Whether and when a lease is satisfied and replaced by a new lease is determined by state or other applicable law.

5(a) Renegotiations

1. *Basis of disclosures*. Lessors have flexibility in making disclosures so long as they reflect the legal obligation under the renegotiated lease. For example, assume that a 24-month lease is replaced by a 36-month lease. The initial lease began on January 1, 1998, and was renegotiated and replaced on July 1, 1998, so that the new lease term ends on January 1, 2001.

i. If the renegotiated lease covers the 36-month period beginning January 1, 1998, the new disclosures would reflect all payments made by the lessee on the initial lease and all payments on the renegotiated lease. In this example, since the renegotiated lease covers a 36-month period beginning January 1, 1998, the disclosures must reflect payments made since that date. On the model form, the ''total of base periodic payments'' disclosed under §213.4(f)(7) should reflect periodic payments to be made over the entire 36-month term. Payments received since January 1, 1998, are added as a new line item disclosed as ''total of payments received'' and are subtracted from the ''total of base periodic payments'' in calculating a new item disclosed as the ''total of base periodic payments remaining.'' For example, if 6 monthly payments of $300 were received since January 1, 1998, the disclosure form should include a ''total of base periodic payments'' line from which $1,800 is subtracted to arrive at the ''total of base periodic payments remaining.'' The remainder of the disclosures would not change.

ii. If the renegotiated lease covers only the remaining 30 months, from July 1, 1998, to January 1, 2001, the disclosures would reflect only the charges incurred in connection with the renegotiation and the payments for the remaining period.

5(b) Extensions

1. *Time of extension disclosures*. If a consumer lease is extended for a specified term greater than six months, new disclosures are required at the time the extension is agreed

upon. If the lease is extended on a month-to-month basis and the cumulative extensions exceed six months, new disclosures are required at the commencement of the seventh month and at the commencement of each seventh month thereafter for as long as the extensions continue. If a consumer lease is extended for terms of varying durations, one of which will exceed six months beyond the originally scheduled termination date of the lease, new disclosures are required at the commencement of the term that will exceed six months beyond the originally scheduled termination date.

2. *Content of disclosures for month-to-month extensions.* The disclosures for a lease extended on a month-to-month basis for more than six months should reflect the month-to-month nature of the transaction.

3. *Basis of disclosures.* The disclosures should be based on the extension period, including any upfront costs paid in connection with the extension. For example, assume that initially a lease ends on March 1, 1999. In January 1999, agreement is reached to extend the lease until October 1, 1999. The disclosure would include any extension fee paid in January and the periodic payments for the seven-month extension period beginning in March.

Section 213.6—Electronic Communication

6(b) General rule

1. *Relationship to the E-Sign Act.* The E-Sign Act authorizes the use of electronic disclosures. It does not affect any requirement imposed under this part other than a requirement that disclosures be in paper form, and it does not affect the content or timing of disclosures. Electronic disclosures are subject to the regulation's format, timing, and retainability rules and the clear and conspicuous standard. For example, to satisfy the clear and conspicuous standard for disclosures, electronic disclosures must use visual text.

2. *Clear and conspicuous standard.* A lessor must provide electronic disclosures using a clear and conspicuous format. Also in accordance with the E-Sign Act:

i. The lessor must disclose the requirements for accessing and retaining disclosures in that format;

ii. The lessee must demonstrate the ability to access the information electronically and affirmatively consent to electronic delivery; and

iii. The lessor must provide the disclosures in accordance with the specified requirements.

3. *Timing and effective delivery.* When a lessor permits the lessee to consummate a lease transaction on-line, the lessee must be required to access the required disclosures before becoming obligated. A link to the disclosures satisfies the timing rule if the lessee cannot bypass the disclosures before becoming obligated. Or the disclosures in this example must automatically appear on screen, even if multiple screens are required to view the entire disclosure. The lessor is not required to confirm that the lessee has read the disclosures.

4. *Retainability of disclosures.* A lessor satisfies the requirement that disclosures be in a form that the lessee may keep if electronic disclosures are delivered in a format that is capable of being retained (such as by printing or storing electronically). The format must also be consistent with the information required to be provided under section 101(c)(1)(C)(i) of the E-Sign Act (15 U.S.C. 7001(c)(1)(C)(i)) about the hardware and software requirements for accessing and retaining electronic disclosures.

5. *Disclosures provided on lessor's equipment.* To the extent applicable in connection with a lease transaction, a lessor that controls the equipment providing electronic disclosures to lessees (for example, a computer terminal in a lessor's place of business) must ensure that the equipment satisfies the regulation's requirements to provide timely disclosures in a clear and conspicuous format and in a form that the lessee may keep. For example, if disclosures are required at the time of an on-line transaction, the disclosures must be sent to the lessee's e-mail address or must be made available at another location such as the lessor's Internet web site, unless the lessor provides a printer that automatically prints the disclosures.

6(d) Address or Location to Receive Electronic Communication

Paragraph 6(d)(1)

1. *Electronic address.* A lessee's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by the lessor.

Paragraph 6(d)(2)

1. *90-day rule.* The actual disclosures provided to a lessee must be available for at least 90-days, but the lessor had discretion to determine whether they should be available at the same location for the entire period.

6(e) Redelivery.

1. *E-mail message returned as undeliverable.* If an e-mail message to the lessee (containing an alert notice or other disclosure) is returned as undeliverable, the redelivery requirement is satisfied if, for example, the lessor sends the disclosure to a different e-mail address or postal address that the lessor has on file for the lessee. Sending the disclosures a second time to the same electronic address is not sufficient if the lessor has a different address for the lessee on file.

Section 213.7—Advertising

7(a) General Rule

1. *Persons covered.* All ''persons'' must comply with the advertising provisions in this section, not just those that meet the definition of a lessor in §213.2(h). Thus, automobile dealers, merchants, and others who are not themselves lessors must comply with the advertising provisions of the regulation if they advertise consumer lease transactions. Pursuant to section 184(b) of the act, however, owners and personnel of the media in which an advertisement appears or through which it is disseminated are not subject to civil liability for violations under section 185(b) of the act.

2. *''Usually and customarily.''* Section 213.7(a) does not prohibit the advertising of a single item or the promotion of a new leasing program, but prohibits the advertising of terms that are not and will not be available. Thus, an advertisement may state terms that will be offered for only a limited period or terms that will become available at a future date.

7(b) Clear and Conspicuous Standard

1. *Standard.* The disclosures in an advertisement in any media must be reasonably understandable. For example, very fine print in a television advertisement or detailed and very rapidly stated information in a radio advertisement does not meet the clear and conspicuous standard if consumers cannot see and read or hear, and cannot comprehend, the information required to be disclosed.

7(b)(1) Amount due at Lease Signing or Delivery

1. *Itemization not required.* Only a total of amounts due at lease signing or delivery is required to be disclosed, not an itemization of its component parts. Such an itemization is provided in any transaction-specific disclosures provided under §213.4.

2. *Prominence rule.* Except for a periodic payment, oral or written references to components of the total due at lease signing or delivery (for example, a reference to a capitalized cost reduction, where permitted) may not be more prominent than the disclosure of the total amount due at lease signing or delivery.

3. *Electronic advertisements.* For advertisements using electronic communication, to satisfy the prominence rule in §213.7(b)(1), both the triggering terms and the required disclosures must appear in the same location so that they can be viewed simultaneously.

7(b)(2) Advertisement of a Lease Rate

1. *Location of statement.* The notice required to accompany a percentage rate stated in an advertisement must be placed in close proximity to the rate without any other intervening language or symbols. For example, a lessor may not place an asterisk next to the rate and place the notice elsewhere in the advertisement. In addition, with the exception of the notice required by §213.4(s), the rate cannot be more prominent than any other §213.4 disclosure stated in the advertisement. For advertisements using electronic communication, to comply with proximity rule in, both the rate and the accompanying notice must appear in the same location so that they can be viewed simultaneously. The prominent rule in §213.7(b)(2) is not met if the disclosures can be viewed only by use of a link that connects the consumer to the information appearing at another location.

7(c) Catalogs or Other Multi-Page Advertisements; Electronic Advertisements

1. *General rule.* The multiple-page advertisements referred to in §213.7(c) are advertisements consisting of a series of numbered pages—for example, a supplement to a newspaper. A mailing comprising several separate flyers or pieces of promotional material in a single envelope is not a single multiple-page advertisement.

2. *Cross references.* A catalog or other multiple-page advertisement or an electronic advertisement is a single advertisement (requiring only one set of lease disclosures) if it contains a table, chart, or schedule with the disclosures required under §213.7(d)(2)(i) through (v). If one of the triggering terms listed in §213.7(d)(1) appears in a catalog, or in a multiple-page or electronic advertisement, it must clearly direct the consumer to the page or location where the table, chart, or schedule begins. For example, in an electronic advertisement, a term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional information (but see comments under §213.7(b) about rules regarding the prominence of disclosures).

7(d)(1) Triggering Terms

1. *Typical example.* When any triggering term appears in a lease advertisement, the additional terms enumerated in §213.7(d)(2)(i) through (v) must also appear. In a multi-lease advertisement, an example of one or more typical leases with a statement of all the terms applicable to each may be used. The examples must be labeled as such and must reflect representative lease terms that are made available by the lessor to consumers.

7(d)(2) Additional Terms

1. *Third-party fees that vary by state or locality.* The disclosure of a periodic payment or total amount due at lease signing or delivery may:

i. Exclude third-party fees, such as taxes, licenses, and registration fees and disclose that fact; or

ii. Provide a periodic payment or total that includes third-party fees based on a particular state or locality as long as that fact and the fact that fees may vary by state or locality are disclosed.

7(e) Alternative Disclosures—Merchandise Tags

1. *Multiple-item leases.* Multiple-item leases that utilize merchandise tags requiring additional disclosures may use the alternate disclosure rule.

7(f) Alternative Disclosures—Television or Radio Advertisements

7(f)(1) Toll-Free Number or Print Advertisement

1. *Publication in general circulation.* A reference to a written advertisement appearing in a newspaper circulated nationally, for example, USA Today or the Wall Street Journal, may satisfy the general circulation requirement in §213.7(f)(1)(ii).

2. *Toll-free number, local or collect calls.* In complying with the disclosure requirements of §213.7(f)(1)(i), a lessor must provide a toll-free number for nonlocal calls made from an area code other than the one used in the lessor's dialing area. Alternatively, a lessor may provide any telephone number that allows a consumer to reverse the phone charges when calling for information.

3. *Multi-purpose number.* When an advertised toll-free number responds with a recording, lease disclosures must be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several dialing options—such as providing directions to the lessor's place of business—the option allowing the consumer to request lease disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

4. *Statement accompanying toll free number.* Language must accompany a telephone and television number indicating that disclosures are available by calling the toll-free number, such as ''call 1–800–000–0000 for details about costs and terms.''

Section 213.8—Record Retention

1. *Manner of retaining evidence.* A lessor must retain evidence of having performed required actions and of having made required disclosures. Such records may be retained in paper form, on microfilm, microfiche, or computer, or by any other method designed to reproduce records accurately. The lessor need retain only enough information to reconstruct the required disclosures or other records.

Section 213.9—Relation to State Laws

1. *Exemptions granted.* Effective October 1, 1982, the Board granted the following exemptions from portions of the Consumer Leasing Act:

i. *Maine.* Lease transactions subject to the Maine Consumer Credit Code and its implementing regulations are exempt from chapters 2, 4, and 5 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a lessor.)

ii. *Oklahoma.* Lease transactions subject to the Oklahoma Consumer Credit Code are exempt from chapters 2 and 5 of the federal act. (The exemption does not apply to sections 132 through 135 of the federal act, nor does it apply to transactions in which a federally chartered institution is a lessor.)

Appendix A—Model Forms

1. *Permissible changes.* Although use of the model forms is not required, lessors using them properly will be deemed to be in compliance with the regulation. Generally, lessors may make certain changes in the format or content of the forms and may delete any disclosures that are inapplicable to a transaction without losing the act's protection from liability. For example, the model form based on monthly periodic payments may be modified for single-payment lease transactions or for quarterly or other regular or irregular periodic payments. The model form may also be modified to reflect that a transaction is an extension. The content, format, and headings for the segregated disclosures must be substantially similar to those contained in the model forms; therefore, any changes should be minimal. The changes to the model forms should not be so extensive as to affect the substance and the clarity of the disclosures.

2. *Examples of acceptable changes.*

i. Using the first person, instead of the second person, in referring to the lessee.

ii. Using ''lessee,'' ''lessor,'' or names instead of pronouns.

iii. Rearranging the sequence of the nonsegregated disclosures.

iv. Incorporating certain state ''plain English'' requirements.

v. Deleting or blocking out inapplicable disclosures, filling in ''N/A'' (not applicable) or ''0,'' crossing out, leaving blanks, checking a box for applicable items, or circling applicable items (this should facilitate use of multipurpose standard forms).

vi. Adding language or symbols to indicate estimates.

vii. Adding numeric or alphabetic designations.

viii. Rearranging the disclosures into vertical columns, except for §213.4 (b) through (e) disclosures.

ix. Using icons and other graphics.

3. *Model closed-end or net vehicle lease disclosure.* Model A–2 is designed for a closed-end or net vehicle lease. Under the ''Early Termination and Default'' provision a reference to the lessee's right to an independent appraisal of the leased vehicle under §213.4(l) is included for those closed-end leases in which the lessee's liability at early termination is based on the vehicle's realized value.

4. *Model furniture lease disclosures.* Model A–3 is a closed-end lease disclosure statement designed for a typical furniture lease. It does not include a disclosure of the appraisal right at early termination required under §213.4(l) because few closed-end furniture leases base the lessee's liability at early termination on the realized value of the leased property. The disclosure should be added if it is applicable.

[Reg. M, 62 FR 16058, Apr. 4, 1997, as amended at 63 FR 52115, Sept. 29, 1998; 64 FR 16613, 16614, Apr. 6, 1999; 66 FR 17328, Mar. 30, 2001]

PART 214—RELATIONS WITH FOREIGN BANKS AND BANKERS (REGULATION N)

REGULATIONS

Sec.
214.1 Scope of part.
214.2 Information to be furnished to the Board.
214.3 Conferences and negotiations with foreign banks, bankers, or States.
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214.6 Amendments.

AUTHORITY: 12 U.S.C. 248, 348a, 358, 632.

SOURCE: Reg. N, 8 FR 17290, Dec. 24, 1943, unless otherwise noted.

REGULATIONS

§214.1 Scope of part.

Pursuant to the authority conferred upon it by section 14 of the Federal Reserve Act, as amended (40 Stat. 235, 48 Stat. 181; 12 U.S.C. 358, 348a), and by other provisions of law, the Board of Governors of the Federal Reserve System prescribes the following regulations governing relationships and transactions between Federal Reserve Banks and foreign banks or bankers or groups of foreign banks, or bankers, or a foreign State as defined in section 25(b) of the Federal Reserve Act (55 Stat. 131; 12 U.S.C. 632).

§214.2 Information to be furnished to the Board.

In order that the Board of Governors of the Federal Reserve System may perform its statutory duty of exercising special supervision over all relationships and transactions of any kind entered into by any Federal Reserve Bank with any foreign bank or banker or with any group of foreign banks or bankers or with any foreign State, each Federal Reserve Bank shall promptly submit to the Board of Governors of the Federal Reserve System in writing full information concerning all existing relationships and transactions of any kind heretofore entered into by such Federal Reserve Bank with any foreign bank or banker or with any group of foreign banks or bankers or with any foreign State and copies of all written agreements between it and any foreign bank or banker or any group of foreign banks or bankers or any foreign State which are now in force, unless copies have heretofore been furnished to the Board. Each Federal Reserve Bank shall also keep the Board of Governors of the Federal Reserve System promptly and fully advised of all transactions with any foreign bank or banker or with any group of foreign banks or bankers or with any foreign State, except transactions of a routine character.

