

JOINT AGENCY STATEMENT ON PARALLEL-OWNED BANKING ORGANIZATIONS

PURPOSE

This statement discusses the characteristics of parallel-owned banking organizations, reviews potential risks associated with these banking organizations, and sets forth the approach of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (collectively, "the banking agencies") to supervision of those risks. It also provides information on the applications process for proposals involving parallel-owned banking organizations.

The banking agencies' supervisory approach seeks to better understand how the overall strategy and management of a parallel-owned banking organization affects a U.S. depository institution within such a structure, how the activities of foreign affiliates are supervised, how home-country supervisors view the condition and operations of foreign affiliates, and how affiliates could affect the U.S. depository institution. Through this understanding, the banking agencies may be better able to monitor and address risks affecting a U.S. depository institution that arise in parallel-owned banking organizations. Enhanced communication and cooperation with foreign bank supervisors is important to this process.

The supervisory approach outlined in this statement cannot eliminate the risks inherent with a parallel-owned banking structure. However, this supervisory approach may assist the banking agencies in determining the extent of inter-organizational transactions, for example, loan participations or sales, insider loans and contractual obligations for services. The banking agencies may also be better able to assess the effects that another member of the organization may have on a U.S. depository institution.

IDENTIFYING PARALLEL-OWNED BANKING ORGANIZATIONS

A parallel-owned banking organization is created when at least one U.S. depository institution and one foreign bank¹ are controlled either directly or indirectly by the same person or group of persons² who are closely associated in their business dealings or otherwise acting in concert. It does not include structures in which one depository institution is a subsidiary of the other, or the organization is controlled by a company subject to the Bank Holding Company Act, 12 USC 1841 et seq., or the Savings and Loan Holding Company Act, 12 USC 1467a³. The banking agencies consider whether

a person or group of persons may control a depository institution if the person or group of persons controls 10 percent or more of any class of voting shares of the depository institution⁴.

The characteristics listed below may be indicators that a U.S. depository institution is directly or indirectly controlled by a person or group of persons that also controls a foreign bank. If one or more of the following factors exist, depending upon the circumstances, the banking agencies may conduct additional inquiries:

- An individual or group of individuals acting in concert that controls a foreign bank also controls any class of voting shares of a U.S. depository institution; or financing for persons owning or controlling the shares is received from, or arranged by, the foreign bank, especially if the shares of the U.S. depository institution are collateral for the stock purchase loan.
- The U.S. depository institution has adopted particular or unique policies or strategies similar to those of the foreign bank, such as common or joint marketing strategies, sharing of customer information, cross-selling of products, or linked Web sites.
- An officer or director of the U.S. depository institution either: 1) serves as an officer or director⁵ of a foreign bank; or 2) controls a foreign bank or is a member of a group of individuals acting in concert or with common ties that controls a foreign bank.
- The name of the U.S. depository institution is similar to that of the foreign bank.

Parallel-owned banking organizations are established and maintained for a variety of reasons, including tax and estate planning, and risks of nationalization. While these reasons may be legitimate and not prohibited by U.S. or foreign law, the structure of such organizations creates or increases the risks outlined below and may make it more difficult for supervisors to monitor and address such risks.

SUPERVISORY RISKS IN PARALLEL-OWNED BANKING ORGANIZATIONS

Parallel-owned banking organizations present supervisory risks similar to those arising from chain banking organizations in the United States. The fundamental risk presented by these organizations is that they may be acting in a *de facto* organizational structure that, because it is not formalized, is not subject to comprehensive consolidated supervision. Consequently, relationships between the U.S. depository institution and other affiliates may be harder to understand and monitor. This risk can be reduced but not eliminated by (1) working with the appropriate non-U.S. supervisors to better understand and monitor the activities of the foreign affiliates and owners; (2) sharing information, as appropriate, with foreign and domestic banking supervisory agencies with supervisory responsibility for other entities within the organization; and (3)

imposing special conditions or obtaining special commitments or representations related to an application or enforcement or other supervisory action, where warranted.

