INTRODUCTION

This Section highlights the various ways that holding company enterprises may be structured, and the importance of reviewing and understanding each structure. This Section will also provide an overview of control thresholds to help you determine if there have been changes in the ownership structure, and, if so, what regulatory processes apply. Finally, the framework for determining what activities a holding company may engage in is outlined. As you will see, there is a correlation between how a holding company is structured and the activities in which it may engage.

Once you understand the holding company enterprise and its activities, you must then evaluate what risks, if any, may affect the subsidiary thrift. You must determine whether there are elements of the holding company structure, or business interests of the holding company enterprise, that hold potential risks for the thrift. This means considering not only the activities of the holding company and other affiliates, but also activities of the thrift itself.

You must ensure that the thrift is not being used as a dumping ground for low-quality or high-risk assets, or a vehicle for conducting risky activities. Furthermore, you must consider the materiality of the thrift to the holding company enterprise and its controlling shareholders. If the thrift is immaterial to the overall holdings of the holding company or controlling shareholders, there may be less incentive for them to ensure its safe and sound operation or to provide financial support if needed. On the other hand, regardless of materiality, the holding company may not want to risk tarnishing its reputation and, therefore, do whatever is necessary to safeguard the thrift. This same strategy may extend to an uninsured affiliate that is in trouble. To protect its reputation, the holding company may divert thrift resources to the troubled affiliate.

Every holding company enterprise is uniquely structured and managed. Each presents different risks and issues. These risks change not only from enterprise to enterprise, but over time within a given holding company enterprise. Keep in mind that as you assess the organizational structure, you must consider not only the current risks that may be evident, but also prospective risks.

STRUCTURE

A savings and loan holding company is any company that directly or indirectly controls a savings association. This ownership interest can result in several forms of organization. In their most basic form, holding companies are either ***unitary*** or ***multiple***. For the most part, these designations are self-explanatory:

- A ***unitary*** holding company controls one thrift.
- A ***multiple*** holding company controls more than one thrift.

The vast majority of thrift holding companies are unitary.

Many times a holding company is simply a shell corporation established for the sole purpose of owning a thrift. Shell holding companies have the following characteristics:

- Low or insignificant amounts of debt;
- Minimal activities, other than holding the stock in the thrift; and
- Low risk, highly liquid investments.

Thrift holding companies are also designated as ***diversified*** or ***nondiversified***. This distinction is based on the business interests of the company.

- A ***diversified*** holding company's thrift and related activities[1] represent less than 50 percent

[1] Related activities are specified in 12 CFR 584.2(b), 584.2-1 and 584.2-2.

of the company's consolidated net worth and consolidated earnings.

- A ***nondiversified*** holding company is one that does not meet both of these thresholds, and, thus, has banking and banking related businesses as its principal operation.

The vast majority of OTS regulated holding companies are nondiversified.[2]

You may also encounter other types of holding companies. One is a ***mutual holding company (MHC)***. A MHC structure combines the elements of a mutual thrift, which is owned/controlled by its depositors and, in some cases by its borrowers, with elements of a stock thrift. In a MHC, the depositors (and borrowers, if applicable) own/control the mutual holding company, which in turn holds a majority of the voting stock of its subsidiary thrift. The remainder of the thrift stock can be sold to outside investors to raise capital. Some MHCs have mid-tier stock holding companies.

Another structure is a ***HOLA 10(l) holding company***. Section 10(l) of the Home Owners' Loan Act (HOLA) allows state savings banks and cooperative banks that are not regulated by OTS to elect to be treated as savings associations for purposes of regulating their holding company. Without such an election, these holding companies would otherwise be regulated by the Board of Governors of the Federal Reserve (Federal Reserve) as bank holding companies. In order to qualify as a HOLA 10(l) holding company, the subsidiary bank must be a qualified thrift lender. These structures present novel examination concerns because OTS regulates the holding company, but not the subsidiary financial institution. Specific examination issues for this population of holding companies are contained in Section 910.

A third type of structure is one in which a bank or financial holding company controls both a bank and a thrift. Although these companies control a thrift, they are considered bank holding companies and are, therefore, regulated by the Federal Reserve. OTS is the primary regulator of the thrift itself, but does not regulate the holding company.

