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(5) The Board expects that one effect of this guideline would be to hold down the size of the nonvoting equity investment by the investing company relative to the acquiree's total equity, thus avoiding the potential for control because the investor holds a very large proportion of the acquiree's total equity. Observance of the 25 percent guideline will also make provisions in agreements providing for a right of first refusal or a public and widely dispersed offering of rights to the acquiree's shares more practical and realistic.

(6) Finally, certain arrangements should clearly be avoided regardless of other provisions in the agreement that are designed to avoid control. These are:

(i) Agreements that enable the investing bank holding company (or its designee) to direct in any manner the voting of more than 5 per cent of the voting shares of the acquiree;

(ii) Agreements whereby the investing company has the right to direct the acquiree's use of the proceeds of an equity investment by the investing company to effect certain actions, such as the purchase and redemption of the acquiree's voting shares; and

(iii) The acquisition of more than 5 per cent of the voting shares of the acquiree that ''simultaneously'' with their acquisition by the investing company become nonvoting shares, remain nonvoting shares while held by the investor, and revert to voting shares when transferred to a third party.

(e) *Review by the Board.* This statement does not constitute the exclusive scope of the Board's concerns, nor are the considerations with respect to control outlined in this statement an exhaustive catalog of permissible or impermissible arrangements. The Board has instructed its staff to review agreements of the kind discussed in this statement and to bring to the Board's attention those that raise problems of consistency with the Act. In this regard, companies are requested to notify the Board of the terms of such proposed merger or asset acquisition agreements or nonvoting equity investments prior to their execution or consummation.

[47 FR 30966, July 16, 1982]

§ 225.145 Limitations established by the Competitive Equality Banking Act of 1987 on the activities and growth of nonbank banks.

(a) *Introduction.* Effective August 10, 1987, the Competitive Equality Banking Act of 1987 (''CEBA'') redefined the term ''bank'' in the Bank Holding Company Act (''BHC Act'' or ''Act'') to include any bank the deposits of which are insured by the Federal Deposit Insurance Corporation as well as any other institution that accepts demand or checkable deposit accounts and is engaged in the business of making commercial loans. 12 U.S.C. 1841(c). CEBA also contained a grandfather provision for certain companies affected by this redefinition. CEBA amended section 4 of the BHC Act to permit a company that on March 5, 1987, controlled a nonbank bank (an institution that became a bank as a result of enactment of CEBA) and that was not a bank holding company on August 9, 1987, to retain its nonbank bank and not be treated as a bank holding company for purposes of the BHC Act if the company and its subsidiary nonbank bank observe certain limitations imposed by CEBA.[1] Certain of these limitations are codified in section 4(f)(3) of the BHC Act and generally restrict nonbank banks from commencing new activities or certain cross-marketing activities with affiliates after March 5, 1987, or permitting overdrafts for affiliates or incurring overdrafts on behalf of affiliates at a Federal Reserve Bank. 12 U.S.C. 1843(f)(3).[2] The Board's views regarding

[1] 12 U.S.C. 1843(f). Such a company is treated as a bank holding company, however, for purposes of the anti-tying provisions in section 106 of the BHC Act Amendments of 1970 (12 U.S.C. 1971 *et seq.*) and the insider lending limitations of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b). The company is also subject to certain examination and enforcement provisions to assure compliance with CEBA.

[2] CEBA also prohibits, with certain limited exceptions, a company controlling a grandfathered nonbank bank from acquiring control of an additional bank or thrift institution or acquiring, directly or indirectly after March 5, 1987, more than 5 percent of the assets or shares of a bank or thrift institution. 12 U.S.C. 1843(f)(2).

the meaning and scope of these limitations are set forth below and in provisions of the Board's Regulation Y (12 CFR 225.52).