§214.3 Conferences and negotiations with foreign banks, bankers, or States.

(a) Without first obtaining the permission of the Board of Governors of the Federal Reserve System, no officer or other representative of any Federal Reserve Bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker or any group of foreign banks or bankers of any foreign State, except communications in the ordinary course of business in connection with transactions pursuant to agreements previously approved by the Board of Governors of the Federal Reserve System. Any request for the Board's permission to conduct any such negotiations shall

be submitted in writting and shall include a full statement of the occasion and objects of the proposed negotiations.

(b) The Board of Governors of the Federal Reserve System reserves the right, in its discretion, to be represented by such representatives as it may designate in any negotiations between any officer or other representative of any Federal Reserve Bank and any officers or representatives of any foreign bank or banker or any group of foreign banks or bankers or any foreign State; and the Board shall be given reasonable notice in advance of the time and place of any such negotiations; and may itself designate the time and place of any such negotiations.

(c) A full report of all such conferences or negotiations and all understandings or agreements arrived at or transactions agreed upon and all other material facts appertaining to such conferences or negotiations shall be filed with the Board of Governors of the Federal Reserve System in writing by a duly authorized officer of each Federal Reserve Bank which shall have participated in such conferences or negotiations, including copies of all correspondence appertaining thereto.

§ 214.4 Agreements with foreign banks, bankers, or States, and participation in foreign accounts.

(a) No Federal Reserve Bank shall enter into any agreement, contract, or understanding with any foreign bank or banker or with any group of foreign banks or bankers or with any foreign State without first obtaining the permission of the Board of Governors of the Federal Reserve System.

(b) When any Federal Reserve Bank, with the approval of the Board of Governors of the Federal Reserve System, has opened an account for any foreign bank or banker or group of foreign banks or bankers or for any foreign State, or has entered into any agreement, contract, or understanding with reference to opening or maintaining such an account, or with reference to any other matter or matters, any other Federal Reserve Bank may participate in such account, or in such agreement, contract, or understanding, and in operations and transactions performed therein or pursuant thereto, with the approval of the Board of Governors of the Federal Reserve System.

§ 214.5 Accounts with foreign banks.

(a) Any Federal Reserve Bank, with the consent of the Board, may open and maintain accounts payable in foreign currencies with such foreign banks as may be designated by the Board.

(b) Notwithstanding other provisions of this part, any officer or other representatives of the Federal Reserve Bank which maintains an account with a foreign bank may conduct such negotiations and enter into such agreements, contracts, or understandings with such foreign bank as may be authorized or directed by the Federal Open Market Committee in order to effectuate the conduct of open market transactions of the Federal Reserve Banks incident to the opening, maintenance, operation, increase, reduction, or discontinuance of such account; and, in any such case, such negotiations, agreements, contracts, or understandings shall be subject to such authorizations, directions, regulations, and limitations as may be prescribed by, or pursuant to authority of, the Federal Open Market Committee.

(c) Any Federal Reserve Bank may, when authorized or directed so to do by, or under the authority of, the Federal Open Market Committee, carry on or conduct, through any other Federal Reserve Bank which maintains an account with a foreign bank, any open market transactions authorized by section 14 of the Federal Reserve Act. Transactions authorized by section 14 which are not open market transactions may be carried on or conducted through such other Federal Reserve Bank only with the approval of the Board.

(d) Notwithstanding other provisions of this part, reports with respect to any accounts opened and maintained, and negotiations, agreements, contracts, and understandings entered into, pursuant to this section shall be made to the Board at least quarterly, and more frequently if so requested by the Board, by a duly authorized officer of the Federal Reserve Bank involved.

[Reg. N, 27 FR 1719, Feb. 22, 1962]

§214.6 Amendments.

The Board of Governors of the Federal Reserve System reserves the right, in its discretion, to alter, amend or repeal these regulations and to prescribe such additional regulations, conditions, and limitations as it may deem desirable, respecting relationships and transactions of any kind entered into by any Federal Reserve Bank with any foreign bank or banker or with any group of foreign banks or bankers or with any foreign State.

[Reg. N, 8 FR 17290, Dec. 24, 1943. Redesignated at 27 FR 1719, Feb. 22, 1962]

PART 215—LOANS TO EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS OF MEMBER BANKS (REGULATION O)

Subpart A—Loans by Member Banks to Their Executive Officers, Directors, and Principal Shareholders

Sec.
215.1 Authority, purpose, and scope.
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215.8 Records of member banks.
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215.12 Reporting requirement for credit secured by certain bank stock.
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APPENDIX—SECTION 5200 OF THE REVISED STATUTES TOTAL LOANS AND EXTENSIONS OF CREDIT

Subpart B—Reports on Indebtedness of Executive Officers and Principal Shareholders to Correspondent Banks

215.20 Authority, purpose, and scope.
215.21 Definitions.
215.22 Report by executive officers and principal shareholders.
215.23 Disclosure of credit from correspondent banks to executive officers and principal shareholders.

AUTHORITY: 12 U.S.C. 248(i), 375a(10), 375b(9) and (10), 1817(k)(3) and 1972(2)(G)(ii); Pub. L. 102–242, 105 Stat. 2236.

SOURCE: 44 FR 12964, Mar. 9, 1979, unless otherwise noted.

Subpart A—Loans by Member Banks to Their Executive Officers, Directors, and Principal Shareholders

SOURCE: Reg. O, 59 FR 8837, Feb. 24, 1994, unless otherwise noted.

§215.1 Authority, purpose, and scope.

(a) *Authority*. This subpart is issued pursuant to sections 11(i), 22(g), and 22(h) of the Federal Reserve Act (12 U.S.C. 248(i), 375a, and 375b), 12 U.S.C. 1817(k), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)).

(b) *Purpose and scope*. This subpart A governs any extension of credit by a member bank to an executive officer, director, or principal shareholder of: The member bank; a bank holding company of which the member bank is a subsidiary; and any other subsidiary of that bank holding company. It also applies to any extension of credit by a member bank to: A company controlled by such a person; and a political or campaign committee that benefits or is controlled by such a person. This subpart A also implements the reporting requirements of 12 U.S.C. 375a concerning extensions of credit by a member bank to its executive officers and of 12 U.S.C. 1817(k) concerning extensions of credit by a member bank to its executive officers or principal shareholders, or the related interests of such persons.

§215.2 Definitions.

For the purposes of this subpart A, the following definitions apply unless otherwise specified:

(a) *Affiliate* means any company of which a member bank is a subsidiary or any other subsidiary of that company.

(b) *Company* means any corporation, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship, unincorporated organization, or any other

form of business entity not specifically listed herein. However, the term does not include:

(1) An insured depository institution (as defined in 12 U.S.C. 1813); or

(2) A corporation the majority of the shares of which are owned by the United States or by any State.

(c)(1) *Control of a company or bank* means that a person directly or indirectly, or acting through or in concert with one or more persons:

(i) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the company or bank;

(ii) Controls in any manner the election of a majority of the directors of the company or bank; or

(iii) Has the power to exercise a controlling influence over the management or policies of the company or bank.

(2) A person is presumed to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank if:

(i) The person is:

(A) An executive officer or director of the company or bank; and

(B) Directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; or

(ii)(A) The person directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; and

(B) No other person owns, controls, or has the power to vote a greater percentage of that class of voting securities.

(3) An individual is not considered to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank solely by virtue of the individual's position as an officer or director of the company or bank.

(4) A person may rebut a presumption established by paragraph (c)(2) of this section by submitting to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813(q)) written materials that, in the agency's judgment, demonstrate an absence of control.

(d)(1) *Director of a company or bank* means any director of the company or bank, whether or not receiving compensation. An advisory director is not considered a director if the advisory director:

(i) Is not elected by the shareholders of the company or bank;

(ii) Is not authorized to vote on matters before the board of directors; and

(iii) Provides solely general policy advice to the board of directors.

(2) Extensions of credit to a director of an affiliate of a bank are not subject to §§ 215.4, 215.6, and 215.8 if—

(i) The director of the affiliate is excluded, by resolution of the board of directors or by the bylaws of the bank, from participation in major policymaking functions of the bank, and the director does not actually participate in such functions;

(ii) The affiliate does not control the bank;

(iii) As determined annually, the assets of the affiliate do not constitute more than 10 percent of the consolidated assets of the company that—

(A) Controls the bank; and

(B) Is not controlled by any other company; and

(iv) The director of the affiliate is not otherwise subject to §§ 215.4, 215.6, and 215.8.

(3) For purposes of paragraph (d)(2)(i) of this section, a resolution of the board of directors or a corporate bylaw may—

(i) Include the director (by name or by title) in a list of persons excluded from participation in such functions; or

(ii) Not include the director in a list of persons authorized (by name or by title) to participate in such functions.

(e)(1) *Executive officer* of a company or bank means a person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company or bank, whether or not: the officer has an official title; the title designates the officer an assistant; or the officer is serving without salary or other compensation.[1] The chairman of

[1] The term is not intended to include persons who may have official titles and may exercise a certain measure of discretion in the performance of their duties, including

the board, the president, every vice president, the cashier, the secretary, and the treasurer of a company or bank are considered executive officers, unless the officer is excluded, by resolution of the board of directors or by the bylaws of the bank or company, from participation (other than in the capacity of a director) in major policymaking functions of the bank or company, and the officer does not actually participate therein.

(2) Extensions of credit to an executive officer of an affiliate of a bank are not subject to §§215.4, 215.6, and 215.8 if—

(i) The executive officer is excluded, by resolution of the board of directors or by the bylaws of the bank, from participation in major policymaking functions of the bank, and the executive officer does not actually participate in such functions;

(ii) The affiliate does not control the bank;

(iii) As determined annually, the assets of the affiliate do not constitute more than 10 percent of the consolidated assets of the company that—

(A) Controls the bank; and

(B) Is not controlled by any other company; and

(iv) The executive officer of the affiliate is not otherwise subject to §§215.4, 215.6, and 215.8.

(3) For purposes of paragraphs (e)(1) and (e)(2)(i) of this section, a resolution of the board of directors or a corporate bylaw may—

(i) Include the executive officer (by name or by title) in a list of persons excluded from participation in such functions; or

(ii) Not include the executive officer in a list of persons authorized (by name or by title) to participate in such functions.

(f) *Foreign bank* has the meaning given in 12 U.S.C. 3101(7).

(g) *Immediate family* means the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.

(h) *Insider* means an executive officer, director, or principal shareholder, and includes any related interest of such a person.

(i) *Lending limit*. The lending limit for a member bank is an amount equal to the limit of loans to a single borrower established by section 5200 of the Revised Statutes,[2] 12 U.S.C. 84. This amount is 15 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are not fully secured, and an additional 10 percent of the bank's unimpaired capital and unimpaired surplus in the case of loans that are fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan. The lending limit also includes any higher amounts that are permitted by section 5200 of the Revised Statutes for the types of obligations listed therein as exceptions to the limit. A member bank's unimpaired capital and unimpaired surplus equals:

(1) The bank's Tier 1 and Tier 2 capital included in the bank's risk-based capital under the capital guidelines of the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 USC 1817(a)(3); and

(2) The balance of the bank's allowance for loan and lease losses not included in the bank's Tier 2 capital for purposes of the calculation of risk-based capital by the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 U.S.C. 1817(a)(3)

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discretion in the making of loans, but who do not participate in the determination of major policies of the bank or company and whose decisions are limited by policy standards fixed by the senior management of the bank or company. For example, the term does not include a manager or assistant manager of a branch of a bank unless that individual participates, or is authorized to participate, in major policymaking functions of the bank or company.

[2] Where State law establishes a lending limit for a State member bank that is lower than the amount permitted in section 5200 of the Revised Statutes, the lending limit established by applicable State laws shall be the lending limit for the State member bank.

(j) *Member bank* means any banking institution that is a member of the Federal Reserve System, including any subsidiary of a member bank. The term does not include any foreign bank that maintains a branch in the United States, whether or not the branch is insured (within the meaning of 12 U.S.C. 1813(s)) and regardless of the operation of 12 U.S.C. 1813(h) and 12 U.S.C. 1828(j)(3)(B).

(k) *Pay an overdraft on an account* means to pay an amount upon the order of an account holder in excess of funds on deposit in the account.

(l) *Person* means an individual or a company.

(m)(1) *Principal shareholder* means a person (other than an insured bank) that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank or company. Shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual.

(2) A principal shareholder of a member bank does not include a company of which a member bank is a subsidiary.

(n) *Related interest* of a person means:

(1) A company that is controlled by that person; or

(2) A political or campaign committee that is controlled by that person or the funds or services of which will benefit that person.

(o) *Subsidiary* has the meaning given in 12 U.S.C. 1841(d), but does not include a subsidiary of a member bank.

[Reg. O, 59 FR 8837, Feb. 24, 1994; 59 FR 37930, July 26, 1994, as amended at 60 FR 31054, June 13, 1995; 61 FR 57770, Nov. 8, 1996; 62 FR 13298, Mar. 20, 1997]

§ 215.3 Extension of credit.

(a) An extension of credit is a making or renewal of any loan, a granting of a line of credit, or an extending of credit in any manner whatsoever, and includes:

(1) A purchase under repurchase agreement of securities, other assets, or obligations;

(2) An advance by means of an overdraft, cash item, or otherwise;

(3) Issuance of a standby letter of credit (or other similar arrangement regardless of name or description) or an ineligible acceptance, as those terms are defined in § 208.24 of this chapter;

(4) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which an insider may be liable as maker, drawer, endorser, guarantor, or surety;

(5) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for:

(i) Accrued interest; or

(ii) Taxes, insurance, or other expenses incidental to the existing indebtedness;

(6) An advance of unearned salary or other unearned compensation for a period in excess of 30 days; and

(7) Any other similar transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any means whatsoever.

(b) An extension of credit does not include:

(1) An advance against accrued salary or other accrued compensation, or an advance for the payment of authorized travel or other expenses incurred or to be incurred on behalf of the bank;

(2) A receipt by a bank of a check deposited in or delivered to the bank in the usual course of business unless it results in the carrying of a cash item for or the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid, as described in § 215.4(e) of this part);

(3) An acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through:

(i) A merger or consolidation of banks or a similar transaction by which a bank acquires assets and assumes liabilities of another bank or similar organization; or

(ii) Foreclosure on collateral or similar proceeding for the protection of the bank, provided that such indebtedness is not held for a period of more than

three years from the date of the acquisition, subject to extension by the appropriate Federal banking agency for good cause;

(4)(i) An endorsement or guarantee for the protection of a bank of any loan or other asset previously acquired by the bank in good faith; or

(ii) Any indebtedness to a bank for the purpose of protecting the bank against loss or of giving financial assistance to it;

(5) Indebtedness of $15,000 or less arising by reason of any general arrangement by which a bank:

(i) Acquires charge or time credit accounts; or

(ii) Makes payments to or on behalf of participants in a bank credit card plan, check credit plan, or similar open-end credit plan, provided:

(A) The indebtedness does not involve prior individual clearance or approval by the bank other than for the purposes of determining authority to participate in the arrangement and compliance with any dollar limit under the arrangement; and

(B) The indebtedness is incurred under terms that are not more favorable than those offered to the general public;

(6) Indebtedness of $5,000 or less arising by reason of an interest-bearing overdraft credit plan of the type specified in §215.4(e) of this part; or

(7) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, without recourse.