Structure is one of the first indicators of how a holding company enterprise should be reviewed from an examination perspective. There is a substantial difference in approach between a low risk holding company that does nothing but hold a thrift compared to one that not only holds a thrift, but is also involved in a variety of nonbanking businesses. A complex holding company may be involved in other businesses through various nonthrift subsidiaries. Such increased complexity requires us to assess the effect these businesses may have on the thrift.

The holding company examination encompasses a review of the entire holding company enterprise. Understanding the structure is essential if you are to make an effective assessment of the holding company's condition and its impact on the thrift. Understanding the structure also makes it easier to focus attention on the entities that have the most potential impact on the thrift.

ACQUISITIONS AND CONTROL

The issue of control is very significant in the regulatory process since we are dealing with who has the power over management and policies, and, thus, the direction of the thrift or holding company.[3] It is also important to be aware of

[2] You should note that diversified status is something that a holding company claims. To claim this status, it has to demonstrate that the above percentages are met. Historically, this status was claimed because diversified holding companies were exempt from certain regulatory requirements. In the past, the most notable exception dealt with debt notices. Today, very few regulatory distinctions remain. One exemption that still exists for diversified holding companies is contained in the management interlock regulations.

[3] Direct or indirect control of a thrift by the same person or group of persons that control a foreign bank raises unique supervisory concerns. For a better understanding of the characteristics and potential risks associated with such parallel-owned banking organizations, see the Joint Agency Statement on Parallel-Owned Banking Organizations included as Appendix 400A.

potential acquirers of control. As noted above, a holding company is a company that controls a thrift, directly or indirectly. Specific statutory and regulatory requirements apply to such companies, starting with the fact that OTS must grant approval before any company can acquire control of a thrift. You must understand the control thresholds and presumptions in order to recognize situations where a controlling party has not been properly identified, and, therefore, has not received the requisite approvals from the OTS.

Control of a thrift or holding company can take various forms and, many times, is not obvious. The following highlights some simple facts about control:

- Control can be acquired directly or indirectly.
- Control can occur by persons or entities acting in concert to influence the thrift or holding company.
- Control can be acquired by means other than stock ownership.

For the most part, control of a thrift or holding company is fairly straightforward based on stock ownership or the ability to control the stock in some manner. Such situations are ordinarily acknowledged by the parties, and the proper application or notification process to the OTS is undertaken.

However, there are also situations where the question of control becomes somewhat murky. It is these situations where you need to be aware of possible control issues which have not been acknowledged, and which have not been reviewed by the OTS.

Some of these latter type situations may involve circumstances where control is “backed into.” For example, if a holding company or thrift repurchases stock on a non pro rata basis. Such a repurchase will raise the percentage of ownership of the remaining shareholders. Someone who once owned only nine percent of voting stock may own 11 percent after the stock repurchase is completed. There may also be proportional ownership shifts as a result of corporate changes such as mergers with, or purchase of, another thrift or holding company. Further, beneficial ownership interests that carry the right to acquire stock through, for example, exercisable options, may result in control.

The regulations covering acquisition and control issues are found at 12 CFR Part 574. Determinations of control can be very complex, and conclusions may well have to be made outside the scope of the examination. However, it remains important that you are aware of the more significant elements of control to be able to identify and make preliminary assessments of any control issues encountered during the examination.

Conclusive Control

Conclusive control is essentially a situation where an acquirer, either person or company, owns or controls more than 25 percent of the voting stock of a thrift or holding company. This can arise from outright ownership or holding irrevocable proxies or a combination of both. In addition, if a person or company exercises a controlling influence over the management or policies of the entity, including controlling the election of a majority of directors, then the acquirer is considered to have conclusive control. An acquirer can also have conclusive control if it is a general partner or trustee of the entity, or has contributed more than 25 percent of the capital of a holding company.

Rebuttable Control

Rebuttable control occurs when a person or company does not have conclusive control, but there are circumstances present that, taken together, suggest that a controlling influence may exist. These circumstances generally involve holding ten percent or more of the voting stock, or 25 percent or more of any class of stock, together with a control factor. The control factors are detailed in the regulation at section 574.4(c). For example, an acquirer might have between 10 and 25 percent of the voting stock of the thrift, but be one of the two largest holders of any class of voting stock. Rebuttable control may also arise through holdings of revocable proxies, under section 574.4(b)(2).

Prior to acquiring the stock, or triggering any other element that gives rise to the rebuttable control issue, the acquirer must either:

- Acknowledge their intent to control, and obtain the appropriate approvals to do so; or
- Successfully rebut control.