Parallel-owned banking organizations may raise numerous management and supervisory risks, including:

- Officers and directors of the U.S. depository institution may be unable or unwilling to exercise independent control to ensure that transactions with the foreign parallel bank or affiliates are legitimate and comply with applicable laws and regulations. As a result, the U.S. depository institution may be the conduit or participant in a transaction that violates U.S. law or the laws of a foreign country, or that is designed to prefer a foreign bank or nonbank entity in the group, to the detriment of the U.S. depository institution.
- Money laundering concerns may be heightened due to the potential lack of arms-length transactions between the U.S. depository institution and the foreign parallel bank. Specifically, the flow of funds through wires, pouch activity, and correspondent accounts may be subject to less internal scrutiny by the U.S. depository institution than usually is warranted. This risk is greatly increased when the foreign parallel bank is located in an offshore jurisdiction or other jurisdiction that limits exchange of information through bank secrecy laws, especially if the jurisdiction has been designated as a "non-cooperating country or territory," or the jurisdiction or the foreign bank has been found to be of primary money-laundering concern under the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001⁶.
- Securities, custodial, and trust transactions may be preferential to the extent that assets, earnings, and losses are artificially allocated among parallel banks. Similarly, low-quality assets and problem loans can be shifted among parallel banks to manipulate earnings or losses and avoid regulatory scrutiny. Also, if the foreign parallel bank were to begin experiencing financial difficulties, the foreign bank or the common owners might pressure the U.S. depository institution to provide credit support or liquidity to an affiliate in excess of the legal limits of 12 USC 371c, 371c-1.
- The home country of the foreign parallel bank may have insufficient mechanisms or authority to monitor changes in ownership or to ensure arms-length intercompany transactions between the foreign parallel bank and other members of the group, including the U.S. depository institution, or to monitor concentration of loans or transactions with third parties that may present safety and soundness concerns to the group.
- Capital may be generated artificially through the use of international stock purchase loans. Such loans can be funded by the U.S. depository institution to the foreign affiliate or to a nonaffiliate with the purpose of supporting a loan back to the foreign affiliate and used to leverage the U.S. depository institution or vice

versa. This concern is heightened for parallel-owned banking organizations if the foreign bank is not adequately supervised.

- Political, legal, or economic events in the foreign country may affect the U.S. depository institution. Events in the foreign country, such as the intervention and assumption of control of the foreign parallel bank by its supervisor, may trigger a rapid inflow or outflow of deposits at the U.S. depository institution, thereby affecting liquidity. Foreign events may increase reputational risk to the U.S. depository institution. In addition, these events may adversely affect the foreign bank owner's financial resources and decrease the ability of the foreign bank owner to provide financial support to the U.S. depository institution. Foreign law may change without the U.S. depository institution or the banking agencies becoming aware of the effect of legal changes on the parallel-owned banking organization, including the U.S. depository institution.
- Parallel-owned banking organizations may seek to avoid legal lending limits or limitations imposed by securities or commodities exchanges or clearinghouses on transactions by one counterparty thereby unduly increasing credit risk and other risks to the banking organizations and others.

To minimize these risks, the banking agencies will coordinate their supervision of a parallel-owned banking organization's U.S. operations. The supervisory approach may include unannounced coordinated examinations if more than one regulator has examination authority. Such examinations may be conducted if regulators suspect irregular transactions between parallel-owned banks, such as the shifting of problem assets between the depository institutions. Factors to consider in determining whether to conduct coordinated reviews of an organization's U.S. operations include: intercompany and related transactions; strategy and management of the parallel-owned banking organization; political, legal, or economic events in the foreign country; and compliance with commitments or representations made or conditions imposed in the application process or pursuant to prior supervisory action.

The banking agencies expect the U.S. depository institution's board of directors and senior management to be cognizant of the risks associated with being part of a parallel-owned banking structure, especially with respect to diversion of depository institution resources, conflicts of interest, and affiliate transactions. The depository institution's internal policies and procedures should provide guidance on how personnel should treat affiliates. The banking agencies expect to have access to such policies as well as the results of any audits of compliance with the policies.

The banking agencies will seek an overview of the entire organization, as well as a better understanding of how foreign bank affiliates are supervised. Authorized members of supervisory staff will work with foreign supervisors to better understand the activities of the foreign affiliates and owners. As appropriate and feasible, and in accordance with applicable law, authorized staff members of the banking agencies will share information regarding material developments with foreign and domestic

supervisory agencies that have supervisory responsibility over relevant parts of the parallel-owned banking organization.

