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Legal Developments: Second Quarter, 2012

Order Issued Under Bank Holding Company Act

Order Issued Under Section 3 of the Bank Holding Company Act

Industrial and Commercial Bank of China Limited
Beijing, People's Republic of China

China Investment Corporation
Beijing, People's Republic of China

Central Huijin Investment Ltd.
Beijing, People's Republic of China

Order Approving Acquisition of Shares of a Bank
FRB Order No. 2012–4 (May 9, 2012)

Industrial and Commercial Bank of China Limited ("ICBC"), China Investment Corporation ("CIC"), and Central Huijin Investment Ltd. ("Huijin"), all of Beijing, People's Republic of China (collectively, "Applicants"), have requested the Board's approval to become bank holding companies under section 3 of the Bank Holding Company Act of 1956, as amended ("BHC Act"),[1] by acquiring up to 80 percent of the voting shares of The Bank of East Asia (U.S.A.) National Association ("BEA-USA"), New York, New York.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 21367 (April 15, 2011)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

ICBC, with total assets of approximately $2.5 trillion, is the largest bank in China.[3] The government of China owns approximately 70.7 percent of ICBC's shares through the Ministry of Finance and CIC and Huijin.[4] No other shareholder owns more than 5 percent of ICBC's shares.

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1 12 U.S.C. § 1842.

2 The Bank of East Asia, Limited ("BEA"), Hong Kong SAR, People's Republic of China, and its subsidiary, East Asia Holding Company, Inc. ("EAHC"), New York, New York, both bank holding companies, currently own all the voting shares of BEA-USA and will continue to own 20 percent of the voting shares of the bank after the proposed transaction. BEA and EAHC will continue to be bank holding companies with respect to BEA-USA. BEA has an option to sell the remaining shares of BEA-USA to ICBC, beginning 18 months after consummation of the transaction.

3 Asset and ranking data are as of December 31, 2011.

4 The Ministry of Finance owns approximately 35.3 percent and CIC, indirectly through Huijin, owns approximately 35.4 percent of ICBC's shares, respectively. The National Council for Social Security Fund holds approximately 4 percent of ICBC's shares. Commenters asserted that the government of China must file an application to become a bank holding company due to its control of CIC. The Board has a long-standing posi-

ICBC engages primarily in retail and commercial banking throughout China, including Hong Kong SAR and Macau SAR. Outside China, ICBC operates subsidiary banks in Canada, Indonesia, Kazakhstan, Luxembourg, Malaysia, Thailand, Russia, the United Arab Emirates, and the United Kingdom and operates branches in a number of countries, including Australia, Germany, India, Japan, Luxembourg, Pakistan, Singapore, South Korea, Vietnam, Qatar, and the United Arab Emirates. In the United States, ICBC operates an uninsured state licensed branch in New York City and owns Industrial and Commercial Bank of China Financial Services LLC ("ICBCFS"), New York, New York, a registered broker–dealer that engages in securities brokerage and riskless principal activities.[5] ICBC is a qualifying foreign banking organization and upon consummation of the proposal, it would continue to meet the requirements for a qualifying foreign banking organization under Regulation K.[6]

CIC is an investment vehicle organized by the Chinese government for the purpose of investing its foreign exchange reserves. CIC controls Huijin, a Chinese government-owned investment company organized to invest in Chinese financial institutions.[7] In addition to ICBC, Huijin owns controlling interests in two Chinese banks that operate banking offices in the United States: Bank of China Limited and China Construction Bank Corporation, both also of Beijing.[8] Under the International Banking Act, any foreign bank that operates a branch, agency, or commercial lending company in the United States, and any company that controls the foreign bank, is subject to the BHC Act as if the foreign bank or company were a bank holding company.[9] As a result, CIC and Huijin are subject to the BHC Act as if they were bank holding companies.[10] Through the proposed acquisition of BEA-USA, Applicants would become bank holding companies under the BHC Act.

BEA-USA, with total consolidated assets of approximately $780 million and deposits of approximately $621 million,[11] engages in retail and commercial banking in the United States. BEA-USA operates 13 branches in New York and California.

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tion that, as a legal matter, foreign governments are not "companies" for purposes of the BHC Act and, therefore, are not covered by the act. *See Banca Commerciale Italiana*, 68 *Federal Reserve Bulletin* 423, 425 (1982). However, the Board has determined that foreign government-owned corporations are considered "companies" under the BHC Act. *See* Board letters to Patricia Skigen, Esq., dated August 19, 1988; to H. Rodgin Cohen, Esq., dated August 5, 2008; and to Arthur S. Long, Esq., dated November 26, 2008. The foreign government-owned companies that control ICBC — CIC and Huijin —have filed to become bank holding companies in this case.

5 ICBC received approval to acquire ICBCFS under section 4(c)(8) of the BHC Act. 12 U.S.C. § 1843(c)(8). *See* Federal Reserve Bank of New York letter to Douglas Landy, Esq., dated June 25, 2010.