In the later case, the OTS must accept the rebuttal before the transaction is consummated. The ability to rebut control enables passive investors who do not intend to control or influence the thrift or holding company to have a sizeable investment without undergoing the process and scrutiny of an acquisition filing. However, if the rebuttal is not accepted, then the acquirer would have to proceed with an application or notice to OTS in the normal course of acquisition discussed below.

Acting in Concert

In assessing control issues, there is the possibility that persons or entities may be acting in concert to secure control. **Acting in concert** is best described as a process whereby persons or entities exercise conclusive or rebuttable control by collectively acting together.

Section 574.4(d) sets forth several rebuttable presumptions of concerted action. Parties may rebut a presumption of concerted action by filing a submission supporting their contention that no concerted action exists. OTS may accept a rebuttal that meets applicable standards under section 574.4, including showing by clear and convincing evidence that concerted action does not exist. Even where concerted action presumptions do not apply, parties may be considered to act in concert under the general definition at 574.2(c).

Application Process

In addition to the rebuttals of control and concerted action discussed above, there are several other control related filings.

Companies seeking to acquire control of a thrift or thrift holding company must file one of several holding company acquisition filings referred to as H-(e) applications. When an individual or person seeks to acquire control, a Change-in-Control notice generally must be filed. Section 574.6 sets forth the procedural requirements and outlines the appropriate type of application or notice for each acquirer. These processes are required whether control is conclusive or, in a rebuttable scenario, where the acquirer does not dispute control or OTS has not accepted a prior rebuttal submission.

Individuals or companies that acquire ten percent or more ownership of any class of stock, but do not trigger the rebuttable or conclusive control thresholds, must file a certification of ownership. The required language of the certification is specified in 12 CFR 574.5.

Application forms and detailed filing instructions for holding companies and ownership control are contained in the Applications Processing Handbook.[4] If you identify a control situation where the appropriate application or notice has not been filed, you should review the exemptions set forth at 12 CFR 574.3(c) and (d), before citing a violation or seeking corrective action. There are a few limited instances where approval or notice is either not required at all, or is allowed after the acquisition. One example is where control results from a pledge or hypothecation of stock to secure a loan.

Once you have a clear understanding of the holding company structure, including identifying all controlling parties and affiliates, you can then begin to analyze the activities conducted.

ACTIVITIES

Many factors go in to determining the permissible activities for a holding company. Some holding companies operate without any activities limitations, while others are subject to activities restrictions.

Even when activity restrictions do apply, there are a significant number of businesses that have been deemed related to banking. Therefore, it is im-

[4] The Application Processing Handbook is available on the OTS website at www.ots.treas.gov.

portant that you review what activities are conducted within the holding company enterprise, and what risks they present.

To determine whether activity restrictions apply, you must consider the following factors:

- Holding company type – unitary or multiple;
- Whether the holding company came into existence or filed an application to become a savings and loan holding company prior to May 4, 1999; and
- Whether the subsidiary thrift(s) have Qualified Thrift Lender (QTL) status.

The following table is provided as a quick reference to the factors that determine what activities are permissible. The discussion that follows explains the terminology used.

Type of HC +	***HC in Existence or Filed Application by 5/4/1999 +***	***QTL Status =***	***Activity Limitations***
Unitary	Yes	Yes	**No**
Unitary	Yes	No	**Yes**
Unitary	No	Yes or No	**Yes**
Multiple[5]	Yes	Yes	**Yes or No**
Multiple	Yes	No	**Yes**
Multiple	No	Yes or No	**Yes**

[5] As discussed on the next page, for a multiple holding company to have no activity limitations, all or all but one of the subsidiary thrifts must have been acquired as part of a supervisory acquisition.

Type of Holding Company

As noted in the beginning of this Section, a unitary holding company is a holding company that controls one thrift. A multiple holding company controls more than one thrift. In addition to this general definition, if an insider of the holding company controls another thrift, then special treatment will apply. Specifically, if an individual meeting the following criteria controls more than one savings association (directly or indirectly), then any holding company controlled by that individual is treated as a multiple holding company in determining whether activity restrictions apply. The individuals that this provision applies to are:

- Directors or officers of a holding company, or
- Individuals who own, control, or hold with the power to vote (or hold proxies representing) more than 25 percent of the voting shares of the holding company.

