

Farm Credit System Insurance Corp.

§ 1411.1

(b) Prepare and maintain on its premises books and records in such a manner as to facilitate reconciliation with certified statements prepared from them.

(c) Maintain in its books and records documentation supporting its certified statement for a period no less than 5 years following the date of each certified statement, unless the bank shall have requested in writing, and the Corporation shall have granted to the bank, written permission to dispose of such documentation prior to the expiration of 5 years.

(d) Make all records and any supporting documentation available, without limitation, to Corporation officials upon request.

**PART 1411—RULES OF PRACTICE
AND PROCEDURE**

AUTHORITY: Secs. 5.58(10), 5.65(c) and (d) of the Farm Credit Act; 12 U.S.C. 2277a-7(10), 2277a-14(c) and (d); 28 U.S.C. 2461 note.

**Subpart A—Rules and Procedures
for Assessment and Collection
of Civil Money Penalties**

§ 1411.1 Inflation adjustment of civil money penalties for failure to file a certified statement, pay any premium required or obtain approval before employment of persons convicted of criminal offenses.

In accordance with the Federal Civil Money Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, a civil money penalty imposed pursuant to section 5.65(c) or (d) of the Act for a violation occurring on or after October 23, 1996 shall not exceed \$117 per day for each day the violation continues.

[66 FR 44027, Aug. 22, 2001]

CHAPTER XV—DEPARTMENT OF THE TREASURY

SUBCHAPTER A—GENERAL PROVISIONS

<i>Part</i>		<i>Page</i>
1500	Merchant banking investments	305
1501	Financial subsidiaries	312
1502-1503	[Reserved]	
1505-1507	[Reserved]	

SUBCHAPTER B—RESOLUTION FUNDING CORPORATION

1510	Resolution Funding Corporation operations	315
1511	Book-entry procedure	318

SUBCHAPTER A—GENERAL PROVISIONS

PART 1500—MERCHANT BANKING INVESTMENTS

Sec.

- 1500.1 What type of investments are permitted by this part, and under what conditions may they be made?
- 1500.2 What are the limitations on managing or operating a portfolio company held as a merchant banking investment?
- 1500.3 What are the holding periods permitted for merchant banking investments?
- 1500.4 How are investments in private equity funds treated under this part?
- 1500.5 What aggregate thresholds apply to merchant banking investments?
- 1500.6 What risk management, record keeping and reporting policies are required to make merchant banking investments?
- 1500.7 How do the statutory cross marketing and sections 23A and B limitations apply to merchant banking investments?
- 1500.8 Definitions.

AUTHORITY: 12 U.S.C. 1843(k).

SOURCE: Reg. Y, 66 FR 8489, Jan. 31, 2001, unless otherwise noted.

§ 1500.1 What type of investments are permitted by this part, and under what conditions may they be made?

(a) *What types of investments are permitted by this part?* Section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) and this part authorize a financial holding company, directly or indirectly and as principal or on behalf of one or more persons, to acquire or control any amount of shares, assets or ownership interests of a company or other entity that is engaged in any activity not otherwise authorized for the financial holding company under section 4 of the Bank Holding Company Act. For purposes of this part, shares, assets or ownership interests acquired or controlled under section 4(k)(4)(H) and this part are referred to as “merchant banking investments.” A financial holding company may not directly or indirectly acquire or control any merchant banking investment except in compliance with the requirements of this part.

(b) *Must the investment be a bona fide merchant banking investment?* The acqui-

sition or control of shares, assets or ownership interests under this part is not permitted unless it is part of a bona fide underwriting or merchant or investment banking activity.

(c) *What types of ownership interests may be acquired?* Shares, assets or ownership interests of a company or other entity include any debt or equity security, warrant, option, partnership interest, trust certificate or other instrument representing an ownership interest in the company or entity, whether voting or nonvoting.

(d) *Where in a financial holding company may merchant banking investments be made?* A financial holding company and any subsidiary (other than a depository institution or subsidiary of a depository institution) may acquire or control merchant banking investments. A financial holding company and its subsidiaries may not acquire or control merchant banking investments on behalf of a depository institution or subsidiary of a depository institution.

(e) *May assets other than shares be held directly?* A financial holding company may not under this part acquire or control assets, other than debt or equity securities or other ownership interests in a company, unless:

(1) The assets are held by or promptly transferred to a portfolio company;

(2) The portfolio company maintains policies, books and records, accounts, and other indicia of corporate, partnership or limited liability organization and operation that are separate from the financial holding company and limit the legal liability of the financial holding company for obligations of the portfolio company; and

(3) The portfolio company has management that is separate from the financial holding company to the extent required by § 1500.2.

(f) *What type of affiliate is required for a financial holding company to make merchant banking investments?* A financial holding company may not acquire or control merchant banking investments under this part unless the financial holding company qualifies under at least one of the following paragraphs:

(1) *Securities affiliate.* The financial holding company is or has an affiliate that is registered under the Securities Exchange Act of 1934 (15 U.S.C. 78c, 78o, 78o-4) as:

- (i) A broker or dealer; or
- (ii) A municipal securities dealer, including a separately identifiable department or division of a bank that is registered as a municipal securities dealer.

(2) *Insurance affiliate with an investment adviser affiliate.* The financial holding company controls:

- (i) An insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance), or providing and issuing annuities; and
- (ii) A company that:

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

(B) Provides investment advice to an insurance company.

§ 1500.2 What are the limitations on managing or operating a portfolio company held as a merchant banking investment?

(a) *May a financial holding company routinely manage or operate a portfolio company?* Except as permitted in paragraph (e) of this section, a financial holding company may not routinely manage or operate any portfolio company.

(b) *When does a financial holding company routinely manage or operate a company?*

(1) *Examples of routine management or operation—(i) Executive officer interlocks at the portfolio company.* A financial holding company routinely manages or operates a portfolio company if any director, officer or employee of the financial holding company serves as or has the responsibilities of an executive officer of the portfolio company.

(ii) *Interlocks by executive officers of the financial holding company—(A) Prohibition.* A financial holding company routinely manages or operates a portfolio company if any executive officer of the financial holding company serves as or has the responsibilities of

an officer or employee of the portfolio company.

(B) *Definition.* For purposes of paragraph (b)(1)(ii)(A) of this section, the term “financial holding company” includes the financial holding company and only the following subsidiaries of the financial holding company:

(1) A securities broker or dealer registered under the Securities Exchange Act of 1934;

(2) A depository institution;

(3) An affiliate that engages in merchant banking activities under this part or insurance company investment activities under section 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(I));

(4) A small business investment company (as defined in section 302(b) of the Small Business Investment Act of 1958 (15 U.S.C. 682(b)) controlled by the financial holding company or by any depository institution controlled by the financial holding company; and

(5) Any other affiliate that engages in significant equity investment activities that are subject to a special capital charge under the capital adequacy rules or guidelines of the Board.

(iii) *Covenants regarding ordinary course of business.* A financial holding company routinely manages or operates a portfolio company if any covenant or other contractual arrangement exists between the financial holding company and the portfolio company that would restrict the portfolio company’s ability to make routine business decisions, such as entering into transactions in the ordinary course of business or hiring officers or employees other than executive officers.

