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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 § 225.171.

(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 subpart 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.

§ 225.171 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 subpart 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 this part (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.

(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 subpart.

(2) *Definition applying provisions governing routine management or operation.* For purposes of this section other than paragraph (e) and for purposes of § 225.173(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 subpart.

§ 225.172 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 subpart 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 § 225.173, a financial holding company may not, directly or indirectly, own, control or hold any share, asset or ownership interest pursuant to this subpart for a period that exceeds 10 years.

(2) *Ownership interests acquired from or transferred to companies held under this subpart.* For purposes of paragraph