(c) Non-interest-bearing deposits to the credit of a bank are not considered loans, advances, or extensions of credit to the bank of deposit; nor is the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business considered to be a loan, advance or extension of credit to the depositing bank.

(d) For purposes of §215.4 of this part, an extension of credit by a member bank is considered to have been made at the time the bank enters into a binding commitment to make the extension of credit.

(e) A participation without recourse is considered to be an extension of credit by the participating bank, not by the originating bank.

(f) *Tangible economic benefit rule*—(1) *In general*. An extension of credit is considered made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider.

(2) *Exception*. An extension of credit is not considered made to an insider under paragraph (f)(1) of this section if:

(i) The credit is extended on terms that would satisfy the standard set forth in §215.4(a) of this part for extensions of credit to insiders; and

(ii) The proceeds of the extension of credit are used in a bona fide transaction to acquire property, goods, or services from the insider.

[Reg. O, 59 FR 8837, Feb. 24, 1994; 59 FR 37930, July 26, 1994; 63 FR 58621, Nov. 2, 1998]

§215.4 General prohibitions.

(a) *Terms and creditworthiness*—(1) *In general*. No member bank may extend credit to any insider of the bank or insider of its affiliates unless the extension of credit:

(i) Is made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank; and

(ii) Does not involve more than the normal risk of repayment or present other unfavorable features.

(2) *Exception*. Nothing in this paragraph (a) or paragraph (e)(2)(ii) of this section shall prohibit any extension of credit made pursuant to a benefit or compensation program—

(i) That is widely available to employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, is widely available to employees of the affiliates at which that person is an insider; and

(ii) That does not give preference to any insider of the member bank over other employees of the member bank and, in the case of extensions of credit to an insider of its affiliates, does not give preference to any insider of its affiliates over other employees of the affiliates at which that person is an insider.

(b) *Prior approval.* (1) No member bank may extend credit (which term includes granting a line of credit) to any insider of the bank or insider of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceeds the higher of $25,000 or 5 percent of the member bank's unimpaired capital and unimpaired surplus, unless:

(i) The extension of credit has been approved in advance by a majority of the entire board of directors of that bank; and

(ii) The interested party has abstained from participating directly or indirectly in the voting.

(2) In no event may a member bank extend credit to any insider of the bank or insider of its affiliates in an amount that, when aggregated with all other extensions of credit to that person, and all related interests of that person, exceeds $500,000, except by complying with the requirements of this paragraph (b).

(3) Approval by the board of directors under paragraphs (b)(1) and (b)(2) of this section is not required for an extension of credit that is made pursuant to a line of credit that was approved under paragraph (b)(1) of this section within 14 months of the date of the extension of credit. The extension of credit must also be in compliance with the requirements of § 215.4(a) of this part.

(4) Participation in the discussion, or any attempt to influence the voting, by the board of directors regarding an extension of credit constitutes indirect participation in the voting by the board of directors on an extension of credit.

(c) *Individual lending limit*— No member bank may extend credit to any insider of the bank or insider of its affiliates in an amount that, when aggregated with the amount of all other extensions of credit by the member bank to that person and to all related interests of that person, exceeds the lending limit of the member bank specified in § 215.2(i) of this part. This prohibition does not apply to an extension of credit by a member bank to a company of which the member bank is a subsidiary or to any other subsidiary of that company.

(d) *Aggregate lending limit* —(1) *General limit.* A member bank may not extend credit to any insider of the bank or insider of its affiliates unless the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to all such insiders, does not exceed the bank's unimpaired capital and unimpaired surplus (as defined in § 215.2(i) of this part).

(2) *Member banks with deposits of less than $100,000,000.* (i) A member bank with deposits of less than $100,000,000 may by an annual resolution of its board of directors increase the general limit specified in paragraph (d)(1) of this section to a level not to exceed two times the bank's unimpaired capital and unimpaired surplus, if:

(A) The board of directors determines that such higher limit is consistent with prudent, safe, and sound banking practices in light of the bank's experience in lending to its insiders and is necessary to attract or retain directors or to prevent restricting the availability of credit in small communities;

(B) The resolution sets forth the facts and reasoning on which the board of directors bases the finding, including the amount of the bank's lending to its insiders as a percentage of the bank's unimpaired capital and unimpaired surplus as of the date of the resolution;

(C) The bank meets or exceeds, on a fully-phased in basis, all applicable capital requirements established by the appropriate Federal banking agency; and

(D) The bank received a satisfactory composite rating in its most recent report of examination.

(ii) If a member bank has adopted a resolution authorizing a higher limit pursuant to paragraph (d)(2)(i) of this section and subsequently fails to meet the requirements of paragraph (d)(2)(i)(C) or (d)(2)(i)(D) of this section, the member bank shall not extend any additional credit (including a renewal of any existing extension of credit) to any insider of the bank or its affiliates unless such extension or renewal is consistent with the general limit in paragraph (d)(1) of this section.

(3) *Exceptions*. (i) The general limit specified in paragraph (d)(1) of this section does not apply to the following:

(A) Extensions of credit secured by a perfected security interest in bonds, notes, certificates of indebtedness, or Treasury bills of the United States or in other such obligations fully guaranteed as to principal and interest by the United States;

(B) Extensions of credit to or secured by unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission or establishment of the United States or any corporation wholly owned directly or indirectly by the United States;

(C) Extensions of credit secured by a perfected security interest in a segregated deposit account in the lending bank; or

(D) Extensions of credit arising from the discount of negotiable or nonnegotiable installment consumer paper that is acquired from an insider and carries a full or partial recourse endorsement or guarantee by the insider, provided that:

(*1*) The financial condition of each maker of such consumer paper is reasonably documented in the bank's files or known to its officers;

(*2*) An officer of the bank designated for that purpose by the board of directors of the bank certifies in writing that the bank is relying primarily upon the responsibility of each maker for payment of the obligation and not upon any endorsement or guarantee by the insider; and

(*3*) The maker of the instrument is not an insider.

(ii) The exceptions in paragraphs (d)(3)(i)(A) through (d)(3)(i)(C) of this section apply only to the amounts of such extensions of credit that are secured in the manner described therein.

(e) *Overdrafts*. (1) No member bank may pay an overdraft of an executive officer or director of the bank or executive officer or director of its affiliates[3] on an account at the bank, unless the payment of funds is made in accordance with:

(i) A written, preauthorized, interest-bearing extension of credit plan that specifies a method of repayment; or

(ii) A written, preauthorized transfer of funds from another account of the account holder at the bank.

(2) The prohibition in paragraph (e)(1) of this section does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less, provided:

(i) The account is not overdrawn for more than 5 business days; and

(ii) The member bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

[Reg. O, 59 FR 8837, Feb. 24, 1994; 59 FR 37930, July 26, 1994, as amended at 61 FR 57770, Nov. 8, 1996; 62 FR 13298, Mar. 20, 1997]

§215.5 Additional restrictions on loans to executive officers of member banks.

The following restrictions on extensions of credit by a member bank to any of its executive officers apply in addition to any restrictions on extensions of credit by a member bank to insiders of itself or its affiliates set forth elsewhere in this part. The restrictions of this section apply only to executive officers of the member bank and not to executive officers of its affiliates.

(a) No member bank may extend credit to any of its executive officers, and no executive officer of a member bank shall borrow from or otherwise become indebted to the bank, except in the amounts, for the purposes, and upon the conditions specified in paragraphs (c) and (d) of this section.

(b) No member bank may extend credit in an aggregate amount greater than the amount permitted in paragraph (c)(4) of this section to a partnership in which one or more of the bank's executive officers are partners and, either individually or together, hold a majority interest. For the purposes of paragraph (c)(4) of this section, the

[3] This prohibition does not apply to the payment by a member bank of an overdraft of a principal shareholder of the member bank, unless the principal shareholder is also an executive officer or director. This prohibition also does not apply to the payment by a member bank of an overdraft of a related interest of an executive officer, director, or principal shareholder of the member bank or executive officer, director, or principal shareholder of its affiliates.

total amount of credit extended by a member bank to such partnership is considered to be extended to each executive officer of the member bank who is a member of the partnership.

(c) A member bank is authorized to extend credit to any executive officer of the bank:

(1) In any amount to finance the education of the executive officer's children;

(2) In any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided:

(i) The extension of credit is secured by a first lien on the residence and the residence is owned (or expected to be owned after the extension of credit) by the executive officer; and

(ii) In the case of a refinancing, that only the amount thereof used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount thereof used for any of the purposes enumerated in this paragraph (c)(2), are included within this category of credit;

(3) In any amount, if the extension of credit is secured in a manner described in § 215.4(d)(3)(i)(A) through (d)(3)(i)(C) of this part; and

(4) For any other purpose not specified in paragraphs (c)(1) through (c)(3) of this section, if the aggregate amount of extensions of credit to that executive officer under this paragraph does not exceed at any one time the higher of 2.5 per cent of the bank's unimpaired capital and unimpaired surplus or $25,000, but in no event more than $100,000.

(d) Any extension of credit by a member bank to any of its executive officers shall be:

(1) Promptly reported to the member bank's board of directors;

(2) In compliance with the requirements of § 215.4(a) of this part;

(3) Preceded by the submission of a detailed current financial statement of the executive officer; and

(4) Made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in paragraph (c) of this section.

[Reg. O, 59 FR 8837, Feb. 24, 1994; 59 FR 37930, July 26, 1994; 60 FR 17636, Apr. 7, 1995]

§ 215.6 Prohibition on knowingly receiving unauthorized extension of credit.

No executive officer, director, or principal shareholder of a member bank or any of its affiliates shall knowingly receive (or knowingly permit any of that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this part.

§ 215.7 Extensions of credit outstanding on March 10, 1979.

(a) Any extension of credit that was outstanding on March 10, 1979, and that would, if made on or after March 10, 1979, violate § 215.4(c) of this part, shall be reduced in amount by March 10, 1980, to be in compliance with the lending limit in § 215.4(c) of this part. Any renewal or extension of such an extension of credit on or after March 10, 1979, shall be made only on terms that will bring the extension of credit into compliance with the lending limit of § 215.4(c) of this part by March 10, 1980. However, any extension of credit made before March 10, 1979, that bears a specific maturity date of March 10, 1980, or later, shall be repaid in accordance with its repayment schedule in existence on or before March 10, 1979.

(b) If a member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller or the Reserve Bank, as the case may be, is authorized, on the basis of good cause shown, to extend the March 10, 1980, date for compliance for any extension of credit for not more than two additional one-year periods.

§ 215.8 Records of member banks.

(a) *In general*. Each member bank shall maintain records necessary for compliance with the requirements of this part.

(b) *Recordkeeping for insiders of the member bank*. Any recordkeeping method adopted by a member bank shall:

(1) Identify, through an annual survey, all insiders of the bank itself; and

(2) Maintain records of all extensions of credit to insiders of the bank itself, including the amount and terms of each such extension of credit.

(c) *Recordkeeping for insiders of the member bank's affiliates*. Any recordkeeping method adopted by a member bank shall maintain records of extensions of credit to insiders of the member bank's affiliates by:

(1) *Survey method*. (i) Identifying, through an annual survey, each insider of the member bank's affiliates; and

(ii) Maintaining records of the amount and terms of each extension of credit by the member bank to such insiders; or

(2) *Borrower inquiry method*. (i) Requiring as part of each extension of credit that the borrower indicate whether the borrower is an insider of an affiliate of the member bank; and

(ii) Maintaining records that identify the amount and terms of each extension of credit by the member bank to borrowers so identifying themselves.

(3) *Alternative recordkeeping methods for insiders of affiliates*. A member bank may employ a recordkeeping method other than those identified in paragraphs (c)(1) and (c)(2) of this section if the appropriate Federal banking agency determines that the bank's method is at least as effective as the identified methods.

(d) *Special rule for non-commercial lenders*. A member bank that is prohibited by law or by an express resolution of the board of directors of the bank from making an extension of credit to any company or other entity that is covered by this part as a company is not required to maintain any records of the related interests of the insiders of the bank or its affiliates or to inquire of borrowers whether they are related interests of the insiders of the bank or its affiliates.

§ 215.9 Reports by executive officers.

Each executive officer of a member bank who becomes indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in § 215.5(c) of this part, shall, within 10 days of the date the indebtedness reaches such a level, make a written report to the board of directors of the officer's bank. The report shall state the lender's name, the date and amount of each extension of credit, any security for it, and the purposes for which the proceeds have been or are to be used.

§ 215.10 Reports on credit to executive officers.

Each member bank shall include with (but not as part of) each report of condition (and copy thereof) filed pursuant to 12 U.S.C. 1817(a)(3) a report of all extensions of credit made by the member bank to its executive officers since the date of the bank's previous report of condition.

§ 215.11 Disclosure of credit from member banks to executive officers and principal shareholders.

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

(1) *Principal shareholder of a member bank* means any person[4] other than an insured bank, or a foreign bank as defined in 12 U.S.C. 3101(7), that, directly or indirectly, owns, controls, or has power to vote more than 10 percent of any class of voting securities of the member bank. The term includes a person that controls a principal shareholder (e.g., a person that controls a bank holding company). Shares of a bank (including a foreign bank), bank holding company, or other company owned or controlled by a member of an individual's immediate family are presumed to be owned or controlled by the individual for the purposes of determining principal shareholder status.

(2) *Related interest* means:

(i) Any company controlled by a person; or

[4] The term ''stockholder of record'' appearing in 12 U.S.C. 1972(2)(G) is synonymous with the term ''person.''

(ii) Any political or campaign committee the funds or services of which will benefit a person or that is controlled by a person. For the purpose of this section and subpart B of this part, a related interest does not include a bank or a foreign bank (as defined in 12 U.S.C. 3101(7)).

(b) *Public disclosure.* (1) Upon receipt of a written request from the public, a member bank shall make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person and to all related interests of such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus or $500,000, whichever amount is less. No disclosure under this paragraph is required if the aggregate amount of all extensions of credit outstanding at such time from the member bank to the executive officer or principal shareholder of the member bank and to all related interests of such a person does not exceed $25,000.

(2) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(c) *Maintaining records.* Each member bank shall maintain records of all requests for the information described in paragraph (b) of this section and the disposition of such requests. These records may be disposed of after two years from the date of the request.

[Reg. O, 59 FR 8837, Feb. 24, 1994; 59 FR 37930, July 26, 1994]

§ 215.12 Reporting requirement for credit secured by certain bank stock.

Each executive officer or director of a member bank the shares of which are not publicly traded shall report annually to the board of directors of the member bank the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the member bank.

§ 215.13 Civil penalties.

Any member bank, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank, that violates any provision of this part (other than § 215.11 of this part) is subject to civil penalties as specified in section 29 of the Federal Reserve Act (12 U.S.C. 504).

APPENDIX—SECTION 5200 OF THE REVISED STATUTES TOTAL LOANS AND EXTENSIONS OF CREDIT

(a)(1) The total loans and extensions of credit by a national banking association to a person outstanding at one time and not fully secured, as determined in a manner consistent with paragraph (2) of this subsection, by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 per centum of the unimpaired capital and unimpaired surplus of the association.

(2) The total loans and extensions of credit by a national banking association to a person outstanding at one time and fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the funds outstanding shall not exceed 10 per centum of the unimpaired capital and unimpaired surplus of the association. This limitation shall be separate from and in addition to the limitations contained in paragraph (1) of this subsection.

DEFINITIONS

(b) For the purposes of this section—

(1) The term *loans and extensions of credit* shall include all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds or repayable from specific property pledged by or on behalf of the person, and to the extent specified by the Comptroller of the Currency, such term shall also include any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment; and

(2) The term *person* shall include an individual, sole proprietorship, partnership, joint venture, association, trust, estate, business trust, corporation, sovereign government, or agency, instrumentality, or political subdivision thereof, or any similar entity or organization.