(2) *Presumptions of routine management or operation.* A financial holding company is presumed to routinely manage or operate a portfolio company if:

(i) Any director, officer, or employee of the financial holding company serves as or has the responsibilities of an officer (other than an executive officer) or employee of the portfolio company; or

(ii) Any officer or employee of the portfolio company is supervised by any director, officer, or employee of the financial holding company (other than

in that individual's capacity as a director of the portfolio company).

(c) *How may a financial holding company rebut a presumption that it is routinely managing or operating a portfolio company?* A financial holding company may rebut a presumption that it is routinely managing or operating a portfolio company under paragraph (b)(2) of this section by presenting information to the Board demonstrating to the Board's satisfaction that the financial holding company is not routinely managing or operating the portfolio company.

(d) *What arrangements do not involve routinely managing or operating a portfolio company?*—(1) *Director representation at portfolio companies.* A financial holding company may select any or all of the directors of a portfolio company or have one or more of its directors, officers, or employees serve as directors of a portfolio company if:

(i) The portfolio company employs officers and employees responsible for routinely managing and operating the company; and

(ii) The financial holding company does not routinely manage or operate the portfolio company, except as permitted in paragraph (e) of this section.

(2) *Covenants or other provisions regarding extraordinary events.* A financial holding company may, by virtue of covenants or other written agreements with a portfolio company, restrict the ability of the portfolio company, or require the portfolio company to consult with or obtain the approval of the financial holding company, to take actions outside of the ordinary course of the business of the portfolio company. Examples of the types of actions that may be subject to these types of covenants or agreements include, but are not limited to, the following:

(i) The acquisition of significant assets or control of another company by the portfolio company or any of its subsidiaries;

(ii) Removal or selection of an independent accountant or auditor or investment banker by the portfolio company;

(iii) Significant changes to the business plan or accounting methods or policies of the portfolio company;

(iv) Removal or replacement of any or all of the executive officers of the portfolio company;

(v) The redemption, authorization or issuance of any equity or debt securities (including options, warrants or convertible shares) of the portfolio company or any borrowing by the portfolio company outside of the ordinary course of business;

(vi) The amendment of the articles of incorporation or by-laws (or similar governing documents) of the portfolio company; and

(vii) The sale, merger, consolidation, spin-off, recapitalization, liquidation, dissolution or sale of substantially all of the assets of the portfolio company or any of its significant subsidiaries.

(3) *Providing advisory and underwriting services to, and having consultations with, a portfolio company.* A financial holding company may:

(i) Provide financial, investment and management consulting advice to a portfolio company in a manner consistent with and subject to any restrictions on such activities contained in §§ 225.28(b)(6) or 225.86(b)(1) of the Board's Regulation Y (12 CFR 225.28(b)(6) and 225.86(b)(1));

(ii) Provide assistance to a portfolio company in connection with the underwriting or private placement of its securities, including acting as the underwriter or placement agent for such securities; and

(iii) Meet with the officers or employees of a portfolio company to monitor or provide advice with respect to the portfolio company's performance or activities.

(e) *When may a financial holding company routinely manage or operate a portfolio company?*—(1) *Special circumstances required.* A financial holding company may routinely manage or operate a portfolio company only when intervention by the financial holding company is necessary or required to obtain a reasonable return on the financial holding company's investment in the portfolio company upon resale or other disposition of the investment, such as to avoid or address a significant operating loss or in connection with a loss of senior management at the portfolio company.

§ 1500.3

(2) *Duration Limited.* A financial holding company may routinely manage or operate a portfolio company only for the period of time as may be necessary to address the cause of the financial holding company's involvement, to obtain suitable alternative management arrangements, to dispose of the investment, or to otherwise obtain a reasonable return upon the resale or disposition of the investment.

(3) *Notice required for extended involvement.* A financial holding company may not routinely manage or operate a portfolio company for a period greater than nine months without prior written notice to the Board.

(4) *Documentation required.* A financial holding company must maintain and make available to the Board upon request a written record describing its involvement in routinely managing or operating a portfolio company.

(f) *May a depository institution or its subsidiary routinely manage or operate a portfolio company?*—(1) *In general.* A depository institution and a subsidiary of a depository institution may not routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this part.

(2) *Definition applying provisions governing routine management or operation.* For purposes of this section other than paragraph (e) and for purposes of § 1500.4(d), a financial holding company includes a depository institution controlled by the financial holding company and a subsidiary of such a depository institution.

(3) *Exception for certain subsidiaries of depository institutions.* For purposes of paragraph (e) of this section, a financial holding company includes a financial subsidiary held in accordance with section 5136A of the Revised Statutes (12 U.S.C. 24a) or section 46 of the Federal Deposit Insurance Act (12 U.S.C. 1831w), and a subsidiary that is a small business investment company and that is held in accordance with the Small Business Investment Act (15 U.S.C. 661 *et seq.*), and such a subsidiary may, in accordance with the limitations set forth in this section, routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this part.

12 CFR Ch. XV (1–1–05 Edition)

§ 1500.3 What are the holding periods permitted for merchant banking investments?

(a) *Must investments be made for resale?* A financial holding company may own or control shares, assets and ownership interests pursuant to this part only for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the financial holding company's merchant banking investment activities.

(b) *What period of time is generally permitted for holding merchant banking investments?*—(1) *In general.* Except as provided in this section or § 1500.4, a financial holding company may not, directly or indirectly, own, control or hold any share, asset or ownership interest pursuant to this part for a period that exceeds 10 years.

(2) *Ownership interests acquired from or transferred to companies held under this part.* For purposes of paragraph (b)(1) of this section, shares, assets or ownership interests—

(i) Acquired by a financial holding company from a company in which the financial holding company held an interest under this part will be considered to have been acquired by the financial holding company on the date that the share, asset or ownership interest was acquired by the company; and

(ii) Acquired by a company from a financial holding company will be considered to have been acquired by the company on the date that the share, asset or ownership interest was acquired by the financial holding company if—

(A) The financial holding company held the share, asset, or ownership interest under this part; and

(B) The financial holding company holds an interest in the acquiring company under this part.

(3) *Interests previously held by a financial holding company under limited authority.* For purposes of paragraph (b)(1) of this section, any shares, assets, or ownership interests previously owned or controlled, directly or indirectly, by a financial holding company under any other provision of the Federal banking laws that imposes a limited holding period will if acquired under this part be

considered to have been acquired by the financial holding company under this part on the date the financial holding company first acquired ownership or control of the shares, assets or ownership interests under such other provision of law. For purposes of this paragraph (b)(3), a financial holding company includes a depository institution controlled by the financial holding company and any subsidiary of such a depository institution.

(4) *Approval required to hold interests held in excess of time limit.* A financial holding company may seek Board approval to own, control or hold shares, assets or ownership interests of a company under this part for a period that exceeds the period specified in paragraph (b)(1) of this section. A request for approval must:

- (i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;
- (ii) Provide the reasons for the request, including information that addresses the factors in paragraph (b)(5) of this section; and
- (iii) Explain the financial holding company's plan for divesting the shares, assets or ownership interests.