(b) *Congressional findings.* (1) At the outset, the Board notes that the scope and application of the Act's limitations on nonbank banks must be guided by the Congressional findings set out in section 4(f)(3) of the BHC Act. Congress was aware that these nonbank banks had been acquired by companies that engage in a wide range of nonbanking activities, such as retailing and general securities activities that are forbidden to bank holding companies under section 4 of the BHC Act. In section 4(f)(3), Congress found that nonbank banks controlled by grandfathered nonbanking companies may, because of their relationships with affiliates, be involved in conflicts of interest, concentration of resources, or other effects adverse to bank safety and soundness. Congress also found that nonbank banks may be able to compete unfairly against banks controlled by bank holding companies by combining banking services with financial services not permissible for bank holding companies. Section 4(f)(3) states that the purpose of the nonbank bank limitations is to minimize any such potential adverse effects or inequities by restricting the activities of nonbank banks until further Congressional action in the area of bank powers could be undertaken. Similarly, the Senate Report accompanying CEBA states that the restrictions CEBA places on nonbank banks ''will help prevent existing nonbank banks from changing their basic character * * * while Congress considers proposals for comprehensive legislation; from drastically eroding the separation of banking and commerce; and from increasing the potential for unfair competition, conflicts of interest, undue concentration of resources, and other adverse effects.'' S. Rep. No. 100–19, 100th Cong., 1st Sess. 12 (1987). *See also* H. Rep. No. 100–261, 100th Cong., 1st Sess. 124 (1987) (the ''Conference Report'').

(2) Thus, Congress explicitly recognized in the statute itself that nonbanking companies controlling grandfathered nonbank banks, which include the many of the nation's largest commercial and financial organizations, were being accorded a significant competitive advantage that could not be matched by bank holding companies because of the general prohibition against nonbanking activities in section 4 of the BHC Act. Congress recognized that this inequality in regulatory approach could inflict serious competitive harm on regulated bank holding companies as the grandfathered entities sought to exploit potential synergies between banking and commercial products and services. *See* Conference Report at 125–126. The basic and stated purpose of the restrictions on grandfathered nonbank banks is to minimize these potential anticompetitive effects.

(3) The Board believes that the specific CEBA limitations should be implemented in light of these Congressional findings and the legislative intent reflected in the plain meaning of the terms used in the statute. In those instances when the language of the statute did not provide clear guidance, legislative materials and the Congressional intent manifested in the overall statutory structure were considered. The Board also notes that prior precedent requires that grandfather exceptions in the BHC Act, such as the nonbank bank limitations and particularly the exceptions thereto, are to be interpreted narrowly in order to ensure the proper implementation of Congressional intent.[3]

(c) *Activity limitation*—(1) *Scope of activity.* (i) The first limitation established under section 4(f)(3) provides that a nonbank bank shall not ''engage in any activity in which such bank was not lawfully engaged as of March 5, 1987.'' The term *activity* as used in this provision of CEBA is not defined. The structure and placement of the CEBA activity restriction within section 4 of the BHC Act and its legislative history do, however, provide direction as to certain transactions that Congress intended to treat as separate activities, thereby providing guidance as to the meaning Congress intended to ascribe

[3] *E.g., Maryland National Corporation,* 73 Federal Reserve Bulletin 310, 313–314 (1987). *Cf., Spokane & Inland Empire Railroad Co.* v. *United States,* 241 U.S. 344, 350 (1915).

to the term generally. First, it is clear that the term *activity* was not meant to refer to banking as a single activity. To the contrary, the term must be viewed as distinguishing between deposit taking and lending activities and treating demand deposit-taking as a separate activity from general deposit-taking and commercial lending as separate from the general lending category.

(ii) Under the activity limitation, a nonbank bank may engage only in activities in which it was ''lawfully engaged'' as of March 5, 1987. As of that date, a nonbank bank could not have been engaged in both demand deposit-taking and commercial lending activity without placing it and its parent holding company in violation of the BHC Act. Thus, under the activity limitations, a nonbank bank could not after March 5, 1987, commence the demand deposit-taking or commercial lending activity that it did not conduct as of March 5, 1987. The debates and Senate and Conference Reports on CEBA confirm that Congress intended the activity limitation to prevent a grandfathered nonbank bank from converting itself into a full-service bank by both offering demand deposits and engaging in the business of making commercial loans.[4] Thus, these types of transactions provide a clear guide as to the type of banking transactions that would constitute activities under CEBA and the degree of specificity intended by Congress in interpreting that term.