EXCEPTIONS

(c) The limitations contained in subsection (a) of this section shall be subject to the following exceptions:

(1) Loans or extensions of credit arising from the discount of commercial or business

paper evidencing an obligation to the person negotiating it with recourse shall not be subject to any limitation based on capital and surplus.

(2) The purchase of bankers' acceptances of the kind described in section 372 of this title and issued by other banks shall not be subject to any limitation based on capital and surplus.

(3) Loans and extensions of credit secured by bills of lading, warehouse receipts, or similar documents transferring or securing title to readily marketable staples shall be subject to a limitation of 35 per centum of capital and surplus in addition to the general limitations if the market value of the staples securing each additional loan or extension of credit at all times equals or exceeds 115 per centum of the outstanding amount of such loan or extension of credit. The staples shall be fully covered by insurance whenever it is customary to insure such staples.

(4) Loans or extensions of credit secured by bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by other such obligations fully guaranteed as to principal and interest by the United States shall not be subject to any limitation based on capital and surplus.

(5) Loans or extensions of credit to or secured by unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission, or establishment of the United States or any corporation wholly owned directly or indirectly by the United States shall not be subject to any limitation based on capital and surplus.

(6) Loans or extensions of credit secured by a segregated deposit account in the lending bank shall not be subject to any limitation based on capital and surplus.

(7) Loans or extensions of credit to any financial institution or to any receiver, conservator, superintendent of banks, or other agent in charge of the business and property of such financial institution, when such loans or extensions of credit are approved by the Comptroller of the Currency, shall not be subject to any limitation based on capital and surplus.

(8)(A) Loans and extensions of credit arising from the discount of negotiable or nonnegotiable installment consumer paper which carries a full recourse endorsement or unconditional guarantee by the person transferring the paper shall be subject under this section to a maximum limitation equal to 25 per centum of such capital and surplus, notwithstanding the collateral requirements set forth in subsection (a)(2) of this section.

(B) If the bank's files or the knowledge of its officers of the financial condition of each maker of such consumer paper is reasonably adequate, and an officer of the bank designated for that purpose by the board of directors of the bank certifies in writing that the bank is relying primarily upon the responsibility of each maker for payment of such loans or extensions of credit and not upon any full or partial recourse endorsement or guarantee by the transferor, the limitations of this section as to the loans or extensions of credit of each such maker shall be the sole applicable loan limitations.

(9)(A) Loans and extensions of credit secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115 per centum of the face amount of the note covered, shall be subject under this section notwithstanding the collateral requirements set forth in subsection (a)(2) of this section, to a maximum limitation equal to 25 per centum of such capital and surplus.

(B) Loans and extensions of credit which arise from the discount by dealers in dairy cattle of paper given in payment for dairy cattle, which paper carries a full recourse endorsement or unconditional guarantee of the seller, and which are secured by the cattle being sold, shall be subject under this section, notwithstanding the collateral requirements set forth in paragraph (a)(2) of this section, to a limitation of 25 per centum of such capital and surplus.

(10) Loans or extensions of credit to the Student Loan Marketing Association shall not be subject to any limitation based on capital and surplus.

AUTHORITY OF COMPTROLLER OF THE CURRENCY

(d)(1) The Comptroller of the Currency may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to define or further define terms used in this section and to establish limits or requirements other than those specified in this section for particular classes or categories of loans or extensions of credit.

(2) The Comptroller of the Currency also shall have authority to determine when a loan putatively made to a person shall for purposes of this section be attributed to another person.

[48 FR 42806, Sept. 20, 1983]

Subpart B—Reports on Indebtedness of Executive Officers and Principal Shareholders to Correspondent Banks

§ 215.20 Authority, purpose, and scope.

(a) *Authority*. This subpart is issued pursuant to section 11(i) of the Federal Reserve Act (12 U.S.C. 248(i)) and 12 U.S.C. 1972(2)(F)(vi).

(b) *Purpose and scope.* This subpart implements the reporting requirements of Title VIII of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA) (Pub. L. 95–630) as amended by the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97–320), 12 U.S.C. 1972 (2)(g). Title VIII prohibits (1) preferential lending by a bank to executive officers, directors, and principal shareholders of another bank when there is a correspondent account relationship between the banks, and (2) the opening of a correspondent account relationship between banks where there is a preferential extension of credit by one of the banks to an executive officer, director, or principal shareholder of the other bank.

[44 FR 67979, Nov. 28, 1979, as amended at 48 FR 56936, Dec. 27, 1983]

§ 215.21 Definitions.

For the purposes of this subpart, the following definitions apply unless otherwise specified:

(a) *Bank* has the meaning given in 12 U.S.C. 1971 and 1972, and includes a branch or agency of a foreign bank, or a commercial lending company controlled by a foreign bank or by a company that controls a foreign bank, where the branch or agency is maintained in a State of the United States or in the District of Columbia or the commercial lending company is organized under State law.

(b) *Company, control of a company or bank, executive officer, extension of credit, immediate family,* and *person* have the meanings provided in subpart A.

(c) *Correspondent account* is an account that is maintained by a bank with another bank for the deposit or placement of funds. A correspondent account does not include:

(1) Time deposits at prevailing market rates, and

(2) An account maintained in the ordinary course of business solely for the purpose of effecting federal funds transactions at prevailing market rates or making Eurodollar placements at prevailing market rates.

(d) *Correspondent bank* means a bank that maintains one or more correspondent accounts for a member bank during a calendar year that in the aggregate exceed an average daily balance during that year of $100,000 or 0.5 per cent of such member bank's total deposits (as reported in its first consolidated report of condition during that calendar year), which ever amount is smaller.

(e) *Principal shareholder* and *related interest* have the meanings provided in § 215.10 of Subpart A.

[Reg. O, 44 FR 67979, Nov. 28, 1979, as amended at 48 FR 42805, Sept. 20, 1983; 59 FR 8842, Feb. 24, 1994]

§ 215.22 Report by executive officers and principal shareholders.

(a) *Annual report.* If during any calendar year an executive officer or principal shareholder of a member bank or a related interest of such a person has outstanding an extension of credit from a correspondent bank of the member bank, the executive officer or principal shareholder shall, on or before January 31 of the following year, make a written report to the board of directors of the member bank.[5]

(b) *Contents of report.* The report required by this section shall include the following information:

(1) The maximum amount of indebtedness of the executive officer or principal shareholder and of each of that person's related interests to each of the member bank's correspondent banks during the calendar year;

(2) The amount of indebtedness of the executive officer or principal shareholder and of each of that person's related interests outstanding to each of the member bank's correspondent banks as of ten business days before the report required by this section is filed;[6] and

[5] Persons reporting under this section are not required to include information on extensions of credit that are fully described in a report by a person they control or a person that controls them, provided they identify their relationships with such other person.

[6] If the amount of indebtedness outstanding to a correspondent bank ten days before the filing of the report is not available or cannot be readily ascertained, an estimate of the amount of indebtedness may be filed with the report, provided that the report is supplemented within the next 30 days with the actual amount of indebtedness.

(3) A description of the terms and conditions (including the range of interest rates, the original amount and date, maturity date, payment terms, security, if any, and any other unusual terms or conditions) of each extension of credit included in the indebtedness reported under paragraph (b)(1) of this section.

(c) *Definitions*. For the purposes of this section:

(1) *Indebtedness* means an extension of credit, but does not include:

(i) Commercial paper, bonds, and debentures issued in the ordinary course of business; and

(ii) Consumer credit (as defined in 12 CFR 226.2(a)(12) in an aggregate amount of $5,000 or less from each of the member bank's correspondent banks, provided the indebtedness is incurred under terms that are not more favorable than those offered to the general public.

(2) *Maximum amount of indebtedness* means, at the option of the reporting person, either (i) the highest outstanding indebtedness during the calendar year for which the report is made, or (ii) the highest end of the month indebtedness outstanding during the calendar year for which the report is made.

(d) *Retention of reports at member banks*. The reports required by this section shall be retained at the member bank for a period of three years. The Reserve Bank or the Comptroller, as the case may be, may require these reports to be retained by the bank for an additional period of time. The reports filed under this section are not required by this regulation to be made available to the public and shall not be filed with the Reserve Bank or the Comptroller unless specifically requested.

(e) *Member bank's responsibility*. Each member bank shall advise each of its executive officers and each of its principal shareholders (to the extent known by the bank) of the reports required by this section and make available to each of these persons a list of the names and addresses of the member bank's correspondent banks.

[Reg. O, 44 FR 67979, Nov. 28, 1979, as amended at 48 FR 42805, Sept. 20, 1983; 59 FR 8842, Feb. 24, 1994]

§ 215.23 Disclosure of credit from correspondent banks to executive officers and principal shareholders.

(a) *Public disclosure*. (1) Upon receipt of a written request from the public, a member bank shall make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, any correspondent bank of the member bank had outstanding, at any time during the previous calendar year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from all correspondent banks of the member bank to such person and to all related interests of such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus or $500,000, whichever amount is less. No disclosure under this paragraph is required if the aggregate amount of all extensions of credit outstanding from all correspondent banks of the member bank to the executive officer or principal shareholder of the member bank and to all related interests of such a person does not exceed $25,000 at any time during the previous calendar year.

(2) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(b) *Maintaining records*. Each member bank shall maintain records of all requests for the information described in paragraph (a) of this section and the disposition of such requests. These records may be disposed of after two years from the date of the request.

[48 FR 56936, Dec. 27, 1983]

PART 216—PRIVACY OF CONSUMER FINANCIAL INFORMATION (REGULATION P)

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AUTHORITY: 15 U.S.C. 6801 *et seq.*

SOURCE: 65 FR 35206, June 1, 2000, unless otherwise noted.

§ 216.1 Purpose and scope.

(a) *Purpose.* This part governs the treatment of nonpublic personal information about consumers by the financial institutions listed in paragraph (b) of this section. This part:

(1) Requires a financial institution to provide notice to customers about its privacy policies and practices;

(2) Describes the conditions under which a financial institution may disclose nonpublic personal information about consumers to nonaffiliated third parties; and

(3) Provides a method for consumers to prevent a financial institution from disclosing that information to most nonaffiliated third parties by ''opting out'' of that disclosure, subject to the exceptions in §§ 216.13, 216.14, and 216.15.

(b) *Scope.* (1) This part applies only to nonpublic personal information about individuals who obtain financial products or services primarily for personal, family, or household purposes from the institutions listed below. This part does not apply to information about companies or about individuals who obtain financial products or services for business, commercial, or agricultural purposes. This part applies to the U. S. offices of entities for which the Board has primary supervisory authority. They are referred to in this part as ''you.'' These are: State member banks, bank holding companies and certain of their nonbank subsidiaries or affiliates, State uninsured branches and agencies of foreign banks, commercial lending companies owned or controlled by foreign banks, and Edge and Agreement corporations.

(2) Nothing in this part modifies, limits, or supersedes the standards governing individually identifiable health information promulgated by the Secretary of Health and Human Services under the authority of sections 262 and 264 of the Health Insurance Portability and Accountability Act of 1996 (42 U.S.C. 1320d–1320d-8).

§ 216.2 Rule of construction.

The examples in this part and the sample clauses in appendix A of this part are not exclusive. Compliance with an example or use of a sample clause, to the extent applicable, constitutes compliance with this part.

§ 216.3 Definitions.

As used in this part, unless the context requires otherwise:

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

(b) (1) *Clear and conspicuous* means that a notice is reasonably understandable and designed to call attention to the nature and significance of the information in the notice.

(2) *Examples*—(i) *Reasonably understandable.* You make your notice reasonably understandable if you:

(A) Present the information in the notice in clear, concise sentences, paragraphs, and sections;

(B) Use short explanatory sentences or bullet lists whenever possible;

(C) Use definite, concrete, everyday words and active voice whenever possible;

(D) Avoid multiple negatives;

(E) Avoid legal and highly technical business terminology whenever possible; and

(F) Avoid explanations that are imprecise and readily subject to different interpretations.

(ii) *Designed to call attention.* You design your notice to call attention to the nature and significance of the information in it if you:

(A) Use a plain-language heading to call attention to the notice;

(B) Use a typeface and type size that are easy to read;

(C) Provide wide margins and ample line spacing;

(D) Use boldface or italics for key words; and

(E) In a form that combines your notice with other information, use distinctive type size, style, and graphic devices, such as shading or sidebars, when you combine your notice with other information.

(iii) *Notices on web sites.* If you provide a notice on a web page, you design your notice to call attention to the nature and significance of the information in it if you use text or visual cues to encourage scrolling down the page if necessary to view the entire notice and ensure that other elements on the web site (such as text, graphics, hyperlinks, or sound) do not distract attention from the notice, and you either:

(A) Place the notice on a screen that consumers frequently access, such as a page on which transactions are conducted; or

(B) Place a link on a screen that consumers frequently access, such as a page on which transactions are conducted, that connects directly to the notice and is labeled appropriately to convey the importance, nature, and relevance of the notice.

(c) *Collect* means to obtain information that you organize or can retrieve by the name of an individual or by identifying number, symbol, or other identifying particular assigned to the individual, irrespective of the source of the underlying information.

(d) *Company* means any corporation, limited liability company, business trust, general or limited partnership, association, or similar organization.

(e)(1) *Consumer* means an individual who obtains or has obtained a financial product or service from you that is to be used primarily for personal, family, or household purposes, or that individual's legal representative.

(2) *Examples*—(i) An individual who applies to you for credit for personal, family, or household purposes is a consumer of a financial service, regardless of whether the credit is extended.

(ii) An individual who provides nonpublic personal information to you in order to obtain a determination about whether he or she may qualify for a loan to be used primarily for personal, family, or household purposes is a consumer of a financial service, regardless of whether the loan is extended.

(iii) An individual who provides nonpublic personal information to you in connection with obtaining or seeking to obtain financial, investment, or economic advisory services is a consumer regardless of whether you establish a continuing advisory relationship.

(iv) If you hold ownership or servicing rights to an individual's loan that is used primarily for personal, family, or household purposes, the individual is your consumer, even if you hold those rights in conjunction with one or more other institutions. (The individual is also a consumer with respect to the other financial institutions involved.) An individual who has a loan in which you have ownership or servicing rights is your consumer, even if you, or another institution with those rights, hire an agent to collect on the loan.

(v) An individual who is a consumer of another financial institution is not your consumer solely because you act as agent for, or provide processing or other services to, that financial institution.

(vi) An individual is not your consumer solely because he or she has designated you as trustee for a trust.

(vii) An individual is not your consumer solely because he or she is a beneficiary of a trust for which you are a trustee.

(viii) An individual is not your consumer solely because he or she is a participant or a beneficiary of an employee benefit plan that you sponsor or for which you act as a trustee or fiduciary.

(f) *Consumer reporting agency* has the same meaning as in section 603(f) of the

Fair Credit Reporting Act (15 U.S.C. 1681a(f)).

(g) *Control* of a company means:

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

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

(3) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the company, as the Board determines.

(h) *Customer* means a consumer who has a customer relationship with you.

(i)(1) *Customer relationship* means a continuing relationship between a consumer and you under which you provide one or more financial products or services to the consumer that are to be used primarily for personal, family, or household purposes.