(5) *Factors governing Board determinations.* In reviewing any proposal under paragraph (b)(4) of this section, the Board may consider all the facts and circumstances related to the investment, including:

- (i) The cost to the financial holding company of disposing of the investment within the applicable period;
- (ii) The total exposure of the financial holding company to the company and the risks that disposing of the investment may pose to the financial holding company;
- (iii) Market conditions;
- (iv) The nature of the portfolio company's business;
- (v) The extent and history of involvement by the financial holding company in the management and operations of the company; and
- (vi) The average holding period of the financial holding company's merchant banking investments.

(6) *Restrictions applicable to investments held beyond time period.* A financial holding company that directly or indirectly owns, controls or holds any

share, asset or ownership interest of a company under this part for a total period that exceeds the period specified in paragraph (b)(1) of this section must—

(i) For purposes of determining the financial holding company's regulatory capital, apply to the financial holding company's adjusted carrying value of such shares, assets, or ownership interests a capital charge determined by the Board that must be:

(A) Higher than the maximum marginal Tier 1 capital charge applicable under the Board's capital adequacy rules or guidelines (see 12 CFR 225 Appendix A) to merchant banking investments held by that financial holding company; and

(B) In no event less than 25 percent of the adjusted carrying value of the investment; and

(ii) Abide by any other restrictions that the Board may impose in connection with granting approval under paragraph (b)(4) of this section.

§1500.4 How are investments in private equity funds treated under this part?

(a) *What is a private equity fund?* For purposes of this part, a "private equity fund" is any company that:

(1) Is formed for the purpose of and is engaged exclusively in the business of investing in shares, assets, and ownership interests of financial and non-financial companies for resale or other disposition;

(2) Is not an operating company;

(3) No more than 25 percent of the total equity of which is held, owned or controlled, directly or indirectly, by the financial holding company and its directors, officers, employees and principal shareholders;

(4) Has a maximum term of not more than 15 years; and

(5) Is not formed or operated for the purpose of making investments inconsistent with the authority granted under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) or evading the limitations governing merchant banking investments contained in this part.

(b) *What form may a private equity fund take?* A private equity fund may be a corporation, partnership, limited

§ 1500.5

12 CFR Ch. XV (1–1–05 Edition)

liability company or other type of company that issues ownership interests in any form.

(c) *What is the holding period permitted for interests in private equity funds?*

(1) *In general.* A financial holding company may own, control or hold any interest in a private equity fund under this part and any interest in a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this part for the duration of the fund, up to a maximum of 15 years.

(2) *Request to hold interest for longer period.* A financial holding company may seek Board approval to own, control or hold an interest in or held through a private equity fund for a period longer than the duration of the fund in accordance with §1500.3(b) of this part.

(3) *Application of rules.* The rules described in §1500.3(b)(2) and (3) governing holding periods of interests acquired, transferred or previously held by a financial holding company apply to interests in, held through, or acquired from a private equity fund.

(d) *How do the restrictions on routine management and operation apply to private equity funds and investments held through a private equity fund?—(1) Portfolio companies held through a private equity fund.* A financial holding company may not routinely manage or operate a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this part, except as permitted under §1500.2(e).

(2) *Private equity funds controlled by a financial holding company.* A private equity fund that is controlled by a financial holding company may not routinely manage or operate a portfolio company, except as permitted under §1500.2(e).

(3) *Private equity funds that are not controlled by a financial holding company.* A private equity fund may routinely manage or operate a portfolio company so long as no financial holding company controls the private equity fund or as permitted under §1500.2(e).

(4) *When does a financial holding company control a private equity fund?* A financial holding company controls a private equity fund for purposes of this part if the financial holding company, including any director, officer, employee or principal shareholder of the financial holding company:

(i) Serves as a general partner, managing member, or trustee of the private equity fund (or serves in a similar role with respect to the private equity fund);

(ii) Owns or controls 25 percent or more of any class of voting shares or similar interests in the private equity fund;

(iii) In any manner selects, controls or constitutes a majority of the directors, trustees or management of the private equity fund; or

(iv) Owns or controls more than 5 percent of any class of voting shares or similar interests in the private equity fund and is the investment adviser to the fund.

§ 1500.5 What aggregate thresholds apply to merchant banking investments?

(a) *In general.* A financial holding company may not, without Board approval, directly or indirectly acquire any additional shares, assets or ownership interests under this part or make any additional capital contribution to any company the shares, assets or ownership interests of which are held by the financial holding company under this part if the aggregate carrying value of all merchant banking investments held by the financial holding company under this part exceeds:

(1) 30 percent of the Tier 1 capital of the financial holding company; or

(2) After excluding interests in private equity funds, 20 percent of the Tier 1 capital of the financial holding company

(b) *How do these thresholds apply to a private equity fund?* Paragraph (a) of this section applies to the interest acquired or controlled by the financial holding company under this part in a private equity fund. Paragraph (a) of this section does not apply to any interest in a company held by a private equity fund or to any interest held by

Department of the Treasury

§ 1500.8

a person that is not affiliated with the financial holding company.

(c) *How long do these thresholds remain in effect?* This § 1500.5 shall cease to be effective on the date that a final rule issued by the Board that specifically addresses the appropriate regulatory capital treatment of merchant banking investments becomes effective.

§ 1500.6 What risk management, record keeping and reporting policies are required to make merchant banking investments?

(a) *What internal controls and records are necessary?*—(1) *General.* A financial holding company, including a private equity fund controlled by a financial holding company, that makes investments under this part must establish and maintain policies, procedures, records and systems reasonably designed to conduct, monitor and manage such investment activities and the risks associated with such investment activities in a safe and sound manner, including policies, procedures, records and systems reasonably designed to:

(i) Monitor and assess the carrying value, market value and performance of each investment and the aggregate portfolio;

(ii) Identify and manage the market, credit, concentration and other risks associated with such investments;

(iii) Identify, monitor and assess the terms, amounts and risks arising from transactions and relationships (including contingent fees or contingent interests) with each company in which the financial holding company holds an interest under this part;

(iv) Ensure the maintenance of corporate separateness between the financial holding company and each company in which the financial holding company holds an interest under this part and protect the financial holding company and its depository institution subsidiaries from legal liability for the operations conducted and financial obligations of each such company; and

(v) Ensure compliance with this part.

(2) *Availability of records.* A financial holding company must make the policies, procedures and records required by paragraph (a)(1) of this section available to the Board or the appropriate Reserve Bank upon request.

(b) Certain additional recordkeeping and reporting requirements for merchant banking investments are set forth in the Board's Regulation Y, 12 CFR 225.175.

§ 1500.7 How do the statutory cross marketing and sections 23A and B limitations apply to merchant banking investments?

Certain cross-marketing limitations and limitations under sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c-1) applicable to merchant banking investments are set forth in the Board's Regulation Y, 12 CFR 225.176.

§ 1500.8 Definitions.

