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(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.

CONDITIONS TO ORDERS

§ 225.200 Conditions to Board's section 20 orders.

(a) *Introduction.* Under section 20 of the Glass-Steagall Act (12 U.S.C. 377) and section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), a nonbank subsidiary of a bank holding company may to a limited extent underwrite and deal in securities for which underwriting and dealing by a member bank is prohibited. Pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, these so-called section 20 subsidiaries are required to register with the SEC as broker-dealers and are subject to all the financial reporting, anti-fraud and financial responsibility rules applicable to broker-dealers. In addition, transactions between insured depository institutions and their section 20 affiliates are restricted by sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1). The Board expects a section 20 subsidiary, like any other subsidiary of a bank holding company, to be operated prudently. Doing so would include observing corporate formalities (such as the maintenance of separate accounting and corporate records), and instituting appropriate risk management, including independent trading and exposure limits consistent with parent company guidelines.

(b) *Conditions.* As a condition of each order approving establishment of a section 20 subsidiary, a bank holding company shall comply with the following conditions.

(1) *Capital.* (i) A bank holding company shall maintain adequate capital on a fully consolidated basis. If operating a section 20 authorized to underwrite and deal in all types of debt and equity securities, a bank holding company shall maintain strong capital on a fully consolidated basis.

(ii) In the event that a bank or thrift affiliate of a section 20 subsidiary shall become less than well capitalized (as defined in section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o), and the bank holding company shall fail to restore it promptly to the well capitalized level, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1989 order allowing underwriting and dealing in bank-ineligible securities,[1] or order the bank holding company to divest the section 20 subsidiary.

(iii) A foreign bank that operates a branch or agency in the United States shall maintain strong capital on a fully consolidated basis at levels above the minimum levels required by the Basle Capital Accord. In the event that the Board determines that the foreign bank's capital has fallen below these levels and the foreign bank fails to restore its capital position promptly, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1990 order allowing foreign banks to underwrite and deal in bank-ineligible securities,[2] or order the foreign bank to divest the section 20 subsidiary.

(2) *Internal controls.* (i) Each bank holding company or foreign bank shall cause its subsidiary banks, thrifts, branches or agencies[3] to adopt policies and procedures, including appropriate limits on exposure, to govern their participation in transactions underwritten or arranged by a section 20 affiliate.

(ii) Each bank holding company or foreign bank shall ensure that an independent and thorough credit evaluation has been undertaken in connection with participation by a bank, thrift, or branch or agency in such transactions, and that adequate documentation of

[1] Firewalls 5–8, 19, 21 and 22 of *J.P. Morgan & Co., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 Federal Reserve Bulletin 192, 214–16 (1989).

[2] Firewalls 5–8, 19, 21 and 22 of *Canadian Imperial Bank of Commerce, The Royal Bank of Canada, Barclays PLC and Barclays Bank PLC*, 76 Federal Reserve Bulletin 158, (1990).

[3] The terms ''branch'' and ''agency'' refer to a U.S. branch and agency of a foreign bank.

that evaluation is maintained for review by examiners of the appropriate federal banking agency and the Federal Reserve.

(3) *Interlocks restriction.* (i) Directors, officers or employees of a bank or thrift subsidiary of a bank holding company, or a bank or thrift subsidiary or branch or agency of a foreign bank, shall not serve as a majority of the board of directors or the chief executive officer of an affiliated section 20 subsidiary.

(ii) Directors, officers or employees of a section 20 subsidiary shall not serve as a majority of the board of directors or the chief executive officer of an affiliated bank or thrift subsidiary or branch or agency, except that the manager of a branch or agency may act as a director of the underwriting subsidiary.

(iii) For purposes of this standard, the manager of a branch or agency of a foreign bank generally will be considered to be the chief executive officer of the branch or agency.

(4) *Customer disclosure*—(i) *Disclosure to section 20 customers.* A section 20 subsidiary shall provide, in writing, to each of its retail customers,[4] at the time an investment account is opened, the same minimum disclosures, and obtain the same customer acknowledgment, described in the Interagency Statement on Retail Sales of Nondeposit Investment Products (Statement) as applicable in such situations. These disclosures must be provided regardless of whether the section 20 subsidiary is itself engaged in activities through arrangements with a bank that is covered by the Statement.

(ii) *Disclosures accompanying investment advice.* A director, officer, or employee of a bank, thrift, branch or agency may not express an opinion on the value or the advisability of the purchase or the sale of a bank-ineligible security that he or she knows is being underwritten or dealt in by a section 20 affiliate unless he or she notifies the customer of the affiliate's role.

[4] For purposes of this operating standard, a retail customer is any customer that is not an ''accredited investor'' as defined in 17 CFR 230.501(a).

(5) *Intra-day credit.* Any intra-day extension of credit to a section 20 subsidiary by an affiliated bank, thrift, branch or agency shall be on market terms consistent with section 23B of the Federal Reserve Act.

(6) *Restriction on funding purchases of securities during underwriting period.* No bank, thrift, branch or agency shall knowingly extend credit to a customer secured by, or for the purpose of purchasing, any bank-ineligible security that a section 20 affiliate is underwriting or has underwritten within the past 30 days, unless:

(i) The extension of credit is made pursuant to, and consistent with any conditions imposed in a preexisting line of credit that was not established in contemplation of the underwriting; or

(ii) The extension of credit is made in connection with clearing transactions for the section 20 affiliate.

(7) *Reporting requirement.* (i) Each bank holding company or foreign bank shall submit quarterly to the appropriate Federal Reserve Bank any FOCUS report filed with the NASD or other self-regulatory organizations, and any information required by the Board to monitor compliance with these operating standards and section 20 of the Glass-Steagall Act, on forms provided by the Board.

(ii) In the event that a section 20 subsidiary is required to furnish notice concerning its capitalization to the Securities and Exchange Commission pursuant to 17 CFR 240.17a–11, a copy of the notice shall be filed concurrently with the appropriate Federal Reserve Bank.

(8) *Foreign banks.* A foreign bank shall ensure that any extension of credit by its branch or agency to a section 20 affiliate, and any purchase by such branch or agency, as principal or fiduciary, of securities for which a section 20 affiliate is a principal underwriter, conforms to sections 23A and 23B of the Federal Reserve Act, and that its branches and agencies not advertise or suggest that they are responsible for the obligations of a section 20 affiliate, consistent with section 23B(c) of the Federal Reserve Act.

[62 FR 45306, Aug. 27, 1997, as amended by Reg. Y, 63 FR 14804, Mar. 27, 1998]