6 12 CFR 211.23(a) .

7 CIC also owns a noncontrolling interest in Morgan Stanley, New York, New York. *See China Investment Corporation*, 96 *Federal Reserve Bulletin* B31 (2010) ("CIC Order").

8 Bank of China Limited operates two grandfathered insured federal branches in New York City and a limited uninsured federal branch in Los Angeles and has received Board approval to establish an additional uninsured federal branch in Chicago. Bank of China Limited, FRB Order No. 2012-6 (May 9, 2012). Bank of China Limited also controls a wholly owned subsidiary bank, Nanyang Commercial Bank, Limited, Hong Kong SAR, People's Republic of China, that operates an uninsured federal branch in San Francisco. China Construction Bank Corporation operates an uninsured state-licensed branch and a representative office in New York City. Huijin also owns a controlling interest in Agricultural Bank of China Limited, Beijing, People's Republic of China, which operates a representative office in New York City and has received Board approval to establish an uninsured state-licensed branch in New York City. Agricultural Bank of China Limited, FRB Order No. 2012-5 (May 9, 2012).

9 12 U.S.C. § 3106.

10 The Board previously provided certain exemptions to CIC and Huijin under section 4(c)(9) of the BHC Act, which authorizes the Board to grant to foreign companies exemptions from the nonbanking restrictions of the BHC Act when the exemptions would not be substantially at variance with the purposes of the act and would be in the public interest. *See* 12 U.S.C. §1843(c)(9). The exemptions provided to CIC and Huijin do not extend to ICBC, Bank of China Limited, China Construction Bank Corporation, or any other Chinese banking subsidiary of CIC or Huijin that operates a branch or agency in the United States. *See* Board letter dated August 5, 2008, to H. Rodgin Cohen, Esq.

11 Deposit data are as of December 31, 2011.

Competitive Considerations

The Board has considered the competitive effects of the proposal in light of all the facts of the record. Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[12]

BEA-USA operates in New York and in California. As noted, Bank of China Limited maintains insured branches in New York City that compete directly with BEA-USA in the metropolitan New York-New Jersey-Pennsylvania-Connecticut ("Metropolitan New York") banking market.[13] CIC also owns a noncontrolling interest in Morgan Stanley, which competes in that market. The Board has reviewed the competitive effects of the proposal in the Metropolitan New York banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking market, the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by relevant institutions,[14] and the concentration level of market deposits and the increase in that level as measured by the Herfindahl-Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines") as if CIC controlled Morgan Stanley.[15]

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[12] 12 U.S.C. § 1842(c)(1). *See e.g., Emigrant Bancorp, Inc.,*82 *Federal Reserve Bulletin* 555 (1996). One commenter conjectured, without providing any supporting information, that this proposal would result in an anticompetitive effect for the United States banking system if ICBC's primary purpose is to control or strongly influence the U.S. financial system. In addition to the facts cited below, the Board notes that BEA-USA is relatively small and that BEA-USA, the ownership and operation of BEA-USA by Applicants, and the activities of Applicants in the United States are subject to the supervisory, examination, and enforcement authority of the federal banking agencies, including the Board, and to all applicable U.S. laws, including banking and financial laws. In addition, any subsequent bank acquisitions or commencement of additional banking activities by Applicants in the United States are subject to the same standards, including antitrust and financial stability standards, that are applicable to similar proposals by domestic organizations.

[13] The Metropolitan New York banking market includes Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester Counties in New York; Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren Counties and the northern portion of Mercer County in New Jersey; Monroe and Pike Counties in Pennsylvania; and Fairfield County and portions of Litchfield and New Haven Counties in Connecticut.

Applicants do not currently compete with BEA-USA in any other relevant banking market. ICBC and China Construction Bank Corporation operate branch offices in the Metropolitan New York banking market. Bank of China Limited operates a branch in Los Angeles and Bank of China Limited's subsidiary, Nanyang Commercial Bank, Limited, operates a branch in San Francisco. None of these branches is insured by the Federal Deposit Insurance Corporation, and these branches generally cannot accept retail deposits.

[14] Call report, deposit, and market share data are based on data reported by insured depository institutions in the summary of deposits data as of June 30, 2011. The data are also based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See e.g., Midwest Financial Group, Inc.*, , 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See e.g., First Hawaiian, Inc*, 77 *Federal Reserve Bulletin* 52 (1991).

[15] Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that its guidelines for bank mergers or acquisitions, which were issued in 1995, were not changed. Press Release, Department of Justice (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

Consummation of the acquisition would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Metropolitan New York banking market. On consummation, the banking market would remain moderately concentrated as measured by the HHI, which would remain unchanged at 1401. In addition, numerous competitors would remain in the market, which would continue to have 270 insured depository institution competitors upon consummation of this proposal. The combined deposits of the relevant institutions in the Metropolitan New York banking market represent less than 1 percent of market deposits.