(a) *What do references to a financial holding company include?*—(1) Except as otherwise expressly provided, the term "financial holding company" as used in this part means the financial holding company and all of its subsidiaries, including a private equity fund or other fund controlled by the financial holding company.

(2) Except as otherwise expressly provided, the term "financial holding company" does not include a depository institution or subsidiary of a depository institution or any portfolio company controlled directly or indirectly by the financial holding company.

(b) *What do references to a depository institution include?* For purposes of this part, the term "depository institution" includes a U.S. branch or agency of a foreign bank.

(c) *What is a portfolio company?* A portfolio company is any company or entity:

(1) That is engaged in any activity not authorized for the financial holding company under section 4 of the Bank Holding Company Act (12 U.S.C. 1843); and

(2) Any shares, assets or ownership interests of which are held, owned or controlled directly or indirectly by the financial holding company pursuant to this part, including through a private equity fund that the financial holding company controls.

(d) *Who are the executive officers of a company?*—(1) An executive officer of a

company is any person who participates or has the authority to participate (other than in the capacity as a director) in major policymaking functions of the company, whether or not the officer has an official title, the title designates the officer as an assistant, or the officer serves without salary or other compensation.

(2) The term “executive officer” does not include—

(i) Any person, including a person with an official title, who may exercise a certain measure of discretion in the performance of his duties, including the discretion to make decisions in the ordinary course of the company’s business, but who does not participate in the determination of major policies of the company and whose decisions are limited by policy standards fixed by senior management of the company; or

(ii) Any person who is excluded from participating (other than in the capacity of a director) in major policymaking functions of the company by resolution of the board of directors or by the bylaws of the company and who does not in fact participate in such policymaking functions.

(e) *What is the Board?* The Board means the Board of Governors of the Federal Reserve System.

(f) *How are other terms that are used in this part defined?* Unless otherwise defined in this part, all terms used have the meanings given such terms in the Board’s Regulation Y (12 CFR Part 225).

PART 1501—FINANCIAL SUBSIDIARIES

Sec.

1501.1 How do you request the Secretary to determine that an activity is financial in nature or incidental to a financial activity?

1501.2 What activities has the Secretary determined to be financial in nature or incidental to a financial activity?

1501.3 Comparable ratings requirement for national banks among the second 50 largest insured banks.

AUTHORITY: Section 5136A of the Revised Statutes of the United States (12 U.S.C. 24a).

SOURCE: 65 FR 14821, Mar. 20, 2000, unless otherwise noted.

§ 1501.1 How do you request the Secretary to determine that an activity is financial in nature or incidental to a financial activity?

(a) *Requests regarding activities that may be financial in nature or incidental to a financial activity.* A national bank or other interested party may request the Secretary to determine that an activity not defined to be financial in nature or incidental to a financial activity in Section 4(k)(4) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)), is financial in nature or incidental to a financial activity.

(b) *What information must the request contain?* A request submitted under this section must be in writing and must:

(1) Identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted;

(2) Explain in detail why the activity should be considered financial in nature or incidental to a financial activity; and

(3) Provide information supporting the requested determination and any other information required by the Secretary concerning the proposed activity.

(c) *What factors will the Secretary take into account in making his determination?*

(1) Section 121 of the Gramm-Leach-Bliley Act (GLBA) (Public Law 106–102, 113 Stat. 1373) requires the Secretary to take into account the following factors in making his determination:

(i) The purposes of section 5136A of the Revised Statutes (12 U.S.C. 24a) and the GLBA;

(ii) Changes or reasonably expected changes in the marketplace in which banks compete;

(iii) Changes or reasonably expected changes in the technology for delivering financial services; and

(iv) Whether the activity is necessary or appropriate to allow a bank and the subsidiaries of a bank to—

(A) Compete effectively with any company seeking to provide financial services in the United States;

(B) Efficiently deliver information and services that are financial in nature through the use of technological

means, including any application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; and

(C) Offer customers any available or emerging technological means for using financial services or for the document imaging of data.

(2) Because the Secretary is required to consider the factors in paragraph (c)(1) of this section in making his determination, any request should address the factors in paragraph (c)(1) of this section. The Secretary may also consider other relevant factors.

(d) *What action will the Secretary take after receiving a request?* (1) *Consultation with the Board of Governors of the Federal Reserve System (Board).* Upon receiving the request, the Secretary will send a copy to the Board and consult with the Board in accordance with section 5136A(b)(1)(B)(i) of the Revised Statutes (12 U.S.C. 5136A(b)(1)(B)(i)).

(2) *Public notice.* The Secretary may, as appropriate and after consultation with the Board, publish a description of the proposal in the FEDERAL REGISTER with a request for public comment.

(e) *How and when will the Secretary act on a request?* In the case of each request, the Secretary:

(1) Will inform the requester of the Secretary's final determination regarding the requested activity; and

(2) Will endeavor to inform the requester of the Secretary's final determination within 60 days of completion of both the consultative process described in paragraph (d)(1) of this section and the public comment period, if any.

(f) *What must a national bank do in order for a financial subsidiary to engage in activities that the Secretary has determined are financial in nature or incidental to financial activities?* Once the Secretary determines that an activity is financial in nature or incidental to a financial activity (either in accordance with this section or after evaluation of a proposal raised by the Board under section 5136A(b)(1)(B)(ii) of the Revised Statutes), a financial subsidiary may engage in the activity subject to the requirements of 12 CFR part 5 and in accordance with any terms or conditions established by the Secretary in

connection with authorizing the activity.

§ 1501.2 What activities has the Secretary determined to be financial in nature or incidental to a financial activity?

(a) *Activities permitted under section 5136A(b)(3) of the Revised Statutes (12 U.S.C. 24a(b)(3)).*

(1) The following types of activities are financial in nature or incidental to a financial activity when conducted pursuant to a determination by the Secretary under paragraph (a)(2) of this section:

(i) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

(ii) Providing any device or other instrumentality for transferring money or other financial assets; and

(iii) Arranging, effecting, or facilitating financial transactions for the account of third parties.

(2) *Review of specific activities.*

(i) *Is a specific request required?* A financial subsidiary that wishes to engage on the basis of paragraph (a)(1) of this section in an activity that is not otherwise permissible for a financial subsidiary must obtain a determination from the Secretary that the activity is permitted under paragraph (a)(1).

(ii) *Consultation with the Board of Governors of the Federal Reserve System.* After receiving a request under this section, the Secretary will provide the Board of Governors of the Federal Reserve System (Board) with a copy of the request and consult with the Board in accordance with section 5136A(b)(1)(B)(i) of the Revised Statutes (12 U.S.C. 24a(b)(1)(B)(i)).

(iii) *Secretary action on requests.* After consultation with the Board, the Secretary will promptly make a written determination regarding whether the specific activity described in the request is included in an activity category listed in paragraph (a)(1) of this section and is therefore either financial in nature or incidental to a financial activity.

(3) *What factors will the Secretary consider?* In evaluating a request made under this section, the Secretary will take into account the factors listed in

§ 1501.3

section 5136A(b)(2) of the Revised Statutes (12 U.S.C. 24a(b)(2)) that the Secretary must consider when determining whether an activity is financial in nature or incidental to a financial activity.