(iii) It is also clear that the activity limitation was not intended simply to prevent a nonbank bank from both accepting demand deposits and making commercial loans; it has a broader scope and purpose. If Congress had meant the term to refer to just these two activities, it would have used the restriction it used in another section of CEBA dealing with nonbank banks owned by bank holding companies which has this result, *i.e.*, the nonbank bank could not engage in any activity that would have caused it to become a bank under the prior bank definition in the Act. *See* 12 U.S.C. 1843(g)(1)(A). Indeed, an earlier version of CEBA under consideration by the Senate Banking Committee contained such a provision for nonbank banks owned by commercial holding companies, which was deleted in favor of the broader activity limitation actually enacted. Committee Print No. 1, (Feb. 17, 1987). In this regard, both the Senate Report and Conference Report refer to demand deposit-taking and commercial lending as examples of activities that could be affected by the activity limitation, not as the sole activities to be limited by the provision.[5]

(iv) Finally, additional guidance as to the meaning of the term *activity* is provided by the statutory context in which the term appears. The activity limitation is contained in section 4 of the BHC Act, which regulates the investments and activities of bank holding companies and their nonbank subsidiaries. The Board believes it reasonable to conclude that by placing the CEBA activity limitation in section 4 of the BHC Act, Congress meant that Board and judicial decisions regarding the meaning of the term *activity* in that section be looked to for guidance. This is particularly appropriate given the fact that grandfathered nonbank banks, whether owned by bank holding companies or unregulated holding companies, were treated as nonbank companies and not banks before enactment of CEBA.

(v) This interpretation of the term activity draws support from comments by Senator Proxmire during the Senate's consideration of the provision that the term was not intended to apply ''on a product-by-product, customer-by-customer basis.'' 133 Cong. Rec. S4054–5 (daily ed. March 27, 1987). This is the same manner in which the Board has interpreted the term activity in the nonbanking provision of section 4 as referring to generic categories

[4] Conference Report at 124–25; S. Rep. No. 100–19 at 12, 32; H. Rep. No. 99–175, 99th Cong., 1st Sess. 3 (1985) (''the activities limitation is to prevent an institution engaged in a limited range of functions from expanding into new areas and becoming, in essence, a full-service bank''); 133 Cong. Rec. S4054 (daily ed. March 27, 1987); (Comments of Senator Proxmire).

[5] Conference Report at 124–125; S. Rep. No. 100–19 at 32.

of activities, not to discrete products and services.

(vi) Accordingly, consistent with the terms and purposes of the legislation and the Congressional intent to minimize unfair competition and the other adverse effects set out in the CEBA findings, the Board concludes that the term *activity* as used in section 4(f)(3) means any line of banking or nonbanking business. This definition does not, however, envision a product-by-product approach to the activity limitation. The Board believes it would be helpful to describe the application of the activity limitation in the context of the following major categories of activities: deposit-taking, lending, trust, and other activities engaged in by banks.

(2) *Deposit-taking activities.* (i) With respect to deposit-taking, the Board believes that the activity limitation in section 4(f)(3) generally refers to three types of activity: demand deposit-taking; non-demand deposit-taking with a third party payment capability; and time and savings deposit-taking without third party payment powers. As previously discussed, it is clear from the terms and intent of CEBA that the activity limitation would prevent, and was designed to prevent, nonbank banks that prior to the enactment of CEBA had refrained from accepting demand deposits in order to avoid coverage as a *bank* under the BHC Act, from starting to take these deposits after enactment of CEBA and thus becoming full-service banks. Accordingly, CEBA requires that the taking of demand deposits be treated as a separate activity.

(ii) The Board also considers nondemand deposits withdrawable by check or other similar means for payment to third parties or others to constitute a separate line of business for purposes of applying the activity limitation. In this regard, the Board has previously recognized that this line of businesss constitutes a permissible but separate activity under section 4 of the BHC Act. Furthermore, the offering of accounts with transaction capability requires different expertise and systems than non-transaction deposit-taking and represented a distinct new activity that traditionally separated banks from thrift and similar institutions.