The DOJ also has reviewed the matter and has advised the Board that the DOJ does not believe that the acquisition of BEA-USA by CIC, Huijin, and ICBC would be likely to have a significantly adverse effect on competition in any relevant banking market. In addition, the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") have been afforded an opportunity to comment and have not objected to the transaction.

Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval of the proposal.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal as well as the effectiveness of these companies in combatting money-laundering activities.[16] Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act.[17]

The review was conducted in light of all the facts of record, including confidential supervisory and examination information regarding ICBC's U.S. operations and BEA-USA, publicly reported and other financial information, and information provided by Applicants and by public commenters. The Board also has consulted with the China Banking Regulatory Commission ("CBRC"), the agency with primary responsibility for the supervision and regulation of Chinese banking organizations, including ICBC.[18]

In evaluating financial factors, the Board reviews the financial condition of the applicants and the target depository institutions. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance.[19] The Board also evaluates the financial condition of the combined organization and the impact of the proposed funding of the transaction. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

Applicants are large relative to the size of BEA-USA and have substantial financial resources to consummate the proposal and to provide ongoing financial support to BEA-

[16] The discussion of the effectiveness of the anti-money-laundering efforts of Applicants and their home country supervisors is included in the explanation of the Board's assessment of whether Applicants are subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in their home country.

[17] 12 U.S.C. § 1842(c)(3)(A).

[18] The CBRC approved ICBC's application to acquire 80 percent of BEA-USA on March 10, 2011.

[19] Commenters expressed concerns regarding ICBC's capital adequacy.

USA. As discussed more fully below, the CBRC requires Chinese banks to follow the Basel I Capital Accord with certain enhancements from the Basel II Capital Accord.[20] The capital levels of ICBC exceed the minimum levels that would be required under the Basel I Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization seeking to acquire an organization of the size and profile of BEA-USA. The Board notes that ICBC engages in a relatively traditional set of commercial banking activities. ICBC's reported asset quality indicators, including nonperforming loans and reserves for loan losses, are consistent with approval of the proposal. ICBC has implemented enhancements to its internal risk management and internal control framework to monitor and manage its asset quality. ICBC's earnings performance also is consistent with approval.

The proposed transaction is structured as a cash purchase of shares. ICBC will use existing resources to fund the purchase of shares and has sufficient financial resources to effect the proposal. BEA-USA is well capitalized and would remain so on consummation. In light of the size of ICBC in relation to BEA-USA, the transaction would have a minimal impact on ICBC's financial condition. In addition, ICBC would have the financial resources to provide continued financial support to BEA USA as needed.

CIC and Huijin are government-owned investment companies that were capitalized by the government of China to invest the government's foreign exchange reserves. CIC's assets are primarily composed of long-term equity investments and financial assets such as equities and fixed-income securities. Huijin invests solely in the shares of Chinese financial institutions.

In considering the managerial resources of the organizations involved and the proposed combined organization, the Board has reviewed the examination records of ICBC's U.S. operations and BEA-USA, including assessments of their management, risk management systems, and operations. The Board has also considered ICBC's plans for implementing the proposal and for the proposed management of BEA-USA after consummation. As noted, the Board has consulted with the CBRC. In addition, the Board has considered the managerial resources and future prospects of CIC and Huijin in light of the fact that CIC and Huijin are government-owned investment companies. The Board also has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations, including consultations in connection with this proposal, and their records of compliance with applicable banking and anti-money-laundering laws. ICBC plans to gradually integrate BEA-USA into its operations and risk management systems, drawing on experiences from its integration of the Bank of East Asia (Canada), Toronto, Canada, which ICBC acquired in 2010. ICBC has represented that it will devote adequate financial and other resources to address all aspects of the post-acquisition integration process for this proposal.

The Board has considered the future prospects of Applicants and BEA-USA in light of their financial and managerial resources and the proposed business plan for BEA USA. ICBC plans to continue BEA-USA's lending and other activities in the markets and communities served by BEA-USA's branches. ICBC's management has the experience and resources to ensure that BEA-USA operates in a safe and sound manner. The Board has also considered the level of capital that Applicants will have on consummation to support BEA-USA's current operations and any future expansion.

[20] The CBRC also requires all large, internationally active banks, such as ICBC, to have a minimum tier 1 risk-based capital ratio of 9 percent and a total risk-based capital ratio of 11.5 percent. ICBC's capital ratios exceed these levels.