(2) *Examples*—(i) *Continuing relationship.* A consumer has a continuing relationship with you if the consumer:

(A) Has a deposit or investment account with you;

(B) Obtains a loan from you;

(C) Has a loan for which you own the servicing rights;

(D) Purchases an insurance product from you;

(E) Holds an investment product through you, such as when you act as a custodian for securities or for assets in an Individual Retirement Arrangement;

(F) Enters into an agreement or understanding with you whereby you undertake to arrange or broker a home mortgage loan for the consumer;

(G) Enters into a lease of personal property with you; or

(H) Obtains financial, investment, or economic advisory services from you for a fee.

(ii) *No continuing relationship.* A consumer does not, however, have a continuing relationship with you if:

(A) The consumer obtains a financial product or service only in isolated transactions, such as using your ATM to withdraw cash from an account at another financial institution or purchasing a cashier's check or money order;

(B) You sell the consumer's loan and do not retain the rights to service that loan; or

(C) You sell the consumer airline tickets, travel insurance, or traveler's checks in isolated transactions.

(j) *Federal functional regulator* means:

(1) The Board of Governors of the Federal Reserve System;

(2) The Office of the Comptroller of the Currency;

(3) The Board of Directors of the Federal Deposit Insurance Corporation;

(4) The Director of the Office of Thrift Supervision;

(5) The National Credit Union Administration Board; and

(6) The Securities and Exchange Commission.

(k)(1) *Financial institution* means any institution the business of which is engaging in activities that are financial in nature or incidental to such financial activities as described in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

(2) *Financial institution* does not include:

(i) Any person or entity with respect to any financial activity that is subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*);

(ii) The Federal Agricultural Mortgage Corporation or any entity chartered and operating under the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*); or

(iii) Institutions chartered by Congress specifically to engage in securitizations, secondary market sales (including sales of servicing rights), or similar transactions related to a transaction of a consumer, as long as such institutions do not sell or transfer nonpublic personal information to a nonaffiliated third party.

(l)(1) *Financial product or service* means any product or service that a financial holding company could offer by engaging in an activity that is financial in nature or incidental to such a financial activity under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

(2) *Financial service* includes your evaluation or brokerage of information that you collect in connection with a request or an application from a consumer for a financial product or service.

(m)(1) *Nonaffiliated third party* means any person except:

(i) Your affiliate; or

(ii) A person employed jointly by you and any company that is not your affiliate (but *nonaffiliated third party* includes the other company that jointly employs the person).

(2) *Nonaffiliated third party* includes any company that is an affiliate solely by virtue of your or your affiliate's direct or indirect ownership or control of the company in conducting merchant banking or investment banking activities of the type described in section 4(k)(4)(H) or insurance company investment activities of the type described in section 4(k)(4)(I) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)(4)(H) and (I)).

(n)(1) *Nonpublic personal information* means:

(i) Personally identifiable financial information; and

(ii) Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available.

(2) *Nonpublic personal information* does not include:

(i) Publicly available information, except as included on a list described in paragraph (n)(1)(ii) of this section; or

(ii) Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived without using any personally identifiable financial information that is not publicly available.

(3) *Examples of lists*—(i) Nonpublic personal information includes any list of individuals' names and street addresses that is derived in whole or in part using personally identifiable financial information that is not publicly available, such as account numbers.

(ii) Nonpublic personal information does not include any list of individuals' names and addresses that contains only publicly available information, is not derived in whole or in part using personally identifiable financial information that is not publicly available, and is not disclosed in a manner that indicates that any of the individuals on the list is a consumer of a financial institution.

(o)(1) *Personally identifiable financial information* means any information:

(i) A consumer provides to you to obtain a financial product or service from you;

(ii) About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or

(iii) You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer.

(2) *Examples*—(i) *Information included*. Personally identifiable financial information includes:

(A) Information a consumer provides to you on an application to obtain a loan, credit card, or other financial product or service;

(B) Account balance information, payment history, overdraft history, and credit or debit card purchase information;

(C) The fact that an individual is or has been one of your customers or has obtained a financial product or service from you;

(D) Any information about your consumer if it is disclosed in a manner that indicates that the individual is or has been your consumer;

(E) Any information that a consumer provides to you or that you or your agent otherwise obtain in connection with collecting on a loan or servicing a loan;

(F) Any information you collect through an Internet ''cookie'' (an information collecting device from a web server); and

(G) Information from a consumer report.

(ii) *Information not included*. Personally identifiable financial information does not include:

(A) A list of names and addresses of customers of an entity that is not a financial institution; and

(B) Information that does not identify a consumer, such as aggregate information or blind data that does not contain personal identifiers such as account numbers, names, or addresses.

(p)(1) *Publicly available information* means any information that you have a reasonable basis to believe is lawfully made available to the general public from:

(i) Federal, State, or local government records;

(ii) Widely distributed media; or

(iii) Disclosures to the general public that are required to be made by Federal, State, or local law.

(2) *Reasonable basis.* You have a reasonable basis to believe that information is lawfully made available to the general public if you have taken steps to determine:

(i) That the information is of the type that is available to the general public; and

(ii) Whether an individual can direct that the information not be made available to the general public and, if so, that your consumer has not done so.

(3) *Examples*—(i) *Government records.* Publicly available information in government records includes information in government real estate records and security interest filings.

(ii) *Widely distributed media.* Publicly available information from widely distributed media includes information from a telephone book, a television or radio program, a newspaper, or a web site that is available to the general public on an unrestricted basis. A web site is not restricted merely because an Internet service provider or a site operator requires a fee or a password, so long as access is available to the general public.

(iii) *Reasonable basis*—(A) You have a reasonable basis to believe that mortgage information is lawfully made available to the general public if you have determined that the information is of the type included on the public record in the jurisdiction where the mortgage would be recorded.

(B) You have a reasonable basis to believe that an individual's telephone number is lawfully made available to the general public if you have located the telephone number in the telephone book or the consumer has informed you that the telephone number is not unlisted.

(q) *You* means:

(1) A State member bank, as defined in 12 CFR 208.3(g);

(2) A bank holding company, as defined in 12 CFR 225.2(c);

(3) A subsidiary (as defined in 12 CFR 225.2(o)) or affiliate of a bank holding company and a subsidiary of a State member bank, except for:

(i) A national bank or a State bank that is not a member of the Federal Reserve System;

(ii) A broker or dealer that is registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*);

(iii) A registered investment adviser, properly registered by or on behalf of either the Securities Exchange Commission or any State, with respect to its investment advisory activities and its activities incidental to those investment advisory activities;

(iv) An investment company that is registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*); or

(v) An insurance company, with respect to its insurance activities and its activities incidental to those insurance activities, that is subject to supervision by a State insurance regulator;

(4) A State agency or State branch of a foreign bank, as those terms are defined in 12 U.S.C. 3101(b) (11) and (12), the deposits of which agency or branch are not insured by the Federal Deposit Insurance Corporation;

(5) A commercial lending company, as defined in 12 CFR 211.21(f), that is owned or controlled by a foreign bank, as defined in 12 CFR 211.21(m); or

(6) A corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611–631) or a corporation having an agreement or undertaking with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601–604a).

Subpart A—Privacy and Opt Out Notices

§ 216.4 Initial privacy notice to consumers required.

(a) *Initial notice requirement.* You must provide a clear and conspicuous

notice that accurately reflects your privacy policies and practices to:

(1) *Customer*. An individual who becomes your customer, not later than when you establish a customer relationship, except as provided in paragraph (e) of this section; and

(2) *Consumer*. A consumer, before you disclose any nonpublic personal information about the consumer to any nonaffiliated third party, if you make such a disclosure other than as authorized by §§216.14 and 216.15.

(b) *When initial notice to a consumer is not required*. You are not required to provide an initial notice to a consumer under paragraph (a) of this section if:

(1) You do not disclose any nonpublic personal information about the consumer to any nonaffiliated third party, other than as authorized by §§216.14 and 216.15; and

(2) You do not have a customer relationship with the consumer.

(c) *When you establish a customer relationship*—(1) *General rule*. You establish a customer relationship when you and the consumer enter into a continuing relationship.

(2) *Special rule for loans*—You establish a customer relationship with a consumer when you originate a loan to the consumer for personal, family, or household purposes. If you subsequently transfer the servicing rights to that loan to another financial institution, the customer relationship transfers with the servicing rights.

(3)(i) *Examples of establishing customer relationship*. You establish a customer relationship when the consumer:

(A) Opens a credit card account with you;

(B) Executes the contract to open a deposit account with you, obtains credit from you, or purchases insurance from you;

(C) Agrees to obtain financial, economic, or investment advisory services from you for a fee; or

(D) Becomes your client for the purpose of your providing credit counseling or tax preparation services.

(ii) *Examples of loan rule*. You establish a customer relationship with a consumer who obtains a loan for personal, family, or household purposes when you:

(A) Originate the loan to the consumer; or

(B) Purchase the servicing rights to the consumer's loan.

(d) *Existing customers*. When an existing customer obtains a new financial product or service from you that is to be used primarily for personal, family, or household purposes, you satisfy the initial notice requirements of paragraph (a) of this section as follows:

(1) You may provide a revised privacy notice, under §216.8, that covers the customer's new financial product or service; or

(2) If the initial, revised, or annual notice that you most recently provided to that customer was accurate with respect to the new financial product or service, you do not need to provide a new privacy notice under paragraph (a) of this section.

(e) *Exceptions to allow subsequent delivery of notice*. (1) You may provide the initial notice required by paragraph (a)(1) of this section within a reasonable time after you establish a customer relationship if:

(i) Establishing the customer relationship is not at the customer's election; or

(ii) Providing notice not later than when you establish a customer relationship would substantially delay the customer's transaction and the customer agrees to receive the notice at a later time.

(2) *Examples of exceptions*—(i) *Not at customer's election*. Establishing a customer relationship is not at the customer's election if you acquire a customer's deposit liability or the servicing rights to a customer's loan from another financial institution and the customer does not have a choice about your acquisition.

(ii) *Substantial delay of customer's transaction*. Providing notice not later than when you establish a customer relationship would substantially delay the customer's transaction when:

(A) You and the individual agree over the telephone to enter into a customer relationship involving prompt delivery of the financial product or service; or

(B) You establish a customer relationship with an individual under a program authorized by Title IV of the Higher Education Act of 1965 (20 U.S.C.

1070 *et seq.*) or similar student loan programs where loan proceeds are disbursed promptly without prior communication between you and the customer.

(iii) *No substantial delay of customer's transaction*. Providing notice not later than when you establish a customer relationship would not substantially delay the customer's transaction when the relationship is initiated in person at your office or through other means by which the customer may view the notice, such as on a web site.

(f) *Delivery*. When you are required to deliver an initial privacy notice by this section, you must deliver it according to § 216.9. If you use a short-form initial notice for non-customers according to § 216.6(d), you may deliver your privacy notice according to § 216.6(d)(3).

§ 216.5 Annual privacy notice to customers required.

(a)(1) *General rule*. You must provide a clear and conspicuous notice to customers that accurately reflects your privacy policies and practices not less than annually during the continuation of the customer relationship. *Annually* means at least once in any period of 12 consecutive months during which that relationship exists. You may define the 12-consecutive-month period, but you must apply it to the customer on a consistent basis.

(2) *Example*. You provide a notice annually if you define the 12-consecutive-month period as a calendar year and provide the annual notice to the customer once in each calendar year following the calendar year in which you provided the initial notice. For example, if a customer opens an account on any day of year 1, you must provide an annual notice to that customer by December 31 of year 2.

(b)(1) *Termination of customer relationship*. You are not required to provide an annual notice to a former customer.

(2) *Examples*. Your customer becomes a former customer when:

(i) In the case of a deposit account, the account is inactive under your policies;

(ii) In the case of a closed-end loan, the customer pays the loan in full, you charge off the loan, or you sell the loan without retaining servicing rights;

(iii) In the case of a credit card relationship or other open-end credit relationship, you no longer provide any statements or notices to the customer concerning that relationship or you sell the credit card receivables without retaining servicing rights; or

(iv) You have not communicated with the customer about the relationship for a period of 12 consecutive months, other than to provide annual privacy notices or promotional material.

(c) *Special rule for loans*. If you do not have a customer relationship with a consumer under the special rule for loans in § 216.4(c)(2), then you need not provide an annual notice to that consumer under this section.

(d) *Delivery*. When you are required to deliver an annual privacy notice by this section, you must deliver it according to § 216.9.

§ 216.6 Information to be included in privacy notices.

(a) *General rule*. The initial, annual, and revised privacy notices that you provide under §§ 216.4, 216.5, and 216.8 must include each of the following items of information, in addition to any other information you wish to provide, that applies to you and to the consumers to whom you send your privacy notice:

(1) The categories of nonpublic personal information that you collect;

(2) The categories of nonpublic personal information that you disclose;

(3) The categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information, other than those parties to whom you disclose information under §§ 216.14 and 216.15;

(4) The categories of nonpublic personal information about your former customers that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information about your former customers, other than those parties to whom you disclose information under §§ 216.14 and 216.15;

(5) If you disclose nonpublic personal information to a nonaffiliated third party under § 216.13 (and no other exception in § 216.14 or 216.15 applies to that disclosure), a separate statement

of the categories of information you disclose and the categories of third parties with whom you have contracted;

(6) An explanation of the consumer's right under §216.10(a) to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including the method(s) by which the consumer may exercise that right at that time;

(7) Any disclosures that you make under section 603(d)(2)(A)(iii) of the Fair Credit Reporting Act (15 U.S.C. 1681a(d)(2)(A)(iii)) (that is, notices regarding the ability to opt out of disclosures of information among affiliates);

(8) Your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and

(9) Any disclosure that you make under paragraph (b) of this section.

(b) *Description of nonaffiliated third parties subject to exceptions.* If you disclose nonpublic personal information to third parties as authorized under §§216.14 and 216.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§216.4 and 216.5. When describing the categories with respect to those parties, you are required to state only that you make disclosures to other nonaffiliated third parties as permitted by law.

(c) *Examples*—(1) *Categories of nonpublic personal information that you collect.* You satisfy the requirement to categorize the nonpublic personal information that you collect if you list the following categories, as applicable:

(i) Information from the consumer;

(ii) Information about the consumer's transactions with you or your affiliates;

(iii) Information about the consumer's transactions with nonaffiliated third parties; and

(iv) Information from a consumer reporting agency.

(2) *Categories of nonpublic personal information you disclose*—(i) You satisfy the requirement to categorize the nonpublic personal information that you disclose if you list the categories described in paragraph (c)(1) of this section, as applicable, and a few examples to illustrate the types of information in each category.

(ii) If you reserve the right to disclose all of the nonpublic personal information about consumers that you collect, you may simply state that fact without describing the categories or examples of the nonpublic personal information you disclose.

(3) *Categories of affiliates and nonaffiliated third parties to whom you disclose.* You satisfy the requirement to categorize the affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information if you list the following categories, as applicable, and a few examples to illustrate the types of third parties in each category.

(i) Financial service providers;

(ii) Non-financial companies; and

(iii) Others.

(4) *Disclosures under exception for service providers and joint marketers.* If you disclose nonpublic personal information under the exception in §216.13 to a nonaffiliated third party to market products or services that you offer alone or jointly with another financial institution, you satisfy the disclosure requirement of paragraph (a)(5) of this section if you:

(i) List the categories of nonpublic personal information you disclose, using the same categories and examples you used to meet the requirements of paragraph (a)(2) of this section, as applicable; and

(ii) State whether the third party is:

(A) A service provider that performs marketing services on your behalf or on behalf of you and another financial institution; or

(B) A financial institution with whom you have a joint marketing agreement.

(5) *Simplified notices.* If you do not disclose, and do not wish to reserve the right to disclose, nonpublic personal information about customers or former customers to affiliates or nonaffiliated third parties except as authorized under §§216.14 and 216.15, you may simply state that fact, in addition to the information you must provide under paragraphs (a)(1), (a)(8), (a)(9), and (b) of this section.