(iii) Support for this view may also be found in the House Banking Committee report on proposed legislation prior to CEBA that contained a similar prohibition on new activities for nonbank banks. In discussing the activity limitation, the report recognized a distinction between demand deposits and accounts with transaction capability and those without transaction capability:

> With respect to deposits, the Committee recognizes that it is legitimate for an institution currently involved in offering demand deposits or other third party transaction accounts to make use of new technologies that are in the process of replacing the existing check-based, paper payment system. Again, however, the Committee does not believe that technology should be used as a lever for an institution that was only incidentally involved in the payment system to transform itself into a significant offeror of transaction account capability.[6]

(iv) Finally, this distinction between demand and nondemand checkable accounts and accounts not subject to withdrawal by check was specifically recognized by Congress in the redefinition of the term *bank* in CEBA to include an institution that takes demand deposits or ''deposits that the depositor may withdraw by check or other means for payment to third parties or others'' as well as in various exemptions from that definition for trust companies, credit card banks, and certain industrial banks.[7]

(v) Thus, an institution that as of March 5, 1987, offered only time and savings accounts that were not withdrawable by check for payment to third parties could not thereafter begin offering accounts with transaction capability, for example, NOW accounts or other types of transaction accounts.

(3) *Lending.* As noted, the CEBA activity limitation does not treat lending as a single activity; it clearly distinguishes between commercial and other types of lending. This distinction is also reflected in the definition of *bank* in the BHC Act in effect both prior to

[6] H. Rep. No. 99–175, 99th Cong., 1st Sess. 13 (1985).

[7] See 12 U.S.C. 1841(c)(2) (D), (F), (H), and (I).

and after enactment of CEBA as well as in various of the exceptions from this definition. In addition, commercial lending is a specialized form of lending involving different techniques and analysis from other types of lending. Based upon these factors, the Board would view commercial lending as a separate and distinct activity for purposes of the activity limitation in section 4(f)(3). The Board's decisions under section 4 of the BHC Act have not generally differentiated between types of commercial lending, and thus the Board would view commercial lending as a single activity for purposes of CEBA. Thus, a nonbank bank that made commercial loans as of March 5, 1987, could make any type of commercial loan thereafter.

(i) *Commercial lending.* For purposes of the activity limitation, a commercial loan is defined in accordance with the Supreme Court's decision in *Board of Governors* v. *Dimension Financial Corporation,* 474 U.S. 361 (1986), as a direct loan to a business customer for the purpose of providing funds for that customer's business. In this regard, the Board notes that whether a particular transaction is a commercial loan must be determined not from the face of the instrument, but from the application of the definition of commercial loan in the *Dimension* decision to that transaction. Thus, certain transactions of the type mentioned in the Board's ruling at issue in *Dimension* and in the Senate and Conference Reports in the CEBA legislation[8] would be commercial loans if they meet the test for commercial loans established in *Dimension*. Under this test, a commercial loan would not include, for example, an open-market investment in a commercial entity that does not involve a borrower-lender relationship or negotiation of credit terms, such as a money market transaction.

(ii) *Other lending.* Based upon the guidance in the Act as to the degree of specificity required in applying the activity limitation with respect to lending, the Board believes that, in addition to commercial lending, there are three other types of lending activities: consumer mortgage lending, consumer credit card lending, and other consumer lending. Mortgage lending and credit card lending are recognized, discrete lines of banking and business activity, involving techniques and processes that are different from and more specialized than those required for general consumer lending. For example, these activities are, in many cases, conducted by specialized institutions, such as mortgage companies and credit card institutions, or through separate organizational structures within an institution, particularly in the case of mortgage lending. Additionally, the Board's decisions under section 4 of the Act have recognized mortgage banking and credit card lending as separate activities for bank holding companies. The Board's Regulation Y reflects this specialization, noting as examples of permissible lending activity: consumer finance, credit card and mortgage lending. 12 CFR 225.25(b)(1). Finally, CEBA itself recognizes the specialized nature of credit card lending by exempting an institution specializing in that activity from the bank definition. For purpose of the activity limitation, a consumer mortgage loan will mean any loan to an individual that is secured by real estate and that is not a commercial loan. A credit card loan would be any loan made to an individual by means of a credit card that is not a commercial loan.

(4) *Trust activities.* Under section 4 of the Act, the Board has historically treated trust activities as a single activity and has not differentiated the function on the basis of whether the customer was an individual or a business. *See* 12 CFR 225.25(b)(3). Similarly, the trust company exemption from the bank definition in CEBA makes no distinction between various types of trust activities. Accordingly, the Board would view trust activities as a separate activity without additional differentiation for purposes of the activity limitation in section 4(f)(3).