In addition, the Board has assessed whether Applicants have provided adequate assurances to provide information to the Board, as required by the BHC Act. Applicants have committed that, to the extent not prohibited by applicable law, they will make available to the Board such information on their operations and the operations of their affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. Applicants also have committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable them or their affiliates to make such information available to the Board. The Board has consulted with the CBRC about access to information. The CBRC has represented that it would facilitate the Board's access to information, and it has entered into a statement of cooperation with the Board and other U.S. banking regulators with respect to the sharing of supervisory information.[21] Moreover, U.S. bank regulators participated in the November 2009 supervisory college for ICBC hosted by the CBRC.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal, as well as access to information by the Board, are consistent with approval.

Supervision or Regulation on a Consolidated Basis

In evaluating this application, and as required by section 3 of the BHC Act, the Board has considered whether Applicants are subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in their home country.[22] The Board has long held that "the legal systems for supervision and regulation vary from country to country, and comprehensive supervision or regulation on a consolidated basis can be achieved in different ways.[23] In applying this standard, the Board has considered the Basel Core Principles for Effective Banking Supervision ("Basel Core Principles"),[24] which are recognized as the international standard for assessing the quality of bank supervisory systems, including with respect to comprehensive, consolidated supervision ("CCS").[25]

ICBC: For a number of years, authorities in China have continued to enhance the standards of consolidated supervision to which banks in China are subject, including through additional or refined statutory authority, regulations, and guidance; adoption of interna-

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[21] *See* Memorandum of Understanding between the CBRC and the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, June 17, 2004

[22] 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home country supervision under the standards set forth in Regulation K. *See*12 CFR 225.13(a)(4). Regulation K provides that a foreign bank is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii). In assessing this standard under section 211.24 of Regulation K, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is determinative, and other elements may inform the Board's determination.

[23] 57 *Federal Register* 12992, 12995 (April 15, 1992).

[24] Bank for International Settlements, Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision*(October 2006), available at www.bis.org/publ/bcbs129.pdf.

[25] *See*, e.g., 93rd Annual Report of the Board of Governors of the Federal Reserve System (2006), at 76 ("The Core Principles, developed by the Basel Committee in 1997, have become the de facto international standard for sound prudential regulation and supervision of banks.").

tional standards and best practices; enhancements to the supervisory system arising out of supervisory experiences; upgrades to the CBRC in the areas of organization, technological capacity, staffing, and training; and increased coordination between the CBRC and other financial supervisory authorities in China.[26]

The Board has reviewed the record in this case and has determined that the enhancements to standards of bank supervision in China warrant a finding that ICBC is subject to CCS by its home country supervisors. In making this determination, the Board has considered that the CBRC is the principal supervisory authority of ICBC, including its foreign subsidiaries and affiliates, for all matters other than money laundering.[27] The CBRC has primary responsibility and authority for regulating the establishment and activities and the expansion and dissolution of banking institutions, both domestically in China and abroad. The CBRC monitors Chinese banks' consolidated financial condition, compliance with laws and regulations, and internal controls through a combination of on-site examinations, off-site surveillance through the review of required regulatory reports and external audit reports, and interaction with senior management.

Since its establishment in 2003, the CBRC has augmented its supervisory structure, staffing, and internal operations; enhanced its existing supervisory programs; and developed new policies and procedures to create a framework for the consolidated supervision of the largest banks in China. The CBRC also has strengthened its supervisory regime related to accounting requirements and standards for loan classification, internal controls, risk management, and capital adequacy, and it has developed and implemented a risk focused supervisory framework.

The CBRC has issued additional guidance in various supervisory areas, including stricter prudential requirements for capital, loan-loss allowance coverage, executive compensation, banks' equity investments in insurance companies, and enhanced risk-management requirements for operations, liquidity, derivatives, reputational, and market risk. The guidance is designed to make supervision more risk focused and to strengthen practices consistent with the Basel Core Principles.

The CBRC has its head office in Beijing and branch offices in other provinces. The head office sets policy and directs supervisory activities for the largest banks in China, including ICBC. Although some day-to-day supervisory activities are undertaken by the CBRC's branch offices, the head office directs these efforts and ensures consistency of approach through training programs and frequent communication with the branches.

The CBRC head office prepares annual examination plans for the largest Chinese banks, including ICBC. The plans encompass both on- and off-site activities. Applicable Chinese law and banking regulation do not require that on-site examinations be conducted at any specified interval. In practice, the CBRC performs on-site examinations of its largest banks frequently, although off-site surveillance is continuous. On-site examinations are scheduled

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[26] The Board has previously approved applications from Chinese banks, including ICBC, to establish U.S. branches under a lower standard than the CCS standard. *See China Merchants Bank Co*., Limited, 94 *Federal Reserve Bulletin* C24 (2008); *Industrial and Commercial Bank of China Limited,*94 *Federal Reserve Bulletin* C114 (2008); *China Construction Bank Corporation*, 95 *Federal Reserve Bulletin* B54 (2009); and *Bank of Communications Co., Ltd.*(order dated April 8, 2011), 97 *Federal Reserve Bulletin* 49 (2nd Quar. 2011). In each case, the Board made a determination that the bank's home country supervisors were actively working to establish arrangements for the consolidated supervision of the bank. 12 U.S.C.§ 3105(d)(6).