(4) *What information must the request contain?* Any request by financial subsidiary under this section must be in writing and must:

(i) Identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted; and

(ii) Provide information supporting the requested determination, including information regarding how the proposed activity falls into one of the categories listed in paragraph (a)(1) of this section, and any other information required by the Secretary concerning the proposed activity.

(b) [Reserved]

[66 FR 260, Jan. 3, 2001]

§ 1501.3 Comparable ratings requirement for national banks among the second 50 largest insured banks.

(a) *Scope and purpose.* Section 5136A of the Revised Statutes permits a national bank that is within the second 50 largest insured banks to own or control a financial subsidiary only if, among other requirements, the bank satisfies the eligible debt requirement set forth in section 5136A or an alter-

12 CFR Ch. XV (1–1–05 Edition)

native criteria jointly established by the Secretary of the Treasury and the Board of Governors of the Federal Reserve System. This section establishes the alternative criteria that a national bank among the second 50 largest insured banks may meet, which criteria is comparable to and consistent with the purposes of the eligible debt requirement established by section 5136A.

(b) *Alternative criteria.* A national bank satisfies the alternative criteria referenced in Section 5136A(a)(2)(E) of the Revised Statutes (12 U.S.C. 24a) and 12 CFR 5.39(g)(3) if 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.

(c) *Definition of long-term issuer credit rating.* A “long-term issuer credit rating” is 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.

[66 FR 8750, Feb. 2, 2001]

PARTS 1502–1503 [RESERVED]

PARTS 1505–1507 [RESERVED]

SUBCHAPTER B—RESOLUTION FUNDING CORPORATION

PART 1510—RESOLUTION FUNDING CORPORATION OPERATIONS

Sec.

- 1510.1 Authority, purpose, and scope.
1510.2 Definitions.
1510.3 How does the Funding Corporation pay administrative expenses?
1510.4 Who may act as the depository and fiscal agent for the Funding Corporation?
1510.5 How does the Funding Corporation make interest payments on its obligations?
1510.6 What must the Funding Corporation do with surplus funds?
1510.7 What are the Funding Corporation's reporting requirements?
1510.8 What are the audit requirements for the Funding Corporation?

AUTHORITY: 12 U.S.C. 1441b; Sec. 14(d), Pub. L. 105-216, 112 Stat. 910.

SOURCE: 65 FR 12069, Mar. 8, 2000, unless otherwise noted.

§ 1510.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued under the authority of section 14(d) of the Homeowners Protection Act of 1998 (Public Law 105-216, 112 Stat. 910) and section 21B(l) of the Federal Home Loan Bank Act (12 U.S.C. 1441b(l)).

(b) *Purpose and scope.* The purpose of this part is to provide direction to the Funding Corporation in carrying out its statutory mandate to make interest payments on its outstanding debt obligations. This part also provides direction to the Funding Corporation regarding funding the administrative costs of its operations. This part does not provide direction to the Funding Corporation, however, on activities that the Funding Corporation is authorized to carry out under the Act, but that it previously has completed or is not likely to undertake in the future, such as raising capital and issuing obligations. Although the Funding Corporation continues to have statutory authority to undertake these activities, the circumstances under which it would do so are limited. If such circumstances were to arise, the Secretary has the authority to provide any necessary direction to the Funding Corporation.

(c) *Authority of the Funding Corporation.* The Funding Corporation may exercise all authority granted to it by the Act in accordance with its bylaws, whether or not specifically implemented by regulation, subject to the requirements of this part and such other regulations, orders and directions as the Secretary may prescribe.

§ 1510.2 Definitions.

The following definitions apply to terms used in this part unless the context requires otherwise:

Act means the Federal Home Loan Bank Act (12 U.S.C. 1421 *et seq.*).

Administrative expenses means costs incurred as necessary to carry out the functions of the Funding Corporation, including custodian fees, but does not include any interest on obligations.

Bank means a Federal Home Loan Bank established under the authority of the Act.

Custodian fee means any fee incurred by the Funding Corporation in connection with the transfer of any security to, or the maintenance of any security in, the Funding Corporation Principal Fund and any other expense incurred in connection with the establishment or maintenance of the Funding Corporation Principal Fund.

Directorate means the Directorate of the Funding Corporation established pursuant to section 21B(c) of the Act (12 U.S.C. 1421b(c)).

FDIC means the Federal Deposit Insurance Corporation established pursuant to section 1 of the Federal Deposit Insurance Act (12 U.S.C. 1811, *et seq.*).

Finance Board means the Federal Housing Finance Board established pursuant to section 2A(a)(1) of the Act.

FSLIC Resolution Fund means the Federal Savings and Loan Insurance Corporation Resolution Fund established pursuant to section 11A(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1811, *et seq.*).

Funding Corporation means the Resolution Funding Corporation established pursuant to section 21B(b) of the Act.

Funding Corporation Principal Fund means the separate account established under section 21B(g)(2) of the Act.

§ 1510.3

Interest payment due date means the date on which the next quarterly interest payments on obligations are due.

Net earnings means net earnings after deducting expenses relating to section 10(j) of the Act (Affordable Housing Program) and operating expenses, but without reduction for chargeoffs and payments to fund interest payments on obligations.

Obligations means bonds issued by the Funding Corporation under section 21B(f) of the Act.

RTC means the Resolution Trust Corporation established pursuant to section 21A(b)(1)(A) of the Act and which terminated on December 31, 1995, pursuant to section 21A(m) of the Act.

Secretary means the Secretary of the Treasury or the designee of the Secretary of the Treasury.

§ 1510.3 How does the Funding Corporation pay administrative expenses?

(a) *The Directorate proposes a budget.* By November 15 of each year, the Directorate must approve and submit to the Secretary a proposed budget for the administrative expenses of the Funding Corporation for the following year.

(b) *The Secretary approves the budget.* The Funding Corporation's budget is subject to the Secretary's prior approval. The proposed budget submitted by the Directorate shall be deemed to be approved by the Secretary unless the Secretary disapproves it within 45 days of the date submitted. The Funding Corporation must transmit a copy of the approved budget to each Bank.

(c) *Budget changes must be approved by the Secretary.* If the Funding Corporation projects or anticipates incurring expenses exceeding its approved budget, the Directorate must submit an amended budget to the Secretary for approval.

(d) *The Funding Corporation collects funds from the Banks to pay its administrative expenses.* At least semiannually, the Funding Corporation must request that each Bank submit within 10 business days of the request payment for a portion of the administrative expenses in the Funding Corporation's budget for the current calendar year. The amount of each Bank's payment must be pro rated according to the percent-

12 CFR Ch. XV (1-1-05 Edition)

age of the total outstanding Funding Corporation capital stock owned by the Bank. The Funding Corporation must adjust the amount of each Bank's payment as necessary to reflect differences between aggregate projected and actual administrative expenses incurred during the calendar year and to reflect any changes in estimated aggregate administrative expenses for the coming period. The Funding Corporation must not request payments from the Banks that, in the aggregate, exceed the administrative expenses in the Funding Corporation's approved budget.