The significance of being a unitary or multiple holding company is that multiple holding companies must acquire all, or all but one, of their thrifts as part of a supervisory acquisition to be free from activity restrictions. This requirement applies in addition to the qualified thrift lender status and the date of acquisition/application discussed below. To qualify as a supervisory acquisition, provisions of Sections 13(c), 13(i) or 13(k) of the Federal Deposit Insurance Act, or the former Section 408(m) of the National Housing Act must have been invoked.

In addition to whether the holding company is unitary or multiple, you must also consider whether it is a mutual holding company. As discussed further in Section 920, all mutual holding companies are subject to activities restrictions.

Date of Acquisition or Application

The Gramm-Leach-Bliley Act (GLB), enacted in November 1999, restricted the creation of new thrift holding companies that engage in commercial or other nonfinancial activities. The GLB did, however, grandfather most holding companies in existence at the time. Specifically, those holding companies that were in existence on May 4, 1999, and those that had filed an application on or before May 4, 1999, to acquire a thrift, can operate without activity restriction if both of the following are met:

- The holding company continues to hold at least one thrift (or its successor) that it controlled on May 4, 1999, or that it acquired under an application pending with the OTS on or before that date; and
- The subsidiary thrift(s) have QTL status.

As noted, a multiple holding company must also have acquired all, or all but one, of its subsidiary thrifts in a supervisory acquisition.

Qualified Thrift Lender Status

To operate without activity restrictions, all of the holding company's subsidiary thrifts must be qualified thrift lenders. This means that the thrift must satisfy either the:

- OTS QTL Test; or
- Internal Revenue Service tax code Domestic Building and Loan Association (DBLA) test.

To be a QTL under the OTS test, the thrift must maintain qualifying thrift investments equal to or exceeding 65 percent of portfolio assets for 9 out of every 12 months. Initially, these investments were predominantly mortgage loans and mortgage-related securities. However, 1996 legislation liberalized the definition to include small business loans, education loans, and credit card loans. This allowed a thrift to expand its consumer type portfolios without the consequence of losing its QTL status.

To be a QTL under the DBLA test (IRS regulation 20 CFR Section 301.7701-13A), a thrift must meet a "business operations test" and a "60 percent assets test."

If the subsidiary thrift fails to maintain its QTL status, the holding company's activities are restricted. Further, it must discontinue any nonpermissible business, although the OTS may grant a grace period up to two years for good cause. Nonetheless, any company that controls a thrift that does not have QTL status must register as a bank holding company within one year of the thrift's failure to meet the QTL test.

Permissible Activities

If activities restrictions apply, you must determine whether the activities conducted by the holding company and other affiliates are permissible. The following activities are permissible for all holding companies:

- Furnishing or performing management services for its thrift subsidiary;
- Conducting an insurance agency or an escrow business;
- Holding, managing, or liquidating assets owned by, or acquired from, its thrift subsidiary;
- Holding or managing properties used or occupied by its thrift subsidiary;
- Acting as trustee under deed of trust;
- Any other activity that the Board of Governors of the Federal Reserve System has permitted for financial holding companies under Section 4(k) of the Bank Holding Company Act (as outlined in 12 CFR 225.86 or 225.88 and 225.89); and
- Any activity that multiple savings and loan holding companies were authorized (by regulation) to engage in directly on March 5, 1987.[6]

[6] These activities are outlined in 12 CFR 584.2-1 (including, for example, investment in various lending transactions, furnishing various services to affiliates, and acquiring improved and unimproved real estate).

Prohibited Acts and Acquisitions

Evasion of Laws and Regulations. Despite the broad range of activities that thrift holding companies can engage in, there is a general prohibition regarding evasion of laws and regulations. Section 584.2(a) prohibits a holding company from engaging in any activity or rendering any service with the purpose of evading any law or regulation that applies to the thrift. You must exercise judgment in deciding what is an evasion of law or regulation as opposed to a company structuring its operations to take full advantage of the flexibility that holding companies and their subsidiaries possess. The deciding factor ultimately revolves around the holding company's purpose and intent, as well as the effect on the thrift.

Multi-State Multiple Holding Companies. Section 574.3(e) generally prohibits the formation of an interstate multiple thrift holding company. Unless certain criteria are met, this applies to any acquisition that would result in a holding company that controls thrifts in more than one state where the thrifts were not previously affiliated.