[27] Before April 2003, the People's Bank of China ("PBOC") acted as both China's central bank and primary banking supervisor, including with respect to anti-money-laundering matters. In April 2003, the CBRC was established as the primary banking supervisor and assumed the majority of the PBOC's bank regulatory functions. The PBOC maintained its roles as China's central bank and primary supervisor for anti-money-laundering matters.

based on the CBRC's continuous off-site monitoring tools, analysis of the institution's periodic filings, results of the institution's internal stress testing, and the institution's overall risk profile and activities. On-site examinations by the CBRC typically cover, among other things, the major areas of operation: corporate governance and senior management responsibilities; capital adequacy; asset structure and asset quality (including structure and quality of loans); off-balance-sheet activities; earnings; liquidity; liability structure and funding sources; expansionary plans; internal controls (including accounting control and administrative systems); legal compliance; accounting supervision and internal auditing; and any other areas deemed necessary by the CBRC. The PBOC examines ICBC for compliance with anti-money-laundering laws and requirements.

Examination ratings are based on the CAMELS rating model and emphasize credit-risk management, the quality of the bank's loan portfolio, internal controls, liability structure, capital adequacy, liquidity, and the adequacy of reserves. The areas of emphasis reflect the fact that the largest Chinese banks, including ICBC, engage in traditional commercial banking and are not materially engaged in complex derivatives or other activities. Ratings are derived from off-site quantitative and qualitative analysis and on site risk reviews. Examination findings and areas of concern are discussed with senior management of the bank, and corrective actions taken by the bank are monitored by the CBRC. In 2009, the CBRC developed an information technology system to assist in on-site examinations by improving data analysis and regulatory information sharing.

Chinese banks are required to report key regulatory indicators to the CBRC periodically on general schedules. All Chinese banks are required to submit monthly, quarterly, semiannual, or annual reports relating to asset quality, lending concentrations, capital adequacy, earnings, liquidity, affiliate transactions, off-balance-sheet exposures, internal controls, and ownership and control.

Banks must report to the CBRC their unconsolidated capital adequacy ratios quarterly and their consolidated ratios semiannually. China's bank capital rules are based on the Basel I Capital Accord, while taking into account certain aspects of the Basel II Capital Accord. In addition, the CBRC, as a member of the Basel Committee on Banking Supervision, has supported the Basel III Capital Accord framework and implementation time frame. The CBRC can take enforcement actions when capital ratios or other financial indicators fall below specified levels. These actions may include issuing supervisory notices, requiring the bank to submit and implement an acceptable capital replenishment plan, restricting asset growth, requiring reduction of higher risk assets, restricting the purchase of fixed assets, and restricting dividends and other forms of distributions. Significantly undercapitalized banks may be required to make changes in senior management or restructure their operations.

ICBC, like other large Chinese banks, is required to be audited annually by an external accounting firm that meets the standards of Chinese authorities, including the Ministry of Finance, PBOC, and CBRC, and the audit results are shared with the CBRC and PBOC. The scope of the required audit includes a review of ICBC's financial statements, asset quality, capital adequacy, internal controls, and compliance with applicable laws. At its discretion, the CBRC may order a special audit at any time. In addition, in connection with its listing on the Shanghai and Hong Kong stock exchanges, ICBC is required to report financial statements under both International Financial Reporting Standards ("IFRS") and Chi-

nese Accounting Standards ("CAS").[28] These financial statements are audited by an international accounting firm under applicable IFRS auditing standards.[29]

ICBC conducts internal audits of its offices and operations, including its overseas operations, generally on an annual schedule. The internal audit results are shared with the CBRC, the PBOC, and ICBC's external auditors.

Chinese law imposes various prudential limitations on banks, including limits on transactions with affiliates and on large exposures.[30] Related-party transactions include credit extensions, asset transfers, and the provision of any type of services. Chinese banks are required to adopt appropriate policies and procedures to manage related-party transactions and the board of directors must appoint a committee to supervise such transactions and relationships. Applicable laws require all related-party transactions to be conducted on an arm's-length basis.

Chinese banking law also establishes single-borrower credit limits. Loans to a single borrower may not exceed 10 percent of the bank's total regulatory capital, the aggregate lending to a group of related companies may not exceed 15 percent of the bank's total regulatory capital, and the aggregate amount of credit granted to all related parties may not exceed 50 percent of the bank's total regulatory capital. The status of related-party transactions must be reported to the CBRC quarterly.

In addition, the CBRC has certain operational limitations for commercial banks in China relating to matters such as liquidity and foreign currency exposure. In 2009, the CBRC issued new rules concerning liquidity management and corporate governance. Compliance with these limits is monitored by the CBRC through periodic reports and reviewed during on-site examinations.