§ 1510.4 Who may act as the depository and fiscal agent for the Funding Corporation?

(a) *In general, the Federal Reserve Banks.* The Funding Corporation must use one or more Federal Reserve Banks as depositories for or fiscal agents or custodians of the Funding Corporation.

(b) *For administrative accounts, insured depository institutions.* Subject to approval by the Secretary, the Funding Corporation may establish demand deposit accounts at one or more federally insured depository institutions for the management of funds used to pay administrative expenses.

§ 1510.5 How does the Funding Corporation make interest payments on its obligations?

(a) *The Funding Corporation must obtain funds from up to four sources.* The Funding Corporation must pay the interest due on its obligations with funds it obtains from the following sources and in the following order:

(1) Earnings on assets of the Funding Corporation not invested in the Funding Corporation Principal Fund.

(2) To the extent funds identified in paragraph (a)(1) of this section are insufficient, the Funding Corporation must obtain from each Bank in each calendar year payments totaling 20 percent of the net earnings of the Bank. The Funding Corporation must not obtain funds from a Bank under this paragraph after the date upon which the term of the Bank's payment obligation has ended, as determined by the Finance Board pursuant to section 21B(f)(2)(C)(iii) of the Act.

Department of the Treasury

§ 1510.5

(3) To the extent funds identified in paragraphs (a)(1) and (2) of this section are insufficient, the Funding Corporation must obtain from the FSLIC Resolution Fund amounts available from any net proceeds from the sale of assets received from the RTC by the FSLIC Resolution Fund.

(4) To the extent that funds from the sources identified in paragraphs (a)(1) through (3) of this section are insufficient, the Funding Corporation must obtain from the Secretary the additional amount due.

(b) *The Funding Corporation must obtain projections of funds availability from the Banks and the FSLIC Resolution Fund.* Not later than March 15, June 15, September 15, and December 15 of each year:

(1) The Funding Corporation must obtain from each Bank a statement signed by an officer of such Bank containing sufficient information on the Banks net earnings to enable the Funding Corporation to make quarterly projections of funds available from the Bank for the current quarter and the next three quarters; and

(2) The Funding Corporation must obtain from an authorized representative of the FSLIC Resolution Fund projections of the amount of funds available in the current quarter and the next three quarters from the net proceeds from the sale of received from the RTC.

(c) *The Funding Corporation must report funding projections to the Secretary.* Not later than March 20, June 20, September 20, and December 20 of each year, the Funding Corporation must submit to the Secretary a report containing:

(1) The aggregate amounts of each of the next four quarterly interest payments due on obligations; and

(2) The amounts projected to be available to fund such payments from:

(i) Earnings on assets of the Funding Corporation not invested in the Funding Corporation Principal Fund;

(ii) Payments from the Banks; and

(iii) Funds transferred from the FSLIC Resolution Fund.

(d) *The Funding Corporation must request funds from the Banks, the FSLIC Resolution Fund, and the Secretary—*(1) *Requests to the Banks.* Not less than

four business days prior to the interest payment due date, the Funding Corporation must obtain from each Bank a report of its actual net earnings for the prior quarter and notify each Bank in writing of the interest payment due date and the amount of the payment due from the Bank. To the extent funds identified in paragraph (a)(1) of this section are insufficient to pay the interest due, the amount of each Bank's payment must be 20 percent of the Bank's actual quarterly net earnings, taking into account any adjustment to the Bank's earnings for any previous quarters. The Funding Corporation must request the Bank to provide payment through wiring immediately available and finally collected funds to the Funding Corporation no later than the interest payment due date.

(2) *Request to the FSLIC Resolution Fund.* On the day the Funding Corporation notifies the Banks of the payments due from them under paragraph (d)(1) of this section, the Funding Corporation must:

(i) Notify the FSLIC Resolution Fund in writing of:

(A) The interest payment due date;

(B) The aggregate amount of the quarterly interest payment due on that date; and

(C) The amount of the quarterly interest payment that will be funded by earnings on assets of the Funding Corporation not invested in the Funding Corporation Principal Fund and payments due from the Banks; and

(ii) Request that the FSLIC Resolution Fund transfer to the Funding Corporation by noon on the third business day prior to the interest payment due date any funds available from the net proceeds from the sale of assets received from the RTC, to the extent funds identified in paragraphs (a)(1) and (2) of this section are insufficient to pay the interest due.

(3) *Request to the Secretary.* No less than three business days prior to the interest payment due date, the Funding Corporation must request payment from the Secretary by providing a certification, in a form satisfactory to the Secretary, stating the total amounts of the quarterly interest payment to be paid by the Funding Corporation from sources other than the Secretary and

§ 1510.6

the amounts necessary to make up the deficiency. Any amount paid by the Secretary becomes a liability of the Funding Corporation to be repaid to the Secretary upon the dissolution of the Funding Corporation, to the extent of its remaining assets.

[65 FR 12069, Mar. 8, 2000, as amended at 66 FR 47071, Sept. 11, 2001]

§ 1510.6 What must the Funding Corporation do with surplus funds?

If the Funding Corporation has funds that are not needed for current interest payments on obligations, it must invest the funds in obligations of the United States issued by the Secretary, in accordance with an investment policy approved by the Secretary.

§ 1510.7 What are the Funding Corporation's reporting requirements?

In addition to the budget submission required by § 1510.3 and the funding projection reports required by § 1510.5, the Funding Corporation must prepare such reports as the Secretary may require, including reports necessary to assist the Secretary in making the annual report to Congress and the President on the Funding Corporation under section 21B(i) of the Act.

§ 1510.8 What are the audit requirements for the Funding Corporation?

The Funding Corporation must obtain an audit of its books and records by an independent external auditor at least annually.

PART 1511—BOOK-ENTRY PROCEDURE

Sec.

1511.0 Applicability.

1511.1 Definition of terms.

1511.2 Law governing rights and obligations of the Funding Corporation and Federal Reserve Banks; rights of any Person against the Funding Corporation and the Federal Reserve Banks.

1511.3 Law governing other interests.

1511.4 Creation of Participant's Security Entitlement; security interests.

1511.5 Obligations of Funding Corporation; no adverse claims.

1511.6 Authority of Federal Reserve Banks.

1511.7 Liability of the Funding Corporation and Federal Reserve Banks.

1511.8 Notice of attachment.

12 CFR Ch. XV (1–1–05 Edition)

AUTHORITY: 12 U.S.C. 1441b.

SOURCE: 61 FR 66875, Dec. 19, 1996, unless otherwise noted.

§ 1511.0 Applicability.

The regulations in this part apply to Book-entry Funding Corporation Securities.

§ 1511.1 Definitions of terms.

In this part, unless the context indicates otherwise:

Act means the Federal Home Loan Bank Act as amended (12 U.S.C. 1421 *et seq.*).

Adverse Claim means a claim that a claimant has a property interest in a Book-entry Funding Corporation Security and that it is a violation of the rights of the claimant for another Person to hold, transfer, or deal with the Book-entry Funding Corporation Security.