Nonaffiliated Ownership. Section 584.4 generally prohibits the acquisition of voting stock of nonaffiliated thrifts or thrift holding companies. Specifically, unless several exceptions apply, no thrift holding company may acquire more than five percent of the voting stock of a thrift or thrift holding company that is not a subsidiary, except with OTS approval. Nor can any multiple thrift holding company acquire more than five percent of the voting stock of any company that is not a subsidiary unless that company is engaged in the bulleted permissible activities noted above.

Other Prohibited Acts. Section 584.9 outlines other prohibitions regarding control of mutual thrifts, management interlocks, and convicted persons. These regulatory provisions are discussed further in Relationship Section 500.

Risk Assessment

The above discussion regarding structure, ownership and control issues, and activities is based on what a holding company can do by law and regulation. However, the fact that these objective criteria are met does not mean that there are no supervisory concerns. As in all examination areas, subjective judgments must be made about how well the holding company is being operated. A well designed structure can be undermined when implemented by management.

As outlined above, control of a thrift holding company can take many forms. Similarly, persons or entities exercising that control have widely diverse interests. In most cases, those interests are to oversee and reasonably benefit from the success of the entire organization. However, there may be parties that abuse their control relationship. You need to be able to identify control issues and be alert for any evidence of corporate abuse. You must be particularly watchful for indications that the thrift is the target of abuse for the benefit of other corporate interests. Similarly, you should identify situations where the thrift is not material to the diverse interests of the holding company or its controlling shareholders, and, therefore, vulnerable to a lack of support or inadequate oversight.

The current businesses and transactions of some holding companies are very diverse. The risks created by these activities can range from minor to significant and from permissible to inappropriate. Increased risk taking in holding company investments or businesses not only creates a potential detriment to the holding company itself, it also increases the risk that the subsidiary thrift will be negatively affected.

Your examination must review the businesses and investments of the holding company enterprise and assess the level of risk that is being taken. You should review, for example, whether risks are within the norm for the particular industry. Additionally, you should note whether company investments and other assets are within the ordinary course for the business, or whether they are more speculative. Most importantly, you must determine how these risks affect the insured thrift. Your assessment is not only how the thrift is affected currently; but potential risks as well. The holding company may currently be experiencing success and the thrift may be financially secure. However, there may be elements within that business structure that have the potential for problems. These need to be identified and considered in the overall holding company rating.

RATING THE ORGANIZATIONAL STRUCTURE COMPONENT

To properly assess risk at the holding company, you must consider the entire holding company enterprise. Specifically, you must consider the parties that control the thrift, how the thrift fits in the overall structure, and the activities conducted by the nonbank subsidiaries of the holding company.

You should assign an ***organizational structure component rating of "1"*** when there are no control issues and activities are conducted prudently with reasonable risk. All activities engaged in are permissible relative to the holding company structure.

You should assign an ***organizational structure component rating of "2"*** when activities and lines of business have a neutral effect on the thrift. Any control or activity concerns are addressed in a timely matter when advised, but may not have been independently identified. Activities may present some risk, but the risk is adequately managed, and does not jeopardize the safety and soundness of the thrift.

You should assign an ***organizational structure component rating of "3"*** when there is disregard for control issues or other ownership abuse. A holding company in this category may knowingly engage in impermissible activities. It may accept unreasonable risks or ineffectively manage risks in its activities and lines of business, whether or not permissible, that have negative implications for the holding company or the thrift.

SUMMARY

Thrift holding companies can have various corporate structures and these forms relate to not only the operating ability of these entities, but also how they should be assessed during the examination. Likewise, control of the entities may come about in numerous ways. Control may be conclusive or rebuttable. You must be knowledgeable of, and watchful for, a variety of events that could result in a change of control.

Once structure and control issues have been determined, the actual operation of these entities must be investigated. All material business activities must be identified. You must determine if the activities are permissible for the holding company structure. Finally, you should identify, to the extent possible, risks within the holding company enterprise that may affect the thrift so that appropriate supervisory measures may be initiated.

See Attached Joint Agency Statement on

Parallel-Owned Banking Organization

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 bank[1] are controlled either directly or indirectly by the same person or group of persons[2] 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

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[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.

1841 *et seq*., or the Savings and Loan Holding Company Act, 12 USC 1467a.[3] 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 institution.[4]

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 director[5] 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.

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[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.

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 2001.[6]

- 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.

[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).

- 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.