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[28] Based primarily on newspaper reports, several commenters criticized the reliability and accuracy of Chinese accounting methods. These newspaper articles focus on Chinese firms that are listed on U.S. exchanges through a process called "reverse mergers" whereby the Chinese firm acquires a listed U.S. firm and thereby becomes a listed firm. These articles allege that the listed Chinese firms have reported unreliable financial statements audited by Chinese auditing firms. China's largest banks, such as ICBC, use the "Big Four" accounting firms. There is no evidence that Chinese accounting methods or practices at the large Chinese banks, such as ICBC, are unreliable. The International Monetary Fund's ("IMF") financial system stability assessment report and the accompanying detailed assessment report of observance with the Basel Core Principles, discussed in detail below, both found that "[s]ince 2005, [CAS] have substantially converged with [IFRS] and International Standards on Auditing, respectively." IMF, People's Republic of China, Financial System Stability Assessment at 57 (June 24, 2011); IMF and World Bank, People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision at 9 (April 2012). In addition, the World Bank Report on Observance of Standards and Codes determined that CAS and IFRS are basically compatible and that the Chinese authorities and the International Accounting Standards Board have established a continuing convergence mechanism designed to achieve full convergence in 2012. World Bank, Report on Observance of Standards and Codes (ROSC) Accounting and Auditing – People's Republic of China at Executive Summary and at 12 (October 2009), available at www.worldbank.org/ifa/rosc_aa_chn.pdf.

[29] The commenters also asserted that the "Big Four" accounting firms in the United States, including the parent company of ICBC's auditor, Ernst & Young, were substantially fined for departing from U.S. generally accepted accounting principles ("U.S. GAAP"). The commenters argued, without providing any supporting data, that any operational deficiencies in the United States by Ernst & Young should be imputed to ICBC's auditor and financial statements, and they requested that the Board require ICBC to submit financial data audited by a fully independent auditing firm that has not been the subject of substantial criticisms by the Public Company Oversight Accounting Board ("PCAOB") or other regulatory body. The Board notes that the PCAOB did sanction Ernst & Young for failing to properly evaluate a specific company's sales returns reserves, which the PCAOB found were both a material component of that company's financial statements and not in conformity with U.S. GAAP. The PCAOB did not find that this was a widespread practice by Ernst & Young or indicative of behavior by any of its foreign accounting operations.

[30] The CBRC definition of an "affiliate" or a "related party" of a bank includes subsidiaries, associates/joint ventures, shareholders holding 5 percent or more of the bank's shares, and key management personnel (and immediate relatives) and those individuals' other business affiliations.

The CBRC is authorized to require any bank to provide information and to impose sanctions for failure to comply with such requests. If the CBRC determines that a bank is not in compliance with banking regulations and prudential standards, it may impose various sanctions depending upon the severity of the violation. The CBRC may suspend approval of new products or new offices, suspend part of the bank's operations, impose monetary penalties, and in more serious cases, replace management of the bank. The CBRC also has authority to impose administrative penalties, including warnings and fines for violations of applicable laws and rules. Criminal violations are transferred to the judicial authorities for investigation and prosecution.

ICBC is subject to supervision by several other financial regulators, including the State Administration for Foreign Exchange, China Securities Regulatory Commission ("CSRC"), and China Insurance Regulatory Commission ("CIRC"). These agencies receive periodic financial and operations reports, and they may conduct on-site examinations and impose additional reporting requirements. Chinese financial supervisors coordinate supervision and share supervisory information about Chinese financial institutions as appropriate.

Authorities in China also have increased cooperation with international groups and supervisory authorities in other countries regarding bank supervision. In particular, the CBRC has established mechanisms to cooperate with supervisory authorities in at least 25 other countries for the supervision of cross-border banking. In addition, the PBOC and CBRC officially joined the Basel Committee on Banking Supervision on behalf of China and since their accession, have actively participated in the revision of the Basel II Capital Accord, in the formulation of the Basel III Capital Accord, and in other working groups. China also is active in the ongoing work of the Financial Stability Board. In addition, the PBOC, CBRC, other financial supervisory agencies, and other agencies in China have taken joint measures to maintain financial stability.[31] Moreover, authorities in the United States and China that are responsible for the oversight of auditing services for public companies are engaged in continuing discussions with respect to enhancing cross-border cooperation, and the Board looks forward to timely negotiation of an agreement relating to cooperative actions by these authorities.

The IMF recently concluded a financial system stability assessment of China ("FSSA"), including an assessment of China's compliance with the Basel Core Principles.[32] The FSSA determined that China's overall regulatory and supervisory framework adheres to international standards.[33] The FSSA found that "[t]he laws, rules and guidance that CBRC operates under generally establish a benchmark of prudential standards that is of high quality and was drawn extensively from international standards and the [Basel Core Principles]

[31] China has established a system of preliminary indicators for monitoring financial stability, developed methodology and operational frameworks for monitoring financial risks, and published an annual China Financial Stability Report since 2005.