Book-entry Funding Corporation Security means a Funding Corporation Security in book-entry form that is issued or maintained in the Book-entry System. Solely for the purposes of this Part, it also means the separate interest and principal components of a Book-entry Funding Corporation Security if such security has been divided into such components as authorized by the Securities Documentation and the components are maintained separately on the books of one or more Federal Reserve Banks.

Book-entry System means the automated book-entry system operated by the Federal Reserve Banks acting as the fiscal agent for the Funding Corporation, on which Book-entry Funding Corporation Securities are issued, recorded, transferred and maintained in book-entry form.

Entitlement Holder means a Person to whose account an interest in a Book-entry Funding Corporation Security is credited on the records of a Securities Intermediary.

Federal Reserve Bank or Reserve Bank means a Federal Reserve Bank or Branch.

Federal Reserve Bank Operating Circular means the publication issued by each Federal Reserve Bank that sets forth the terms and conditions under which the Reserve Bank maintains

Department of the Treasury

§ 1511.1

book-entry Securities accounts (including Book-entry Funding Corporation Securities) and transfers book-entry Securities (including Book-entry Funding Corporation Securities).

Funding Corporation means the Resolution Funding Corporation established pursuant to section 21B(b) of the Act.

Funding Corporation Security or *Security* means a Funding Corporation bond, note, debenture and similar obligations issued under section 21B of the Act.

Funds Account means a reserve and/or clearing account at a Federal Reserve Bank to which debits or credits are posted for transfers against payment, book-entry securities transaction fees, or principal and interest payments.

Participant means a Person that maintains a Participant's Securities Account with a Federal Reserve Bank.

Participant's Securities Account means an account in the name of a Participant at a Federal Reserve Bank to which Book-entry Funding Corporation Securities held for a Participant are or may be credited.

Person means and includes an individual, corporation, company, governmental entity, association, firm, partnership, trust, estate, representative, and any other similar organization, but does not mean or include the United States, the Funding Corporation, or a Federal Reserve Bank.

Revised Article 8 means Uniform Commercial Code, Revised Article 8, Investment Securities (with Conforming and Miscellaneous Amendments to Articles 1, 3, 4, 5, 9, and 10) 1994 Official Text. Revised Article 8 of the Uniform Commercial Code is incorporated by reference in this Part pursuant to 5 U.S.C. 552(a) and 1 CFR Part 51. Article 8 was adopted by the American Law Institute and the National Conference of Commissioners on Uniform State laws and approved by the American Bar Association on February 14, 1995. Copies of this publication are available from the Executive Office of the American Law Institute, 4025 Chestnut Street, Philadelphia, PA 19104, and the National Conference of Commissioners on Uniform State Laws, 676 North St. Clair Street, Suite 1700, Chicago, IL 60611. Copies are also available for public inspection at the Department of the Treasury Li-

brary, Room 5030, main Treasury Building, 1500 Pennsylvania Avenue, NW., Washington DC 20220, or at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202-741-6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

Securities Documentation means the applicable offering circular, supplement, or other documents establishing the terms of a Book-entry Funding Corporation Security.

Securities Intermediary means:

(1) A Person that is registered as a "clearing agency" under the Federal securities laws; a Federal Reserve Bank; any other Person that provides clearance or settlement services with respect to a Book-entry Funding Corporation Security that would require it to register as a clearing agency under the Federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a Federal or State governmental authority; or

(2) A Person (other than an individual, unless such individual is registered as a broker or dealer under the federal securities laws) including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

Security Entitlement means the rights and property interest of an Entitlement Holder with respect to a Book-entry Funding Corporation Security.

State means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

Transfer message means an instruction of a Participant to a Federal Reserve Bank to effect a transfer of a Book-entry Funding Corporation Security, as set forth in Federal Reserve Bank Operating Circulars.

[61 FR 66875, Dec. 19, 1996, as amended at 69 FR 18803, Apr. 9, 2004]

§ 1511.2

§ 1511.2 Law governing rights and obligations of the Funding Corporation and Federal Reserve Banks; rights of any Person against the Funding Corporation and the Federal Reserve Banks.

(a) Except as provided in paragraph (b) of this section, the following are governed solely by the regulations contained in this part 1511, the Securities Documentation and Federal Reserve Bank Operating Circulars:

(1) The rights and obligations of the Funding Corporation and the Federal Reserve Banks with respect to:

(i) A Book-entry Funding Corporation Security or Security Entitlement; and

(ii) The operation of the Book-entry System as it applies to Funding Corporation Securities; and

(2) The rights of any Person, including a Participant, against the Funding Corporation and the Federal Reserve Banks with respect to:

(i) A Book-entry Funding Corporation Security or Security Entitlement; and

(ii) The operation of the Book-entry System as it applies to Funding Corporation Securities.

(b) A security interest in a Security Entitlement that is in favor of a Federal Reserve Bank from a Participant and that is not recorded on the books of a Federal Reserve Bank pursuant to § 1511.4(c)(1), is governed by the law (not including the conflict-of-law rules) of the jurisdiction where the head office of the Federal Reserve Bank maintaining the Participant's Securities Account is located. A security interest in a Security Entitlement that is in favor of a Federal Reserve Bank from a Person that is not a Participant, and that is not recorded on the books of a Federal Reserve Bank pursuant to § 1511.4(c)(1), is governed by the law determined in the manner specified in § 1511.3.

(c) If the jurisdiction specified in the first sentence of paragraph (b) of this section is a State that has not adopted Revised Article 8 (incorporated by reference, see § 1511.1), then the law specified in paragraph (b) shall be the law of that State as though Revised Article 8 had been adopted by that State.

12 CFR Ch. XV (1–1–05 Edition)

§ 1511.3 Law governing other interests.

(a) To the extent not inconsistent with the regulations in this part, the law (not including the conflict-of-law rules) of a Securities Intermediary's jurisdiction governs:

(1) The acquisition of a Security Entitlement from the Securities Intermediary;

(2) The rights and duties of the Securities Intermediary and Entitlement Holder arising out of a Security Entitlement;

(3) Whether the Securities Intermediary owes any duties to an adverse claimant to a Security Entitlement;

(4) Whether an Adverse Claim can be asserted against a Person who acquires a Security Entitlement from the Securities Intermediary or a Person who purchases a Security Entitlement or interest therein from an Entitlement Holder; and

(5) Except as otherwise provided in paragraph (c) of this section, the perfection, effect of perfection or non-perfection and priority of a security interest in a Security Entitlement.

(b) The following rules determine a "Securities Intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the Securities Intermediary and its Entitlement Holder specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the Securities Intermediary's jurisdiction.

(2) If an agreement between the Securities Intermediary and its Entitlement Holder does not specify the governing law as provided in paragraph (b)(1) of this section, but expressly specifies that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the Securities Intermediary's jurisdiction.

(3) If an agreement between the Securities Intermediary and its Entitlement Holder does not specify a jurisdiction as provided in paragraph (b)(1) or (b)(2) of this section, the Securities Intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the Entitlement Holder's account.