(5) *Other activities.* With respect to activities other than the various traditional deposit-taking, lending or trust activities, the Board believes it appropriate, for the reasons discussed above,

[8] S. Rep. No. 100–19 at 31; Conference Report at 123.

to apply the activity limitation in section 4(f)(3) as the term *activity* generally applies in other provisions of section 4 of the BHC Act. Thus, a grandfathered nonbank bank could not, for example, commence after March 5, 1987, any of the following activities (unless it was engaged in such an activity as of that date): discount securities brokerage, full-service securities brokerage investment advisory services, underwriting or dealing in government securities as permissible for member banks, foreign exchange transaction services, real or personal property leasing, courier services, data processing for third parties, insurance agency activities,[9] real estate development, real estate brokerage, real estate syndication, insurance underwriting, management consulting, futures commission merchant, or activities of the general type listed in §225.25(b) of Regulation Y.

(6) *Meaning of engaged in.* In order to be *engaged in* an activity, a nonbank bank must demonstrate that it had a program in place to provide a particular product or service included within the grandfathered activity to a customer and that it was in fact offering the product or service to customers as of March 5, 1987. Thus, a nonbank bank is not engaged in an activity as of March 5, 1987, if the product or service in question was in a planning state as of that date and had not been offered or delivered to a customer. Consistent with prior Board interpretations of the term activity in the grandfather provisions of section 4, the Board does not believe that a company may be engaged in an activity on the basis of a single isolated transaction that was not part of a program to offer the particular product or to conduct in the activity on an ongoing basis. For example, a nonbank bank that held an interest in a single real estate project would not thereby be engaged in real estate development for purposes of this provision, unless evidence was presented indicating the interest was held under a program to commence a real estate development business.

(7) *Meaning of as of* The Board believes that the grandfather date ''as of March 5, 1987'' as used throughout section 4(f)(3) should refer to activities engaged in on March 5, 1987, or a reasonably short period preceding this date not exceeding 13 months. 133 Cong. Rec. S3957 (daily ed. March 26, 1987). (Remarks of Senators Dodd and Proxmire). Activities that the institution had terminated prior to March 5, 1988, however, would not be considered to have been conducted or engaged in *as of* March 5. For example, if within 13 months of March 5, 1987, the nonbank bank had terminated its commercial lending activity in order to avoid the *bank* definition in the Act, the nonbank bank could not recommence that activity after enactment of CEBA.

(d) *Cross-marketing limitation*—(1) *In general.* Section 4(f)(3) also limits cross-marketing activities by nonbank banks and their affiliates. Under this provision, a nonbank bank may not offer or market a product or service of an affiliate unless the product or service may be offered by bank holding companies generally under section 4(c)(8) of the BHC Act. In addition, a nonbank bank may not permit any of its products or services to be offered or marketed by or through a nonbank affiliate unless the affiliate engages only in activities permissible for a bank holding company under section 4(c)(8). These limitations are subject to an exception for products or services that were being so offered or marketed as of March 5, 1987, but only in the same manner in which they were being offered or marketed as of that date.

(2) *Examples of impermissible cross-marketing.* The Conference Report illustrates the application of this limitation to the following two covered transactions: (i) products and services of an affiliate that bank holding companies may not offer under the BHC Act, and (ii) products and services of the nonbank bank. In the first case, the restrictions would prohibit, for example, a company from marketing life insurance or automotive supplies through its affiliate nonbank bank because these products are not generally

[9] In this area, section 4 of the Act does not treat all insurance agency activities as a single activity. Thus, for example, the Act treats the sale of credit-related life, accident and health insurance as a separate activity from general insurance agency activities. See 12 U.S.C. 1843(c)(8).

permissible under the BHC Act. Conference Report at 126. In the second case, a nonbank bank may not permit its products or services to be offered or marketed through a life insurance affiliate or automobile parts retailer because these affiliates engage in activities prohibited under the BHC Act. *Id.*

(3) *Permissible cross-marketing.* On the other hand, a nonbank bank could offer to its customers consumer loans from an affiliated mortgage banking or consumer finance company. These affiliates could likewise offer their customers the nonbank bank's products or services provided the affiliates engaged only in activities permitted for bank holding companies under the closely-related-to-banking standard of section 4(c)(8) of the BHC Act. If the affiliate is engaged in both permissible and impermissible activities within the meaning of section 4(c)(8) of the BHC Act, however, the affiliate could not offer or market the nonbank bank's products or services.