[32] The assessment reflects the regulatory and supervisory framework in place as of June 24, 2011. IMF, People's Republic of China, Financial System Stability Assessment (June 24, 2011), available at www.imf.org/external/pubs/ft/scr/2011/cr11321.pdf. The FSSA covers an evaluation of three components: (1) the source, probability, and potential impact of the main risks to macrofinancial stability in the near term; (2) the country's financial stability policy framework; and (3) the authorities' capacity to manage and resolve a financial crisis should the risks materialize. The FSSA is a key input to IMF surveillance. The FSSA is a forward-looking exercise, unlike the Board's assessment of the comprehensive, consolidated supervision of an applicant.

The IMF and World Bank separately publish a detailed assessment of the country's observance of the Basel Core Principles that discusses the country's adherence to the Basel Core Principles in much greater detail. *See* IMF and World Bank, People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision (April 2012) ("DAR"), available at www.imf.org/external/pubs/ft/scr/2012/cr1278.pdf.

[33] FSSA at 39.

themselves."[34] The FSSA additionally noted that "[c]onsolidated supervision of banks and their direct subsidiaries and branches on the mainland or offshore is of high quality."[35] With respect to the CBRC, the FSSA found as follows:All the banks, auditors, ratings agencies and other market participants that the mission interacted with were unhesitating in their regard for the role that the CBRC has played in driving professionalism, risk management and international recognition of the Chinese banking system. In particular, the mission observed that [the CBRC] has been the key driving force in driving improvements in risk management, corporate governance and internal control and disclosure in Chinese banks.[36]

Based on its review, the FSSA rated China's overall compliance with the Basel Core Principles as satisfactory. In giving this overall rating, the FSSA noted several areas that merited improvement and made specific recommendations for continued advances in supervision and regulation.[37] The Chinese authorities noted that some of the recommendations of the FSSA are already being implemented, and others will be taken into account in the CBRC's plans to improve supervisory effectiveness.[38]

The Board has taken into account the FSSA's views that China is, overall, in satisfactory compliance with the Basel Core Principles and that there are areas for further improvement. The Board has also taken into account the responses by Chinese authorities to the FSSA report and the progress made by Chinese authorities to address the issues raised in that report.

Based on all the facts of record, including its review of the supervisory framework implemented by the CBRC for ICBC, the Board has determined that ICBC is subject to comprehensive supervision on a consolidated basis by its home country supervisors. This determination is specific to ICBC.[39] By statute, the Board must review this determination in processing future applications involving ICBC and also must make a determination of comprehensive, consolidated supervision in other applications involving different applicants from China.

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[34] FSSA at 59; DAR at 12.

[35] FSSA at 64; DAR at 16.

[36] DAR at 7.

[37] FSSA at 39-42 and 69-71; DAR at 99-101. China received a materially noncompliant rating in two of the thirty areas assessed by the FSSA. Specifically, the FSSA rated China as materially noncompliant for the Basel Core Principles on independence, accountability and transparency, and risk management process. DAR at 17 and 19. The FSSA stated that "budgeting arrangements, external headcount approval requirements and [the authority for the State Council to override] rules and decisions compromise CBRC effectiveness and could affect operational independence." FSSA at 64; DAR at 17. The FSSA viewed the guidance that the CBRC has issued in risk management to be consistent with international standards but found that banking institutions' compliance with CBRC guidance was lacking (although recognizing that the guidance on some risks "is recent and so could not be expected to be complied with as yet"). FSSA at 61; *see also* DAR at 53. The assessment team also believed that Chinese banks in general do not yet have robust enterprise-wide risk-management systems. FSSA at 66; DAR at 53-54. For comparison, the United Kingdom and Germany received three and two materially noncompliant ratings, respectively, and the United States received one materially noncompliant rating, in their recent financial system stability assessments.

[38] FSSA at 71-73; DAR at 101-103. Chinese authorities responded that, by law in China, the State Council of the People's Republic of China ("State Council") may alter or annul a rule or guideline of the CBRC only if the rule or guideline violates applicable law and that the State Council has never altered or annulled the rules and guidelines issued by the CBRC. Chinese authorities also noted that the State Council has supported the CBRC in undertaking banking regulation and supervision and that the CBRC has upgraded the number and quality of its staff over time. FSSA at 71-72; DAR at 102. In addition, Chinese authorities noted the significant improvements China has made in supervision as well as the relative simplicity of the Chinese banking system. FSSA at 72; DAR at 102-3. Despite the difference in views about the degree to which Chinese banks' risk management is commensurate with the current risk environment, Chinese authorities concurred with the FSSA that "continued improvements in banks' risk management are needed, as financial reform deepens and liberalization creates greater interconnectedness and complexities in the Chinese system." FSSA at 72; DAR at 103.