(4) If an agreement between the Securities Intermediary and its Entitlement Holder does not specify a jurisdiction as provided in paragraph (b)(1) or (b)(2) of this section and an account statement does not identify an office serving the Entitlement Holder's account as provided in paragraph (b)(3) of this section, the Securities Intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the Securities Intermediary.

(c) Notwithstanding the general rule in paragraph (a)(5) of this section, the law (but not the conflict-of-law rules) of the jurisdiction in which the Person creating a security interest is located governs whether and how the security interest may be perfected automatically or by filing a financing statement.

(d) If the jurisdiction specified in paragraph (b) of this section is a State that has not adopted Revised Article 8 (incorporated by reference, see § 1511.1), then the law for the matters specified in paragraph (a) of this section shall be the law of that State as though Revised Article 8 had been adopted by that State. For purposes of the application of the matters specified in paragraph (a) of this section, the Federal Reserve Bank maintaining the Securities Account is a clearing corporation, and the Participant's interest in a Book-entry Funding Corporation Security is a Security Entitlement.

§ 1511.4 Creation of Participant's Security Entitlement; security interests.

(a) A Participant's Security Entitlement is created when a Federal Reserve Bank indicates by book-entry that a Book-entry Funding Corporation Security has been credited to a Participant's Securities Account.

(b) A security interest in a Security Entitlement of a Participant in favor of the United States to secure deposits of public money, including without limitation deposits to the Treasury tax and loan accounts, or other security interest in favor of the United States that is required by Federal statute, regulation, or agreement, and that is marked on the books of a Federal Reserve Bank is thereby effected and perfected, and has priority over any other

interest in the securities. Where a security interest in favor of the United States in a Security Entitlement of a Participant is marked on the books of a Federal Reserve Bank, such Reserve Bank may rely, and is protected in relying, exclusively on the order of an authorized representative of the United States directing the transfer of the security. For purposes of this paragraph, an "authorized representative of the United States" is the official designated in the applicable regulations or agreement to which a Federal Reserve Bank is a party, governing the security interest.

(c)(1) The Funding Corporation and the Federal Reserve Banks have no obligation to agree to act on behalf of any Person or to recognize the interest of any transferee of a security interest or other limited interest in favor of any Person except to the extent of any specific requirement of Federal law or regulation or to the extent set forth in any specific agreement with the Federal Reserve Bank on whose books the interest of the Participant is recorded. To the extent required by such law or regulation or set forth in an agreement with a Federal Reserve Bank, or the Federal Reserve Bank Operating Circular, a security interest in a Security Entitlement that is in favor of a Federal Reserve Bank, the Funding Corporation, or a Person may be created and perfected by a Federal Reserve Bank marking its books to record the security interest. Except as provided in paragraph (b) of this section, a security interest in a Security Entitlement marked on the books of a Federal Reserve Bank shall have priority over any other interest in the securities.

(2) In addition to the method provided in paragraph (c)(1) of this section, a security interest in a Security Entitlement, including a security interest in favor of a Federal Reserve Bank, may be perfected by any method by which a security interest may be perfected under applicable law as described in § 1511.2(b) or § 1511.3. The perfection, effect of perfection or non-perfection and priority of a security interest are governed by such applicable law. A security interest in favor of a Federal Reserve Bank shall be treated as a security interest in favor of a

§ 1511.5

clearing corporation in all respects under such law, including with respect to the effect of perfection and priority of such security interest. A Federal Reserve Bank Operating Circular shall be treated as a rule adopted by a clearing corporation for such purposes.

§ 1511.5 Obligations of Funding Corporation; no adverse claims.

(a) Except in the case of a security interest in favor of the United States or a Federal Reserve Bank or otherwise as provided in § 1511.4(c)(1), for the purposes of this part 1511, the Funding Corporation and the Federal Reserve Banks shall treat the Participant to whose Securities Account an interest in a Book-entry Funding Corporation Security has been credited as the Person exclusively entitled to issue a Transfer Message, to receive interest and other payments with respect thereof and otherwise to exercise all the rights and powers with respect to such Security, notwithstanding any information or notice to the contrary. Neither the Federal Reserve Banks nor the Funding Corporation is liable to a Person asserting or having an Adverse Claim to a Security Entitlement or to a Book-entry Funding Corporation Security in a Participant's Securities Account, including any such claim arising as a result of the transfer or disposition of a Book-entry Funding Corporation Security by a Federal Reserve Bank pursuant to a Transfer Message that the Federal Reserve Bank reasonably believes to be genuine.

(b) The obligation of the Funding Corporation to make payments of interest and principal with respect to Book-entry Funding Corporation Securities is discharged at the time payment in the appropriate amount is made as follows:

(1) Interest on Book-entry Funding Corporation Securities is either credited by a Federal Reserve Bank to a Funds Account maintained at such Bank or otherwise paid as directed by the Participant.

(2) Book-entry Funding Corporation Securities are redeemed in accordance with their terms by a Federal Reserve Bank withdrawing the securities from the Participant's Securities Account in which they are maintained and by ei-

12 CFR Ch. XV (1-1-05 Edition)

ther crediting the amount of the redemption proceeds, including both principal and interest where applicable, to a Funds Account at such Bank or otherwise paying such principal and interest, as directed by the Participant. The principal of such Securities shall be paid using the proceeds of the noninterest bearing instruments maintained by the Funding Corporation for such purpose.

§ 1511.6 Authority of Federal Reserve Banks.

(a) Each Federal Reserve Bank is hereby authorized as fiscal agent of the Funding Corporation to perform functions with respect to the issuance of Book-entry Funding Corporation Securities offered and sold by the Funding Corporation, in accordance with the Securities Documentation, and Federal Reserve Bank Operating Circulars; to service and maintain Book-entry Funding Corporation Securities in accounts established for such purposes; to make payments of principal and interest with respect to such Book-entry Funding Corporation Securities as directed by the Funding Corporation; to effect transfer of Book-entry Funding Corporation Securities between Participants' Securities Accounts as directed by the Participants; and to perform such other duties as fiscal agent as may be requested by the Funding Corporation.

(b) Each Federal Reserve Bank may issue Operating Circulars not inconsistent with this Part, governing the details of its handling of Book-entry Funding Corporation Securities, Security Entitlements, and the operation of the Book-Entry System under this Part.

§ 1511.7 Liability of the Funding Corporation and Federal Reserve Banks.

The Funding Corporation and the Federal Reserve Banks may rely on the information provided in a Transfer Message, or other documentation, and are not required to verify the information. The Funding Corporation and the Federal Reserve Banks shall not be liable for any action taken in accordance with the information set out in a

Department of the Treasury

§ 1511.8

Transfer Message, other documentation, or evidence submitted in support thereof.

§ 1511.8 Notice of attachment.

The interest of a debtor in a Security Entitlement may be reached by a creditor only by legal process upon the Securities Intermediary with whom the debtor's securities account is main-

tained, except where a Security Entitlement is maintained in the name of a secured party, in which case the debtor's interest may be reached by legal process upon the secured party. The regulations in this part do not purport to establish whether a Federal Reserve Bank is required to honor an order or other notice of attachment in any particular case or class of cases.