(4) *Product approach to cross-marketing restriction.* (i) Unlike the activity restrictions, the cross-marketing restrictions of CEBA apply by their terms to individual products and services. Thus, an affiliate of a nonbank bank that was engaged in activities that are not permissible for bank holding companies and that was marketing a particular product or service of a nonbank bank on the grandfather date could continue to market that product and, as discussed below, could change the terms and conditions of the loan. The nonbank affiliate could not, however, begin to offer or market another product or service of the nonbank bank.

(ii) The Board believes that the term *product or service* must be interpreted in light of its accepted ordinary commercial usage. In some instances, commercial usage has identified a group of products so closely related that they constitute a product line (*e.g.,* certificates of deposit) and differences in versions of the product (*e.g.,* a one-year certificate of deposit) simply represent a difference in the terms of the product.[10] This approach is consistent with the treatment in CEBA's legislative history of certificates of deposit as a product line rather than each particular type of CD as a separate product.[11]

(iii) In the area of consumer lending, the Board believes the following provide examples of different consumer loan products: mortgage loans to finance the purchase of the borrower's residence, unsecured consumer loans, consumer installment loans secured by the personal property to be purchased (*e.g.* automobile, boat or home appliance loans), or second mortgage loans.[12] Under this interpretation, a nonbank bank that offered automobile loans through a nonbank affiliate on the grandfather date could market boat loans, appliance loans or any type of secured consumer installment loan through that affiliate. It could not, however, market unsecured consumer loans, home mortgage loans or other types of consumer loans.

(iv) In other areas, the Board believes that the determination as to what constitutes a product or service should be made on a case-by-case basis consistent with the principles that the terms *product or service* must be interpreted in accordance with their ordinary commercial usage and must be narrower in scope than the definition of activity. Essentially, the concept applied in this analysis is one of permitting the continuation of the specific product marketing activity that was undertaken as

[10] American Bankers Association, *Banking Terminology* (1981).

[11] During the Senate debates on CEBA, Senator Proxmire in response to a statement from Senator Cranston that the joint-marketing restrictions do not lock into place the specific terms or conditions of the particular grandfathered product or service, stated:

That is correct. For example, if a nonbank bank was jointly marketing on March 5, 1987, a 3 year, $5,000 certificate of deposit, this bill would not prohibit offering in the same manner a 1 year, $2,000 certificate of deposit with a different interest rate. 133 Cong. Rec. S3959 (daily ed. March 26, 1987).

[12] In this regard, the Supreme Court in *United States* v. *Philadelphia National Bank,* noted that ''the principal banking products are of course various types of credit, for example: unsecured personal and business loans, mortgage loans, loans secured by securities or accounts receivable, automobile installment and consumer goods, installment loans, tuition financing, bank credit cards, revolving credit funds.'' 374 U.S. 321, 326 n.5 (1963).

of March 5, 1987. Thus, for example, while insurance underwriting may constitute a separate activity under CEBA, a nonbank bank could not market a life insurance policy issued by the affiliate if on the grandfather date it had only marketed homeowners' policies issued by the affiliate.

(5) *Change in terms and conditions permitted.* (i) The cross-marketing restrictions would not limit the ability of the institution to change the specific terms and conditions of a particular grandfathered product or service. The Conference Report indicates a legislative intent not to lock into place the specific terms or conditions of a grandfathered product or service. Conference Report at 126. For example, a nonbank bank marketing a three-year, $5,000 certificate of deposit through an affiliate under the exemption could offer a one-year $2,000 certificate of deposit with a different interest rate after the grandfather date. *See* footnote 11 above. Modifications that alter the type of product, however, are not permitted. Thus, a nonbank bank that marketed through affiliates on March 5, 1987, only certificates of deposit could not commence marketing MMDA's or NOW accounts after the grandfather date.

(ii) General changes in the character of the product or service as the result of market or technological innovation are similarly permitted to the extent that they do not transform a grandfathered product into a new product. Thus, an unsecured line of credit could not be modified to include a lien on the borrower's residence without becoming a new product.