(6) *Confidentiality and security.* You describe your policies and practices with respect to protecting the confidentiality and security of nonpublic

personal information if you do both of the following:

(i) Describe in general terms who is authorized to have access to the information; and

(ii) State whether you have security practices and procedures in place to ensure the confidentiality of the information in accordance with your policy. You are not required to describe technical information about the safeguards you use.

(d) *Short-form initial notice with opt out notice for non-customers*—(1) You may satisfy the initial notice requirements in §§ 216.4(a)(2), 216.7(b), and 216.7(c) for a consumer who is not a customer by providing a short-form initial notice at the same time as you deliver an opt out notice as required in § 216.7.

(2) A short-form initial notice must:

(i) Be clear and conspicuous;

(ii) State that your privacy notice is available upon request; and

(iii) Explain a reasonable means by which the consumer may obtain that notice.

(3) You must deliver your short-form initial notice according to § 216.9. You are not required to deliver your privacy notice with your short-form initial notice. You instead may simply provide the consumer a reasonable means to obtain your privacy notice. If a consumer who receives your short-form notice requests your privacy notice, you must deliver your privacy notice according to § 216.9.

(4) *Examples of obtaining privacy notice.* You provide a reasonable means by which a consumer may obtain a copy of your privacy notice if you:

(i) Provide a toll-free telephone number that the consumer may call to request the notice; or

(ii) For a consumer who conducts business in person at your office, maintain copies of the notice on hand that you provide to the consumer immediately upon request.

(e) *Future disclosures.* Your notice may include:

(1) Categories of nonpublic personal information that you reserve the right to disclose in the future, but do not currently disclose; and

(2) Categories of affiliates or nonaffiliated third parties to whom you reserve the right in the future to disclose, but to whom you do not currently disclose, nonpublic personal information.

(f) *Sample clauses.* Sample clauses illustrating some of the notice content required by this section are included in appendix A of this part.

§ 216.7 Form of opt out notice to consumers; opt out methods.

(a)(1) *Form of opt out notice.* If you are required to provide an opt out notice under § 216.10(a), you must provide a clear and conspicuous notice to each of your consumers that accurately explains the right to opt out under that section. The notice must state:

(i) That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;

(ii) That the consumer has the right to opt out of that disclosure; and

(iii) A reasonable means by which the consumer may exercise the opt out right.

(2) *Examples*—(i) *Adequate opt out notice.* You provide adequate notice that the consumer can opt out of the disclosure of nonpublic personal information to a nonaffiliated third party if you:

(A) Identify all of the categories of nonpublic personal information that you disclose or reserve the right to disclose, and all of the categories of nonaffiliated third parties to which you disclose the information, as described in § 216.6(a)(2) and (3), and state that the consumer can opt out of the disclosure of that information; and

(B) Identify the financial products or services that the consumer obtains from you, either singly or jointly, to which the opt out direction would apply.

(ii) *Reasonable opt out means.* You provide a reasonable means to exercise an opt out right if you:

(A) Designate check-off boxes in a prominent position on the relevant forms with the opt out notice;

(B) Include a reply form together with the opt out notice;

(C) Provide an electronic means to opt out, such as a form that can be sent via electronic mail or a process at your web site, if the consumer agrees to the electronic delivery of information; or

(D) Provide a toll-free telephone number that consumers may call to opt out.

(iii) *Unreasonable opt out means*. You *do not* provide a reasonable means of opting out if:

(A) The only means of opting out is for the consumer to write his or her own letter to exercise that opt out right; or

(B) The only means of opting out as described in any notice subsequent to the initial notice is to use a check-off box that you provided with the initial notice but did not include with the subsequent notice.

(iv) *Specific opt out means*. You may require each consumer to opt out through a specific means, as long as that means is reasonable for that consumer.

(b) *Same form as initial notice permitted*. You may provide the opt out notice together with or on the same written or electronic form as the initial notice you provide in accordance with §216.4.

(c) *Initial notice required when opt out notice delivered subsequent to initial notice*. If you provide the opt out notice later than required for the initial notice in accordance with §216.4, you must also include a copy of the initial notice with the opt out notice in writing or, if the consumer agrees, electronically.

(d) *Joint relationships*—(1) If two or more consumers jointly obtain a financial product or service from you, you may provide a single opt out notice. Your opt out notice must explain how you will treat an opt out direction by a joint consumer (as explained in paragraph (d)(5) of this section).

(2) Any of the joint consumers may exercise the right to opt out. You may either:

(i) Treat an opt out direction by a joint consumer as applying to all of the associated joint consumers; or

(ii) Permit each joint consumer to opt out separately.

(3) If you permit each joint consumer to opt out separately, you must permit one of the joint consumers to opt out on behalf of all of the joint consumers.

(4) You may not require *all* joint consumers to opt out before you implement *any* opt out direction.

(5) *Example*. If John and Mary have a joint checking account with you and arrange for you to send statements to John's address, you may do any of the following, but you must explain in your opt out notice which opt out policy you will follow:

(i) Send a single opt out notice to John's address, but you must accept an opt out direction from either John or Mary.

(ii) Treat an opt out direction by either John or Mary as applying to the entire account. If you do so, and John opts out, you may not require Mary to opt out as well before implementing John's opt out direction.

(iii) Permit John and Mary to make different opt out directions. If you do so:

(A) You must permit John and Mary to opt out for each other;

(B) If both opt out, you must permit both to notify you in a single response (such as on a form or through a telephone call); and

(C) If John opts out and Mary does not, you may only disclose nonpublic personal information about Mary, but not about John and not about John and Mary jointly.

(e) *Time to comply with opt out*. You must comply with a consumer's opt out direction as soon as reasonably practicable after you receive it.

(f) *Continuing right to opt out*. A consumer may exercise the right to opt out at any time.

(g) *Duration of consumer's opt out direction*—(1) A consumer's direction to opt out under this section is effective until the consumer revokes it in writing or, if the consumer agrees, electronically.

(2) When a customer relationship terminates, the customer's opt out direction continues to apply to the nonpublic personal information that you collected during or related to that relationship. If the individual subsequently establishes a new customer relationship with you, the opt out direction that applied to the former relationship does not apply to the new relationship.

(h) *Delivery*. When you are required to deliver an opt out notice by this section, you must deliver it according to §216.9.

§ 216.8 Revised privacy notices.

(a) *General rule.* Except as otherwise authorized in this part, you must not, directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party other than as described in the initial notice that you provided to that consumer under § 216.4, unless:

(1) You have provided to the consumer a clear and conspicuous revised notice that accurately describes your policies and practices;

(2) You have provided to the consumer a new opt out notice;

(3) You have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and

(4) The consumer does not opt out.

(b) *Examples*—(1) Except as otherwise permitted by §§ 216.13, 216.14, and 216.15, you must provide a revised notice before you:

(i) Disclose a new category of nonpublic personal information to any nonaffiliated third party;

(ii) Disclose nonpublic personal information to a new category of nonaffiliated third party; or

(iii) Disclose nonpublic personal information about a former customer to a nonaffiliated third party, if that former customer has not had the opportunity to exercise an opt out right regarding that disclosure.

(2) A revised notice is not required if you disclose nonpublic personal information to a new nonaffiliated third party that you adequately described in your prior notice.

(c) *Delivery.* When you are required to deliver a revised privacy notice by this section, you must deliver it according to § 216.9.

§ 216.9 Delivering privacy and opt out notices.

(a) *How to provide notices.* You must provide any privacy notices and opt out notices, including short-form initial notices, that this part requires so that each consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically.

(b) (1) *Examples of reasonable expectation of actual notice.* You may reasonably expect that a consumer will receive actual notice if you:

(i) Hand-deliver a printed copy of the notice to the consumer;

(ii) Mail a printed copy of the notice to the last known address of the consumer;

(iii) For the consumer who conducts transactions electronically, post the notice on the electronic site and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining a particular financial product or service; or

(iv) For an isolated transaction with the consumer, such as an ATM transaction, post the notice on the ATM screen and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining the particular financial product or service.

(2) *Examples of unreasonable expectation of actual notice.* You may *not*, however, reasonably expect that a consumer will receive actual notice of your privacy policies and practices if you:

(i) Only post a sign in your branch or office or generally publish advertisements of your privacy policies and practices; or

(ii) Send the notice via electronic mail to a consumer who does not obtain a financial product or service from you electronically.

(c) *Annual notices only.* You may reasonably expect that a customer will receive actual notice of your annual privacy notice if:

(1) The customer uses your web site to access financial products and services electronically and agrees to receive notices at the web site, and you post your current privacy notice continuously in a clear and conspicuous manner on the web site; or

(2) The customer has requested that you refrain from sending any information regarding the customer relationship, and your current privacy notice remains available to the customer upon request.

(d) *Oral description of notice insufficient.* You may not provide any notice required by this part solely by orally explaining the notice, either in person or over the telephone.

(e) *Retention or accessibility of notices for customers*–(1) For customers only, you must provide the initial notice required by § 216.4(a)(1), the annual notice required by § 216.5(a), and the revised notice required by § 216.8 so that the customer can retain them or obtain them later in writing or, if the customer agrees, electronically.

(2) *Examples of retention or accessibility*. You provide a privacy notice to the customer so that the customer can retain it or obtain it later if you:

(i) Hand-deliver a printed copy of the notice to the customer;

(ii) Mail a printed copy of the notice to the last known address of the customer; or

(iii) Make your current privacy notice available on a web site (or a link to another web site) for the customer who obtains a financial product or service electronically and agrees to receive the notice at the web site.

(f) *Joint notice with other financial institutions*. You may provide a joint notice from you and one or more of your affiliates or other financial institutions, as identified in the notice, as long as the notice is accurate with respect to you and the other institutions.

(g) *Joint relationships*. If two or more consumers jointly obtain a financial product or service from you, you may satisfy the initial, annual, and revised notice requirements of §§ 216.4(a), 216.5(a), and 216.8(a), respectively, by providing one notice to those consumers jointly.

Subpart B—Limits on Disclosures

§ 216.10 Limits on disclosure of nonpublic personal information to nonaffiliated third parties.

(a) (1) *Conditions for disclosure*. Except as otherwise authorized in this part, you may not, directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party unless:

(i) You have provided to the consumer an initial notice as required under § 216.4;

(ii) You have provided to the consumer an opt out notice as required in § 216.7;

(iii) You have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and

(iv) The consumer does not opt out.

(2) *Opt out definition*. Opt out means a direction by the consumer that you not disclose nonpublic personal information about that consumer to a nonaffiliated third party, other than as permitted by §§ 216.13, 216.14, and 216.15.

(3) *Examples of reasonable opportunity to opt out*. You provide a consumer with a reasonable opportunity to opt out if:

(i) *By mail*. You mail the notices required in paragraph (a)(1) of this section to the consumer and allow the consumer to opt out by mailing a form, calling a toll-free telephone number, or any other reasonable means within 30 days from the date you mailed the notices.

(ii) *By electronic means*. A customer opens an on-line account with you and agrees to receive the notices required in paragraph (a)(1) of this section electronically, and you allow the customer to opt out by any reasonable means within 30 days after the date that the customer acknowledges receipt of the notices in conjunction with opening the account.

(iii) *Isolated transaction with consumer*. For an isolated transaction, such as the purchase of a cashier's check by a consumer, you provide the consumer with a reasonable opportunity to opt out if you provide the notices required in paragraph (a)(1) of this section at the time of the transaction and request that the consumer decide, as a necessary part of the transaction, whether to opt out before completing the transaction.

(b) *Application of opt out to all consumers and all nonpublic personal information*—(1) You must comply with this section, regardless of whether you and the consumer have established a customer relationship.

(2) Unless you comply with this section, you may not, directly or through any affiliate, disclose any nonpublic personal information about a consumer that you have collected, regardless of whether you collected it before or after receiving the direction to opt out from the consumer.

(c) *Partial opt out*. You may allow a consumer to select certain nonpublic

personal information or certain nonaffiliated third parties with respect to which the consumer wishes to opt out.

§ 216.11 Limits on redisclosure and reuse of information.

(a)(1) *Information you receive under an exception.* If you receive nonpublic personal information from a nonaffiliated financial institution under an exception in § 216.14 or 216.15 of this part, your disclosure and use of that information is limited as follows:

(i) You may disclose the information to the affiliates of the financial institution from which you received the information;

(ii) You may disclose the information to your affiliates, but your affiliates may, in turn, disclose and use the information only to the extent that you may disclose and use the information; and

(iii) You may disclose and use the information pursuant to an exception in § 216.14 or 216.15 in the ordinary course of business to carry out the activity covered by the exception under which you received the information.

(2) *Example.* If you receive a customer list from a nonaffiliated financial institution in order to provide account processing services under the exception in § 216.14(a), you may disclose that information under any exception in § 216.14 or 216.15 in the ordinary course of business in order to provide those services. For example, you could disclose the information in response to a properly authorized subpoena or to your attorneys, accountants, and auditors. You could not disclose that information to a third party for marketing purposes or use that information for your own marketing purposes.

(b)(1) *Information you receive outside of an exception.* If you receive nonpublic personal information from a nonaffiliated financial institution other than under an exception in § 216.14 or 216.15 of this part, you may disclose the information only:

(i) To the affiliates of the financial institution from which you received the information;

(ii) To your affiliates, but your affiliates may, in turn, disclose the information only to the extent that you can disclose the information; and

(iii) To any other person, if the disclosure would be lawful if made directly to that person by the financial institution from which you received the information.

(2) *Example.* If you obtain a customer list from a nonaffiliated financial institution outside of the exceptions in § 216.14 and 216.15:

(i) You may use that list for your own purposes; and

(ii) You may disclose that list to another nonaffiliated third party only if the financial institution from which you purchased the list could have lawfully disclosed the list to that third party. That is, you may disclose the list in accordance with the privacy policy of the financial institution from which you received the list, as limited by the opt out direction of each consumer whose nonpublic personal information you intend to disclose, and you may disclose the list in accordance with an exception in § 216.14 or 216.15, such as to your attorneys or accountants.

(c) *Information you disclose under an exception.* If you disclose nonpublic personal information to a nonaffiliated third party under an exception in § 216.14 or 216.15 of this part, the third party may disclose and use that information only as follows:

(1) The third party may disclose the information to your affiliates;

(2) The third party may disclose the information to its affiliates, but its affiliates may, in turn, disclose and use the information only to the extent that the third party may disclose and use the information; and

(3) The third party may disclose and use the information pursuant to an exception in § 216.14 or 216.15 in the ordinary course of business to carry out the activity covered by the exception under which it received the information.

(d) *Information you disclose outside of an exception.* If you disclose nonpublic personal information to a nonaffiliated third party other than under an exception in § 216.14 or 216.15 of this part, the third party may disclose the information only:

(1) To your affiliates;

(2) To its affiliates, but its affiliates, in turn, may disclose the information

only to the extent the third party can disclose the information; and

(3) To any other person, if the disclosure would be lawful if you made it directly to that person.

§ 216.12 Limits on sharing account number information for marketing purposes.

(a) *General prohibition on disclosure of account numbers.* You must not, directly or through an affiliate, disclose, other than to a consumer reporting agency, an account number or similar form of access number or access code for a consumer's credit card account, deposit account, or transaction account to any nonaffiliated third party for use in telemarketing, direct mail marketing, or other marketing through electronic mail to the consumer.