APPLICATION PROCESS FOR PROPOSALS INVOLVING PARALLEL-OWNED BANKING ORGANIZATIONS

A person or group of persons who are closely associated in their business dealings or otherwise acting in concert may establish or acquire control of a foreign bank and subsequently establish or acquire control of a U.S. depository institution, where one depository institution is not a subsidiary of the other. This establishment or acquisition of a U.S. depository institution would be subject to the Change in Bank Control Act, the Bank Holding Company Act, the Federal Deposit Insurance Act, or the Savings and Loan Holding Company Act. The banking agencies' policies and procedures for processing applications, including filings under the Change in Bank Control Act, the Bank Holding Company Act, the Federal Deposit Insurance Act, or the Savings and Loan Holding Company Act may be found in regulations and guidance issued by the banking agencies. As with all types of applications, the banking agencies review proposals involving parallel-owned banking organizations on a case-by-case basis, including a review of the corporate structure of the proposed transaction. Therefore, information required, commitments or representations requested, and the imposition of special conditions in a regulatory decision may differ for each applicant or notificant. Depending on specific circumstances, the banking agencies may place additional restrictions on the U.S. depository institution's ability to engage in transactions with foreign affiliates or may impose other restrictions, as applicable.

U.S. depository institutions that learn of the possibility of becoming part of a parallel-owned banking organization should promptly advise the appropriate federal banking agency. Experience shows that obtaining all of the information necessary to gain a complete understanding of the foreign bank, which may require working with the foreign bank supervisor, and an understanding of the impact of the proposal on the U.S. depository institution, can be more complicated and time-consuming in a potential parallel-owned banking organization situation than is ordinarily the case.

ACKNOWLEDGEMENT TO THE APPROPRIATE FEDERAL BANKING AGENCY THAT A U.S. DEPOSITORY INSTITUTION HAS BECOME PART OF A PARALLEL-OWNED BANKING ORGANIZATION

A person or group of persons may first establish or acquire control of the U.S. depository institution and then the foreign bank, where one depository institution is not a subsidiary of the other, or the U.S. depository institution and the foreign bank are not subsidiaries of the same bank holding company or savings and loan holding company. In this instance, a parallel-owned banking organization would be formed without the review of the banking agencies in the application process.

To the extent possible, in order to assure that the U.S. depository institution is properly supervised and identified as part of a parallel-owned banking organization, a U.S. depository institution should provide an acknowledgement to the appropriate federal

banking agency prior to becoming part of a parallel-owned banking organization. A U.S. depository institution's management should advise the individuals who control the depository institution to inform management before they obtain control of a foreign bank. If providing this acknowledgement in advance is not possible, the U.S. depository institution should inform the banking agency promptly after learning of the acquisition of control, so that the banking agency may adjust its supervisory strategy expeditiously and assist the U.S. depository institution in identifying and controlling any risks presented by membership in a parallel-owned banking organizations.

¹ References to "foreign bank" or "foreign parallel bank" also include a holding company of the foreign bank and any U.S. or foreign affiliates of the foreign bank. References to "U.S. depository institution" do not include a U.S. depository institution that is controlled by a foreign bank.

² The term person(s) includes both business entities and natural person(s), which may or may not be U.S. citizens.

³ The approach outlined in this statement applies only to those parallel-owned banking organizations that are not controlled by a "bank holding company" under the Bank Holding Company Act or a "savings and loan holding company" under the Savings and Loan Holding Company Act. Such companies would be subject to the application, notice, and supervisory requirements in the Bank Holding Company Act or Savings and Loan Holding Company Act and not the procedures described in this statement and other related issuances. A bank holding company or savings and loan holding company, however, may be a component of a parallel-owned banking organization. This situation may arise when a bank holding company or savings and loan holding company controls the U.S. depository institution, and the holding company, in turn, is controlled by a person or group of persons who also controls a foreign bank.

⁴ A variety of presumptions of control and technical rules apply to determinations of control. See 12 CFR 5.50, 225.41, 303.82, 574.4.

⁵ The sharing of a director, by itself, is unlikely to indicate common control of the U.S. and foreign depository institutions.

⁶ Certain requirements also may apply if a jurisdiction or a foreign bank is found to be of primary money laundering concern under the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. Pub. L. No. 107-56, 115 Stat. 272, 296 (2001).