

FEDERAL RESERVE SYSTEM
12 CFR Part 211
[Regulation K; Docket No. R-1048]
International Banking Operations

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Interpretation

SUMMARY: The Board of Governors of the Federal Reserve System has issued an interpretation concerning the scope of the data processing provision of Regulation K. The interpretation clarifies that a banking organization may not engage in a broader range of data processing activities outside the United States under Regulation K than is permissible under Regulation Y, without the Board's approval.

EFFECTIVE DATE: November 1, 1999

FOR FURTHER INFORMATION CONTACT: Kathleen M. O'Day, Associate General Counsel (202/452-3786), or Jonathan D. Stoloff, Counsel (202/452-3269), Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Diane Jenkins (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Regulation K provides that a bank holding company or Edge corporation may control a foreign company that engages in activities usual in connection with the transaction of banking or other financial operations abroad. 12 CFR 211. Section 211.5(d)(10) of Regulation K states: "Permissible activities. The Board has determined that the following activities are usual in connection with the transaction of banking or other financial operations abroad: Data processing".

Section 211.5(d)(10) of Regulation K was adopted in 1979. 12 CFR 211 (1980). It was intended to incorporate into the regulation earlier decisions that had allowed an Edge corporation to engage in somewhat broader data processing activities abroad than were permitted domestically, although the activity was intended to consist predominately of processing financial information. At that time, Regulation Y significantly restricted the ability of a bank holding company to engage in data processing activities in the United States. Since 1979, the provision of Regulation Y that encompasses data processing has been amended several times and in some respects can be considered a broader grant of authority than under Regulation K (for example, with respect to the manufacture of hardware, the provision of software, and related activities). Regulation Y also now specifically authorizes a company to derive up to 30 percent of its revenues from processing non-financial data. 12 CFR 225.28(b)(14).

The Board has never specifically considered the scope of activities permitted by section 211.5(d)(10) of Regulation K. A recent prior notice received under Regulation K raised the issue of the scope of this provision. A bank holding company proposed to acquire a foreign data processing company that engaged in a small amount of data processing and related activities that did not otherwise qualify under the standards set out in Regulation Y. The bank holding company assumed there were no restrictions on its ability to engage in any type of data processing or related activities under Regulation K.

Given the potential for misinterpretation of the data processing provision of Regulation K, the Board believes it would be appropriate to clarify the situation and issue this interpretation.

Prior to the issuance of Regulation K in 1979, the Board approved applications to engage in data processing activities abroad. At the time, Regulation Y authorized only "(i) providing bookkeeping or data processing services for the internal operations of the holding company and its subsidiaries and (ii) storing and processing other banking, financial, or related economic data, such as performing payroll, accounts receivable or payable, or billing services."¹

¹12 CFR 222.4(a)(8) (1971). At the time, the Board also authorized limited incidental activities pursuant to section 222.123 of Regulation Y; however, the Board noted that the authority to engage in data processing was "not intended to

(continued...)

Initially, the Board authorized data processing services abroad subject to the same limitations in Regulation Y. Subsequently, the Board authorized a limited expansion of data processing services abroad beyond that permissible under Regulation Y. The Board approved this expansion with the expectation that, as indicated in the application materials, data processing activities overseas would primarily be financial in nature.

The Board subsequently codified the data processing authority under Regulation K in 1979. This authority was based upon the conditions the Board had customarily imposed on such activities. Accordingly, the scope of data processing under Regulation K continued to be somewhat broader than that permitted under Regulation Y.

As noted above, during this period Regulation Y did not permit any nonfinancial data processing for non-affiliates, other than as an incidental activity on a very limited basis. In the revisions to Regulation Y in the 1980s and 1990s, however, the Board substantially expanded the scope of domestic data processing and related activities, which now include data transmission services, manufacture of certain hardware, provision of software, and the ability to derive up to 30 percent of their data processing revenues from nonfinancial data processing activities. Regulation K does not specifically describe these activities. The Board wishes to clarify that such activities are authorized under Regulation K and that the scope of the data processing activity permissible under Regulation K is coextensive with those activities permitted under section 225.28(b)(14) of Regulation Y, as amended. If a banking organization wishes to engage outside the United States in data processing or related activities beyond those permitted in Regulation Y, it should apply to the Board under Regulation K.

List of Subjects in 12 CFR Part 211

Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth in the preamble, the Board amends Regulation K, 12 CFR part 211 as follows:

PART 211 -- INTERNATIONAL BANKING OPERATIONS (REGULATION K)

1. The authority citation for part 211 continues to read as follows:

Authority: 12 U.S.C. 221 et seq., 1818, 1835a, 1841 et seq., 3101 et seq., and 3901 et seq.

2. Part 211 is amended by adding a new § 211.604 to read as follows:

§ 211.604. Data Processing Activities.

(a) Introduction. As a result of a recent proposal by a bank holding company to engage in data processing activities abroad, the Board has considered the scope of permissible data processing activities under Regulation K (12 CFR part 211). This question has arisen as a result of the fact that § 211.5(d)(10) of Regulation K does not specifically indicate the scope of data processing as a permissible activity abroad.

(b) Scope of Data Processing Activities. (1) Prior to 1979, the Board authorized specific banking organizations to engage in data processing activities abroad with the expectation that such activity would be primarily related to financial activities. When Regulation K was issued in 1979, data processing was included as a permissible activity abroad. Although the regulation did not provide specific guidance on the scope of this authority, the Board has considered such authority to be coextensive with the authority granted in specific cases prior to the issuance of Regulation K, which relied on the fact that most of the

¹(...continued)

permit holding companies to engage in automated data processing activities by developing programs either upon their own initiative or upon request, unless the data involved are financially oriented.” 12 CFR 222.123 (1971).

activity would relate to financial data. Regulation K does not address related activities such as the manufacture of hardware or the provision of software or related or incidental services.

(2) In 1979, when the activity was included in Regulation K for the first time, the data processing authority in Regulation K was somewhat broader than that permissible in the United States under Regulation Y (12 CFR part 225) at that time, as the Regulation K authority permitted limited non-financial data processing. In 1979, Regulation Y authorized only financial data processing activities for third parties, with very limited exceptions. By 1997, however, the scope of data processing activities under Regulation Y was expanded such that bank holding companies are permitted to derive up to 30 percent of their data processing revenues from processing data that is not financial, banking, or economic. Moreover, in other respects, the Regulation Y provision is broader than the data processing provision in Regulation K.

(3) In light of the fact that the permissible scope of data processing activities under Regulation Y is now equal to, and in some respects, broader than the activity originally authorized under Regulation K, the Board believes that § 211.5(d)(10) should be read to encompass all of the activities permissible under § 225.28(b)(14) of Regulation Y. In addition, the limitations of that section would also apply to § 211.5(d)(10).

(c) Applications. If a U.S. banking organization wishes to engage abroad in data processing or data transmission activities beyond those described in Regulation Y, it must apply for the Board's prior consent under § 211.5(d)(20) of Regulation K. In addition, if any investor has commenced activities beyond those permitted under § 225.28(b)(14) of Regulation Y in reliance on Regulation K, it should consult with staff of the Board to determine whether such activities have been properly authorized under Regulation K.

By order of the Board of Governors, October 26, 1999.

Robert deV. Frierson,
Associate Secretary of the Board.

BILLING CODE 6210-01-P