(b) *Exceptions.* Paragraph (a) of this section does not apply if you disclose an account number or similar form of access number or access code:

(1) To your agent or service provider solely in order to perform marketing for your own products or services, as long as the agent or service provider is not authorized to directly initiate charges to the account; or

(2) To a participant in a private label credit card program or an affinity or similar program where the participants in the program are identified to the customer when the customer enters into the program.

(c) *Examples*—(1) *Account number.* An account number, or similar form of access number or access code, does not include a number or code in an encrypted form, as long as you do not provide the recipient with a means to decode the number or code.

(2) *Transaction account.* A transaction account is an account other than a deposit account or a credit card account. A transaction account does not include an account to which third parties cannot initiate charges.

Subpart C—Exceptions

§ 216.13 Exception to opt out requirements for service providers and joint marketing.

(a) *General rule.* (1) The opt out requirements in §§ 216.7 and 216.10 do not apply when you provide nonpublic personal information to a nonaffiliated third party to perform services for you or functions on your behalf, if you:

(i) Provide the initial notice in accordance with § 216.4; and

(ii) Enter into a contractual agreement with the third party that prohibits the third party from disclosing or using the information other than to carry out the purposes for which you disclosed the information, including use under an exception in § 216.14 or 216.15 in the ordinary course of business to carry out those purposes.

(2) *Example.* If you disclose nonpublic personal information under this section to a financial institution with which you perform joint marketing, your contractual agreement with that institution meets the requirements of paragraph (a)(1)(ii) of this section if it prohibits the institution from disclosing or using the nonpublic personal information except as necessary to carry out the joint marketing or under an exception in § 216.14 or 216.15 in the ordinary course of business to carry out that joint marketing.

(b) *Service may include joint marketing.* The services a nonaffiliated third party performs for you under paragraph (a) of this section may include marketing of your own products or services or marketing of financial products or services offered pursuant to joint agreements between you and one or more financial institutions.

(c) *Definition of joint agreement.* For purposes of this section, joint agreement means a written contract pursuant to which you and one or more financial institutions jointly offer, endorse, or sponsor a financial product or service.

§ 216.14 Exceptions to notice and opt out requirements for processing and servicing transactions.

(a) *Exceptions for processing transactions at consumer's request.* The requirements for initial notice in § 216.4(a)(2), for the opt out in §§ 216.7 and 216.10, and for service providers and joint marketing in § 216.13 do not apply if you disclose nonpublic personal information as necessary to effect, administer, or enforce a transaction that

a consumer requests or authorizes, or in connection with:

(1) Servicing or processing a financial product or service that a consumer requests or authorizes;

(2) Maintaining or servicing the consumer's account with you, or with another entity as part of a private label credit card program or other extension of credit on behalf of such entity; or

(3) A proposed or actual securitization, secondary market sale (including sales of servicing rights), or similar transaction related to a transaction of the consumer.

(b) *Necessary to effect, administer, or enforce a transaction* means that the disclosure is:

(1) Required, or is one of the lawful or appropriate methods, to enforce your rights or the rights of other persons engaged in carrying out the financial transaction or providing the product or service; or

(2) Required, or is a usual, appropriate or acceptable method:

(i) To carry out the transaction or the product or service business of which the transaction is a part, and record, service, or maintain the consumer's account in the ordinary course of providing the financial service or financial product;

(ii) To administer or service benefits or claims relating to the transaction or the product or service business of which it is a part;

(iii) To provide a confirmation, statement, or other record of the transaction, or information on the status or value of the financial service or financial product to the consumer or the consumer's agent or broker;

(iv) To accrue or recognize incentives or bonuses associated with the transaction that are provided by you or any other party;

(v) To underwrite insurance at the consumer's request or for reinsurance purposes, or for any of the following purposes as they relate to a consumer's insurance: account administration, reporting, investigating, or preventing fraud or material misrepresentation, processing premium payments, processing insurance claims, administering insurance benefits (including utilization review activities), participating in research projects, or as otherwise required or specifically permitted by Federal or State law; or

(vi) In connection with:

(A) The authorization, settlement, billing, processing, clearing, transferring, reconciling or collection of amounts charged, debited, or otherwise paid using a debit, credit, or other payment card, check, or account number, or by other payment means;

(B) The transfer of receivables, accounts, or interests therein; or

(C) The audit of debit, credit, or other payment information.

§ 216.15 Other exceptions to notice and opt out requirements.

(a) *Exceptions to opt out requirements.* The requirements for initial notice in § 216.4(a)(2), for the opt out in §§ 216.7 and 216.10, and for service providers and joint marketing in § 216.13 do not apply when you disclose nonpublic personal information:

(1) With the consent or at the direction of the consumer, provided that the consumer has not revoked the consent or direction;

(2)(i) To protect the confidentiality or security of your records pertaining to the consumer, service, product, or transaction;

(ii) To protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability;

(iii) For required institutional risk control or for resolving consumer disputes or inquiries;

(iv) To persons holding a legal or beneficial interest relating to the consumer; or

(v) To persons acting in a fiduciary or representative capacity on behalf of the consumer;

(3) To provide information to insurance rate advisory organizations, guaranty funds or agencies, agencies that are rating you, persons that are assessing your compliance with industry standards, and your attorneys, accountants, and auditors;

(4) To the extent specifically permitted or required under other provisions of law and in accordance with the Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 *et seq.*), to law enforcement agencies (including a federal functional regulator, the Secretary of the Treasury, with respect to 31 U.S.C.

Chapter 53, Subchapter II (Records and Reports on Monetary Instruments and Transactions) and 12 U.S.C. Chapter 21 (Financial Recordkeeping), a State insurance authority, with respect to any person domiciled in that insurance authority's State that is engaged in providing insurance, and the Federal Trade Commission), self-regulatory organizations, or for an investigation on a matter related to public safety;

(5)(i) To a consumer reporting agency in accordance with the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*), or

(ii) From a consumer report reported by a consumer reporting agency;

(6) In connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit if the disclosure of nonpublic personal information concerns solely consumers of such business or unit; or

(7)(i) To comply with Federal, State, or local laws, rules and other applicable legal requirements;

(ii) To comply with a properly authorized civil, criminal, or regulatory investigation, or subpoena or summons by Federal, State, or local authorities; or

(iii) To respond to judicial process or government regulatory authorities having jurisdiction over you for examination, compliance, or other purposes as authorized by law.

(b) *Examples of consent and revocation of consent.* (1) A consumer may specifically consent to your disclosure to a nonaffiliated insurance company of the fact that the consumer has applied to you for a mortgage so that the insurance company can offer homeowner's insurance to the consumer.

(2) A consumer may revoke consent by subsequently exercising the right to opt out of future disclosures of nonpublic personal information as permitted under § 216.7(f).

Subpart D—Relation to Other Laws; Effective Date

§ 216.16 Protection of Fair Credit Reporting Act.

Nothing in this part shall be construed to modify, limit, or supersede the operation of the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*), and no inference shall be drawn on the basis of the provisions of this part regarding whether information is transaction or experience information under section 603 of that Act.

§ 216.17 Relation to State laws.

(a) *In general.* This part shall not be construed as superseding, altering, or affecting any statute, regulation, order, or interpretation in effect in any State, except to the extent that such State statute, regulation, order, or interpretation is inconsistent with the provisions of this part, and then only to the extent of the inconsistency.

(b) *Greater protection under State law.* For purposes of this section, a State statute, regulation, order, or interpretation is not inconsistent with the provisions of this part if the protection such statute, regulation, order, or interpretation affords any consumer is greater than the protection provided under this part, as determined by the Federal Trade Commission, after consultation with the Board, on the Federal Trade Commission's own motion, or upon the petition of any interested party.

§ 216.18 Effective date; transition rule.

(a) *Effective date.* This part is effective November 13, 2000. In order to provide sufficient time for you to establish policies and systems to comply with the requirements of this part, the Board has extended the time for compliance with this part until July 1, 2001.

(b)(1) *Notice requirement for consumers who are your customers on the compliance date.* By July 1, 2001, you must have provided an initial notice, as required by § 216.4, to consumers who are your customers on July 1, 2001.

(2) *Example.* You provide an initial notice to consumers who are your customers on July 1, 2001, if, by that date, you have established a system for providing an initial notice to all new customers and have mailed the initial notice to all your existing customers.

(c) *Two-year grandfathering of service agreements.* Until July 1, 2002, a contract that you have entered into with a nonaffiliated third party to perform services for you or functions on your behalf satisfies the provisions of § 216.13(a)(1)(ii) of this part, even if the

contract does not include a requirement that the third party maintain the confidentiality of nonpublic personal information, as long as you entered into the contract on or before July 1, 2000.

APPENDIX A TO PART 216—SAMPLE CLAUSES

Financial institutions, including a group of financial holding company affiliates that use a common privacy notice, may use the following sample clauses, if the clause is accurate for each institution that uses the notice. (Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act, such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

A–1—CATEGORIES OF INFORMATION YOU COLLECT (ALL INSTITUTIONS)

You may use this clause, as applicable, to meet the requirement of §216.6(a)(1) to describe the categories of nonpublic personal information you collect.

Sample Clause A–1:

We collect nonpublic personal information about you from the following sources:

• Information we receive from you on applications or other forms;

• Information about your transactions with us, our affiliates, or others; and

• Information we receive from a consumer reporting agency.

A–2—CATEGORIES OF INFORMATION YOU DISCLOSE (INSTITUTIONS THAT DISCLOSE OUTSIDE OF THE EXCEPTIONS)

You may use one of these clauses, as applicable, to meet the requirement of §216.6(a)(2) to describe the categories of nonpublic personal information you disclose. You may use these clauses if you disclose nonpublic personal information other than as permitted by the exceptions in §§216.13, 216.14, and 216.15.

Sample Clause A–2, Alternative 1:

We may disclose the following kinds of nonpublic personal information about you:

• Information we receive from you on applications or other forms, such as [*provide illustrative examples, such as ''your name, address, social security number, assets, and income''*];

• Information about your transactions with us, our affiliates, or others, such as [*provide illustrative examples, such as ''your account balance, payment history, parties to transactions, and credit card usage''*]; and

• Information we receive from a consumer reporting agency, such as [*provide illustrative examples, such as ''your creditworthiness and credit history''*].

Sample Clause A–2, Alternative 2:

We may disclose all of the information that we collect, as described [*describe location in the notice, such as ''above'' or ''below''*].

A–3—CATEGORIES OF INFORMATION YOU DISCLOSE AND PARTIES TO WHOM YOU DISCLOSE (INSTITUTIONS THAT DO NOT DISCLOSE OUTSIDE OF THE EXCEPTIONS)

You may use this clause, as applicable, to meet the requirements of §§216.6(a)(2), (3), and (4) to describe the categories of nonpublic personal information about customers and former customers that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose. You may use this clause if you do not disclose nonpublic personal information to any party, other than as permitted by the exceptions in §§216.14, and 216.15.

Sample Clause A–3:

We do not disclose any nonpublic personal information about our customers or former customers to anyone, except as permitted by law.

A–4—CATEGORIES OF PARTIES TO WHOM YOU DISCLOSE (INSTITUTIONS THAT DISCLOSE OUTSIDE OF THE EXCEPTIONS)

You may use this clause, as applicable, to meet the requirement of §216.6(a)(3) to describe the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information. You may use this clause if you disclose nonpublic personal information other than as permitted by the exceptions in §§216.13, 216.14, and 216.15, as well as when permitted by the exceptions in §§216.14, and 216.15.

Sample Clause A–4:

We may disclose nonpublic personal information about you to the following types of third parties:

• Financial service providers, such as [*provide illustrative examples, such as ''mortgage bankers, securities broker-dealers, and insurance agents''*];

• Non-financial companies, such as [*provide illustrative examples, such as ''retailers, direct marketers, airlines, and publishers''*]; and

• Others, such as [*provide illustrative examples, such as ''non-profit organizations''*].

We may also disclose nonpublic personal information about you to nonaffiliated third parties as permitted by law.

A–5—SERVICE PROVIDER/JOINT MARKETING EXCEPTION

You may use one of these clauses, as applicable, to meet the requirements of §216.6(a)(5) related to the exception for service providers and joint marketers in §216.13.

If you disclose nonpublic personal information under this exception, you must describe the categories of nonpublic personal information you disclose and the categories of third parties with whom you have contracted.

Sample Clause A–5, Alternative 1:

We may disclose the following information to companies that perform marketing services on our behalf or to other financial institutions with whom we have joint marketing agreements:

• Information we receive from you on applications or other forms, such as [*provide illustrative examples, such as ''your name, address, social security number, assets, and income''*];

• Information about your transactions with us, our affiliates, or others, such as [*provide illustrative examples, such as ''your account balance, payment history, parties to transactions, and credit card usage''*]; and

• Information we receive from a consumer reporting agency, such as [*provide illustrative examples, such as ''your creditworthiness and credit history''*].

Sample Clause A–5, Alternative 2:

We may disclose all of the information we collect, as described [*describe location in the notice, such as ''above'' or ''below''*] to companies that perform marketing services on our behalf or to other financial institutions with whom we have joint marketing agreements.

A–6—EXPLANATION OF OPT OUT RIGHT (INSTITUTIONS THAT DISCLOSE OUTSIDE OF THE EXCEPTIONS)

You may use this clause, as applicable, to meet the requirement of §216.6(a)(6) to provide an explanation of the consumer's right to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including the method(s) by which the consumer may exercise that right. You may use this clause if you disclose nonpublic personal information other than as permitted by the exceptions in §§216.13, 216.14, and 216.15.

Sample Clause A–6:

If you prefer that we not disclose nonpublic personal information about you to nonaffiliated third parties, you may opt out of those disclosures, that is, you may direct us not to make those disclosures (other than disclosures permitted by law). If you wish to opt out of disclosures to nonaffiliated third parties, you may [*describe a reasonable means of opting out, such as ''call the following toll-free number: (insert number)''*].

A–7—CONFIDENTIALITY AND SECURITY (ALL INSTITUTIONS)

You may use this clause, as applicable, to meet the requirement of §216.6(a)(8) to describe your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information.

Sample Clause A–7:

We restrict access to nonpublic personal information about you to [*provide an appropriate description, such as ''those employees who need to know that information to provide products or services to you''*]. We maintain physical, electronic, and procedural safeguards that comply with federal standards to guard your nonpublic personal information.

PART 217—PROHIBITION AGAINST THE PAYMENT OF INTEREST ON DEMAND DEPOSITS (REGULATION Q)

REGULATIONS

Sec.
217.1 Authority, purpose, and scope.
217.2 Definitions.
217.3 Interest on demand deposits.

INTERPRETATIONS

217.101 Premiums on deposits.

AUTHORITY: 12 U.S.C. 248, 371a, 461, 505, 1818, and 3105.

REGULATIONS

SOURCE: Sections 217.1 through 217.6 appear at Reg. Q, 51 FR 9637, Mar. 20, 1986, unless otherwise noted.

§217.1 Authority, purpose, and scope.

(a) *Authority*. This part is issued under the authority of section 19 of the Federal Reserve Act (12 U.S.C. 371a, 461, 505), section 7 of the International Banking Act of 1978 (12 U.S.C. 3105), section 11 of the Federal Reserve Act (12 U.S.C. 248), and section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), unless otherwise noted.

(b) *Purpose*. This part prohibits the payment of interest on demand deposits by member banks and other depository institutions within the scope of this part.

(c) *Scope*. (1) This regulation applies to state chartered banks that are members of the Federal Reserve under section 9 of the Federal Reserve Act (12 U.S.C. 321, *et seq.*) and to all national banks. The regulation also applies to any Federal branch or agency of a foreign bank and to a State uninsured branch or agency of a foreign bank in the same manner and to the same extent as if the branch or agency were a

member bank, except as may be otherwise provided by the Board, if:

(i) Its parent foreign bank has total worldwide consolidated bank assets in excess of $1 billion;

(ii) Its parent foreign bank is controlled by a foreign company which owns or controls foreign banks that in the aggregate have total worldwide consolidated bank assets in excess of $1 billion; or

(iii) Its parent foreign bank is controlled by a group of foreign companies that own or control foreign banks that in the aggregate have total worldwide consolidated bank assets in excess of $1 billion.