(6) *Meaning of offer or market.* In the Board's opinion, the terms *offer or market* in the cross-marketing restrictions refer to the presentation to a customer of an institution's products or service through any type of program, including telemarketing, advertising brochures, direct mailing, personal solicitation, customer referrals, or joint-marketing agreements or presentations. An institution must have offered or actually marketed the product or service on March 5 or shortly before that date (as discussed above) to qualify for the grandfather privilege. Thus, if the cross-marketing program was in the planning stage on March 5, 1987, the program would not quality for grandfather treatment under CEBA.

(7) *Limitations on cross-marketing to in the same manner.* (i) The cross-marketing restriction in section 4(f)(3) contains a grandfather provision that permits products or services that would otherwise be prohibited from being offered or marketed under the provision to continue to be offered or marketed by a particular entity if the products or services were being so offered or marketed as of March 5, 1987, but ''only in the same manner in which they were being offered or marketed as of that date.'' Thus, to qualify for the grandfather provision, the manner of offering or marketing the otherwise prohibited product or service must remain the same as on the grandfather date.

(ii) In interpreting this provision, the Board notes that Congress designed the joint-marketing restrictions to prevent the significant risk to the public posed by the conduct of such activities by insured banks affiliated with companies engaged in general commerce, to ensure objectivity in the credit-granting process and to ''minimize the unfair competitive advantage that grandfathered commercial companies owning nonbank banks might otherwise engage over regulated bank holding companies and our competing commercial companies that have no subsidiary bank.'' Conference Report at 125–126. The Board believes that determinations regarding the manner of cross-marketing of a particular product or service may best be accomplished by applying the limitation to the particular facts in each case consistent with the stated purpose of this provision of CEBA and the general principle that grandfather restrictions and exceptions to general prohibitions must be narrowly construed in order to prevent the exception from nullifying the rule. Essentially, as in the scope of the term ''product or service'', the guiding principle of Congressional intent with respect to this term is to permit only the continuation of the specific types of cross-marketing activity that were undertaken as of March 5, 1987.

(8) *Eligibility for cross-marketing grandfather exemption.* The Conference Report also clarifies that entitlement to

an exemption to continue to cross-market products and services otherwise prohibited by the statute applies only to the specific company that was engaged in the activity as of March 5, 1987. Conference Report at 126. Thus, an affiliate that was not engaged in cross-marketing products or services as of the grandfather date may not commence these activities under the exemption even if such activities were being conducted by another affiliate. *Id.*; *see also* S. Rep. No. 100–19 at 33–34.

(e) *Eligibility for grandfathered nonbank bank status.* In reviewing the reports required by CEBA, the Board notes that a number of institutions that had not commenced business operations on August 10, 1987, the date of enactment of CEBA, claimed grandfather privileges under section 4(f)(3) of CEBA. To qualify for grandfather privileges under section 4(f)(3), the institution must have ''bec[o]me a bank as a result of the enactment of [CEBA]'' and must have been controlled by a nonbanking company on March 5, 1987. 12 U.S.C. 1843(f)(1)(A). An institution that did not have FDIC insurance on August 10, 1987, and that did not accept demand deposits or transaction accounts or engage in the business of commercial lending on that date, would not have become a *bank* as a result of enactment of CEBA. Thus, institutions that had not commenced operations on August 10, 1987, could not qualify for grandfather privileges under section 4(f)(3) of CEBA. This view is supported by the activity limitations of section 4(f)(3), which, as noted, limit the activities of grandfathered nonbank banks to those in which they were lawfully engaged as of March 5, 1987. A nonbank bank that had not commenced conducting business activities on March 5, 1987, could not after enactment of CEBA engage in any activities under this provision.

[Reg. Y, 53 FR 37746, Sept. 28, 1988, as amended by Reg. Y, 62 FR 9343, Feb. 28, 1997]

Subpart J—Merchant Banking Investments

SOURCE: Reg. Y, 66 FR 8484, Jan. 31, 2001, unless otherwise noted.

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

(a) *What types of investments are permitted by this subpart?* Section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) and this subpart 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 subpart, shares, assets or ownership interests acquired or controlled under section 4(k)(4)(H) and this subpart 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 subpart.

(b) *Must the investment be a bona fide merchant banking investment?* The acquisition or control of shares, assets or ownership interests under this subpart 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 subpart acquire or