(2) For deposits held by a member bank or a foreign bank, this regulation does not apply to ''any deposit that is payable only at an office located outside of the United States'' (*i.e.*, the States of the United States and the District of Columbia) as defined in § 204.2(t) of the Board's Regulation D—Reserve Requirements of Depository Institutions (12 CFR 20.4).

[Reg. Q, 51 FR 9637, Mar. 20, 1986, as amended at 57 FR 43336, Sept. 21, 1992]

§ 217.2 Definitions.

For purposes of this part, the following definitions apply unless otherwise specified;

(a) *Demand deposit* means any deposit that is considered to be a *demand deposit* under § 204.2(b) of the Board's Regulation D—Reserve Requirements of Depository Institutions (12 CFR part 204).

(b) *Deposit* means any liability of a member bank that is considered to be a *deposit* under § 204.2(a) of the Board's Regulation D—Reserve Requirements of Depository Institutions (12 CFR part 204).

(c) *Foreign bank* means any bank that is considered to be a *foreign bank* under § 204.2(o) of the Board's Regulation D—Reserve Requirements of Depository Institutions (12 CFR part 204).

(d) *Interest* means any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A member bank's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

§ 217.3 Interest on demand deposits.

No member bank of the Federal Reserve System shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit.[1]

INTERPRETATIONS

§ 217.101 Premiums on deposits.

(a) Section 19(i) of the Federal Reserve Act and § 217.3 of Regulation Q prohibits a member bank from paying interest on a demand deposit. Premiums, whether in the form of merchandise, credit, or cash, given by a member bank to a depositor will be regarded as an advertising or promotional expense rather than a payment of interest if:

(1) The premium is given to a depositor only at the time of the opening of a new account or an addition to an existing account;

(2) No more than two premiums per account are given within a 12-month period; and

(3) The value of the premium or, in the case, of articles of merchandise, the total cost (including taxes, shipping, warehousing, packaging, and handling costs) does not exceed $10 for deposits of less than $5,000 or $20 for deposits of $5,000 or more.

The costs of premiums may not be averaged. The member bank should retain sufficient supporting documentation showing that the total cost of a premium, including shipping, warehousing, packaging, and handling costs, does not exceed the applicable $10/$20 limitations and that no portion of the total cost of any premium has

[1] A member bank may continue to pay interest on a time deposit for not more than ten calendar days; (1) Where the member bank has provided in the time deposit contract that, if the deposit or any portion thereof is withdrawn not more than ten calendar days after a maturity date (one business day for ''IBF time deposits'' as defined in § 204.8(a)(2) of Regulation D), interest will continue to be paid for such period; or (2) for a period between a maturity date and the date of renewal of the deposit, provided that such certificate is renewed within ten calendar days after maturity.

been attributed to development, advertising, promotional, or other expenses. A member bank is not permitted directly or indirectly to solicit or promote deposits from customers on the basis that the funds will be divided into more than one account by the institution for the purpose of providing more than two premiums per deposit within a 12-month period.

(b) Notwithstanding paragraph (a) of this section, any premium that is not, directly or indirectly, related to or dependent on the balance in a demand deposit account and the duration of the account balance shall not be considered the payment of interest on a demand deposit account and shall not be subject to the limitations in paragraph (a) of this section.

[52 FR 47698, Dec. 16, 1987. Redesignated at 57 FR 43336, Sept. 21, 1992; 62 FR 26737, May 15, 1997]

PART 219—REIMBURSEMENT FOR PROVIDING FINANCIAL RECORDS; RECORDKEEPING REQUIREMENTS FOR CERTAIN FINANCIAL RECORDS (REGULATION S)

Subpart A—Reimbursement to Financial Institutions for Providing Financial Records

Sec.
219.1 Authority, purpose and scope.
219.2 Definitions.
219.3 Cost reimbursement.
219.4 Exceptions.
219.5 Conditions for payment.
219.6 Payment procedures.

Subpart B—Recordkeeping and Reporting Requirements for Funds Transfers and Transmittals of Funds

219.21 Authority, purpose and scope.
219.22 Definitions.
219.23 Recordkeeping and reporting requirements.
219.24 Retention period.

AUTHORITY: 12 U.S.C. 3415.

SOURCE: 44 FR 55813, Sept. 28, 1979, unless otherwise noted.

Subpart A—Reimbursement to Financial Institutions for Providing Financial Records

§219.1 Authority, purpose and scope.

This subpart of Regulation S (12 CFR part 219, subpart A) is issued by the Board of Governors of the Federal Reserve System (the Board) under section 1115 of the Right to Financial Privacy Act (the Act) (12 U.S.C. 3415). It establishes the rates and conditions for reimbursement of reasonably necessary costs directly incurred by financial institutions in assembling or providing customer financial records to a government authority pursuant to the Act.

[60 FR 233, Jan. 3, 1995]

§219.2 Definitions.

For the purposes of this subpart, the following definitions shall apply:

Customer means any person or authorized representative of that person who uses any service of a financial institution, or for whom a financial institution acts or has acted as a fiduciary in relation to an account maintained in the person's name. Customer does not include corporations or partnerships comprised of more than five persons.

Financial institution means any office of a bank, savings bank, card issuer as defined in section 103 of the Consumers Credit Protection Act (15 U.S.C. 1602(n)), industrial loan company, trust company, savings association, building and loan, or homestead association (including cooperative banks), credit union, or consumer finance institution, located in any State or territory of the United States, the District of Columbia, Puerto Rico, Guam, American Samoa, or the Virgin Islands.

Financial record means an original or copy of, or information known to have been derived from, any record held by a financial institution pertaining to a customer's relationship with the financial institution.

Government authority means any agency or department of the United States, or any officer, employee or agent thereof.

Person means an individual or a partnership of five or fewer individuals.

[Reg. S, 61 FR 29640, June 12, 1996]

§ 219.3 Cost reimbursement.

(a) *Fees payable.* Except as provided in § 219.4, a government authority, or a court issuing an order or subpoena in connection with grand jury proceedings, seeking access to financial records pertaining to a customer shall reimburse the financial institution for reasonably necessary costs directly incurred in searching for, reproducing or transporting books, papers, records, or other data as set forth in this section. The reimbursement schedule for a financial institution is set forth in Appendix A to this section. If a financial institution has financial records that are stored at an independent storage facility that charges a fee to search for, reproduce, or transport particular records requested, these costs are considered to be directly incurred by the financial institution and may be included in the reimbursement.

(b) *Search and processing costs.* (1) Reimbursement of search and processing costs shall cover the total amount of personnel time spent in locating, retrieving, reproducing, and preparing financial records for shipment. Search and processing costs shall not cover analysis of material or legal advice.

(2) If itemized separately, search and processing costs may include the actual cost of extracting information stored by computer in the format in which it is normally produced, based on computer time and necessary supplies; however, personnel time for computer search may be paid for only at the rates specified in Appendix A to this section.

(c) *Reproduction costs.* The reimbursement rates for reproduction costs for requested documents are set forth in Appendix A to this section. Copies of photographs, films, computer tapes, and other materials not listed in Appendix A to this section are reimbursed at actual cost.

(d) *Transportation costs.* Reimbursement for transportation costs shall be for the reasonably necessary costs directly incurred to transport personnel to locate and retrieve the requested information, and to convey such material to the place of examination.

[Reg. S, 61 FR 29640, June 12, 1996]

APPENDIX A TO § 219.3—REIMBURSEMENT SCHEDULE

Reproduction:
- Photocopy, per page—$.25
- Paper copies of microfiche, per frame—$.25
- Duplicate microfiche, per microfiche—$.50
- Computer diskette—$5.00

Search and Processing:
- Clerical/Technical, hourly rate—$11.00
- Manager/Supervisory, hourly rate—$17.00

[Reg. S, 61 FR 29640, June 12, 1996]

§ 219.4 Exceptions.

A financial institution is not entitled to reimbursement under this subpart for costs incurred in assembling or providing financial records or information related to:

(a) *Security interests, bankruptcy claims, debt collection.* Any financial records provided as an incident to perfecting a security interest, proving a claim in bankruptcy, or otherwise collecting on a debt owing either to the financial institution itself or in its role as a fiduciary.

(b) *Government loan programs.* Financial records that are necessary to permit the appropriate government authority to carry out its responsibilities under a government loan, loan guaranty or loan insurance program.

(c) *Nonidentifiable information.* Financial records that are not identified with or identifiable as being derived from the financial records of a particular customer.

(d) *Financial supervisory agencies.* Financial records disclosed to a financial supervisory agency in the exercise of its supervisory, regulatory, or monetary functions with respect to a financial institution.

(e) *Internal Revenue summons.* Financial records disclosed in accordance with procedures authorized by the Internal Revenue Code.

(f) *Federally required reports.* Financial records required to be reported in accordance with any federal statute or rule promulgated thereunder.

(g) *Government civil or criminal litigation.* Financial records sought by a government authority under the Federal Rules of Civil or Criminal Procedure or

comparable rules of other courts in connection with litigation to which the government authority and the customer are parties.

(h) *Administrative agency subpoenas.* Financial records sought by a government authority pursuant to an administrative subpoena issued by an administrative law judge in an adjudicatory proceeding subject to 5 U.S.C. 554, and to which the government authority and the customer are parties.

(i) *Investigation of financial institution or its noncustomer.* Financial records sought by a government authority in connection with a lawful proceeding, investigation, examination, or inspection directed at the financial institution in possession of such records, or at an entity that is not a *customer* as defined in §219.2 of this part.

(j) *General Accounting Office requests.* Financial records sought by the General Accounting Office pursuant to an authorized proceeding, investigation, examination, or audit directed at a government authority.

(k) *Federal Housing Finance Board requests.* Financial records or information sought by the Federal Housing Finance Board (FHFB) or any of the Federal home loan banks in the exercise of the FHFB's authority to extend credit to financial institutions or others.

(l) *Department of Veterans Affairs.* The disclosure of the name and address of any customer to the Department of Veterans Affairs where such disclosure is necessary to, and used solely for, the proper administration of benefits programs under laws administered by that Department.

[Reg. S, 61 FR 29640, June 12, 1996]

§219.5 Conditions for payment.

(a) *Direct costs.* Payment shall be made only for costs that are both directly incurred and reasonably necessary to provide requested material. Search and processing, reproduction, and transportation costs shall be considered separately when determining whether the costs are reasonably necessary.

(b) *Compliance with legal process, request, or authorization.* No payment may be made to a financial institution until it satisfactorily complies with the legal process, the formal written request, or the customer authorization. When the legal process or formal written request is withdrawn, or the customer authorization is revoked, or where the customer successfully challenges disclosure to a grand jury or government authority, the financial institution shall be reimbursed for the reasonably necessary costs incurred in assembling the requested financial records prior to the time the financial institution is notified of such event.

(c) *Itemized bill or invoice.* No reimbursement is required unless a financial institution submits an itemized bill or invoice specifically detailing its search and processing, reproduction, and transportation costs. Search and processing time should be billed in 15-minute increments.

[Reg. S, 61 FR 29641, June 12, 1996]

§219.6 Payment procedures.

(a) *Notice to submit invoice.* Promptly following a service of legal process or request, the court or government authority shall notify the financial institution that it must submit an itemized bill or invoice in order to obtain payment and shall furnish an address for this purpose.

(b) *Special notice.* If a grand jury or government authority withdraws the legal process or formal written request, or if the customer revokes the authorization, or if the legal process or request has been successfully challenged by the customer, the grand jury or government authority shall promptly notify the financial institution of these facts, and shall also notify the financial institution that it must submit an itemized bill or invoice in order to obtain payment of costs incurred prior to the time the financial institution receives this notice.

[Reg. S, 61 FR 29641, June 12, 1996; 61 FR 32317, June 24, 1996]

Subpart B—Recordkeeping and Reporting Requirements for Funds Transfers and Transmittals of Funds

AUTHORITY: 12 U.S.C. 1829b(b)(2) and (3).

SOURCE: 60 FR 233, Jan. 3, 1995, unless otherwise noted.

§ 219.21 Authority, purpose and scope.

This subpart of Regulation S (12 CFR part 219, subpart B) is issued by the Board under the authority of section 21(b) of the Federal Deposit Insurance Act (12 U.S.C. 1829b), as amended by the Annunzio-Wylie Anti-Money Laundering Act of 1992 (Pub. L. 102–550, Title XV; 106 Stat. 3672, 4044), which authorizes the Board and the Secretary of the Treasury jointly to prescribe recordkeeping and reporting requirements for domestic wire transfers by insured depository institutions; and which also requires the Board and the Treasury jointly to prescribe recordkeeping and reporting requirements for international wire transfers by insured depository institutions and by nonbank financial institutions. The definitions and recordkeeping and reporting requirements referenced in this subpart are promulgated and administered jointly by the Board and the Treasury and are codified in 31 CFR 103.11 and 103.33(e) and (f). This subpart does not apply to a particular person or class of persons or a particular transaction or class of transactions to the extent that the Treasury has determined that 31 CFR 103.33(e) or (f) do not apply to that person, transaction, or class of persons or transactions. These recordkeeping and reporting requirements will assist in the prosecution of money laundering activities and are determined to have a high degree of usefulness in criminal, tax or regulatory investigations or proceedings.

[60 FR 233, Jan. 3, 1995, as amended by Reg. S, 61 FR 58975, Nov. 20, 1996]

§ 219.22 Definitions.

The following terms are defined in 31 CFR 103.11 under the joint authority of the Board and the Treasury:

Accept.
Beneficiary.
Beneficiary's bank.
Established customer.
Execution date.
Funds transfer.
Intermediary bank.
Intermediary financial institution.
Originator.
Originator's bank.
Payment date.
Payment order.
Receiving bank.
Receiving financial institution.
Recipient.
Recipient's financial institution.
Sender.
Transmittal of funds.
Transmittal order.
Transmittor.
Transmittor's financial institution.

§ 219.23 Recordkeeping and reporting requirements.

(a) *Domestic and international funds transfers by insured depository institutions.* The Board and the Treasury are authorized to promulgate jointly recordkeeping and reporting requirements for domestic and international funds transfers by insured depository institutions whenever the agencies determine that the maintenance of such records has a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. These regulations are codified at 31 CFR 103.33(e). For the purposes of this subpart, the provisions of 31 CFR 103.33(e) apply only to funds transfers by insured depository institutions.

(b) *International transmittals of funds by financial institutions other than insured depository institutions.* The Board and the Treasury are required to promulgate jointly reporting and recordkeeping requirements for international transmittals of funds by financial institutions, including brokers and dealers in securities and businesses that provide money transmitting services. In prescribing these requirements, the Board and the Treasury take into account the usefulness of these records in criminal, tax, or regulatory investigations or proceedings and the effect the recordkeeping will have on the cost and efficiency of the payment system. These regulations are codified at 31 CFR 103.33(f). For the purposes of this subpart, the provisions of 31 CFR 103.33(f) apply only to international transmittals of funds.

§ 219.24 Retention period.

All records that are required to be retained by this subpart shall be retained for a period of five years. All these records shall be filed or stored in such

a way as to be accessible within a reasonable period of time, taking into consideration the nature of the record and the amount of time that has expired since the record was made. Any records required to be retained by this subpart shall be made available to the Board upon request.