[39] *See* 58 *Federal Register* 6348, 6349 (January 12, 1993).

As part of the Board's supervisory program for foreign banks, the Board actively monitors changes to the supervisory systems in the home countries of foreign banks, as well as differences that may exist in the supervisory framework as it is applied by a home country to institutions of different types or sizes, and would continue to do so with respect to China. The Board also intends to further its relationship with Chinese supervisory authorities and continue to develop its understanding of Chinese banking matters.

CIC and Huijin: In connection with a prior application, the Board determined that CIC was subject to an appropriate type and level of CCS by its home country authorities, given its unique nature and structure.[40] There have been no material changes in the manner in which CIC is supervised or regulated by its home country authorities since the previous determination. Based on this and all the facts of record, the Board has determined that CIC continues to be subject to CCS.

The Board has not made a CCS determination with respect to Huijin. In the CIC Order, the Board noted that the system of comprehensive supervision or regulation may vary, depending on the nature of the acquiring company and the proposed investment.[41] The Board believes that, like CIC, Huijin is subject to an appropriate type and level of comprehensive regulation on a consolidated basis, given its unique nature and structure.

Huijin is a joint stock company established to invest in Chinese financial institutions and is wholly owned by the government of China through CIC.[42] Huijin's articles of association do not permit it to conduct any other commercial activities or interfere in the day-to-day business of the financial institutions it controls. Huijin is governed by a five-member board of directors and a three-member board of supervisors. As is the case with CIC, the members are appointed by the State Council.

Oversight of the operations of CIC and Huijin by the State Council and other agencies of the Chinese government allows for review of the worldwide investment strategy and portfolio of CIC and of Huijin's role as a major shareholder of Chinese financial institutions. On this basis, appropriate authorities in China would appear to have full access to and oversight of Huijin and its activities.

The Board also has taken into account that CIC and Huijin are not operating entities and that CIC's and Huijin's proposed investment in BEA-USA would be indirect and through a substantial foreign bank supervised and regulated by the CBRC. CIC and Huijin have represented that they do not directly engage in the business of banking and do not intervene in the day-to-day business operations of the Chinese financial institutions in which Huijin invests. CIC and Huijin have further represented that they were not involved in the decision by ICBC to enter into the proposed acquisition of BEA-USA or in the negotiation of the terms of the investment, and they conducted no additional due diligence on BEA-USA.

Based on all the facts of record, the Board has determined that Huijin is subject to comprehensive supervision on a consolidated basis by its appropriate home country authorities for purposes of this application.

Efforts to Ensure Against Money Laundering: The government of China has adopted a statutory regime regarding anti-money laundering ("AML") and suspicious activity reporting and has criminalized money-laundering activities and other financial crimes. The

[40] CIC Order.

[41] *Id*. at B33.

[42] Both CIC and Huijin have stated that there is a strict firewall between the two companies regarding their investment activities.

PBOC supervises and examines Chinese banks with respect to AML and coordinates efforts among other agencies.[43] The PBOC collects, monitors, analyzes, and disseminates suspicious transaction reports and large-value transaction reports.

The PBOC over time has increased requirements for its supervised institutions regarding AML compliance. The PBOC issued rules providing clarification of, or further strengthening the implementation of, operating procedures, customer due diligence and risk classification, recordkeeping, AML monitoring and reporting suspicious transactions, and the international remittance agency business. The PBOC also requires the designation of a chief AML compliance officer as a high-level manager to ensure provision of adequate AML resources and timely flow of information to employees responsible for AML compliance throughout the institution. In addition, the PBOC requires the risk rating of customers and the filing of reports on suspicious activity and certain other transactions. Banks are required to (1) establish a customer identification system, in accordance with applicable rules jointly promulgated by the PBOC and three functional financial services regulators;[44] (2) record the identities of customers and information relating to each transaction; and (3) retain retail transaction documents and books. Supervised institutions have been encouraged to move beyond a prescriptive-criteria basis to include a more expansive and risk-based approach to suspicious activity detection and reporting.

China participates in international fora that address the prevention of money laundering and terrorist financing. China became a member of the Financial Action Task Force ("FATF") in June 2007. China also is a member of the Eurasian Group ("EAG"), a FATF-style regional body that supports member countries in their efforts to create and maintain an appropriate legal and institutional framework to combat money laundering and terrorist financing in line with FATF standards.[45] EAG evaluates its member states' AML and counter-terrorist-financing ("CFT") systems for compliance with international standards.[46] In the most recent mutual evaluation report of China, dated February 17, 2012, the FATF considered China to be fully or largely compliant with almost all of the FATF recommendations and held that China has effective AML and CFT systems in force. As a result, the FATF has removed China from its regular follow-up process.[47]

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[43] As noted above, Huijin and CIC are investment vehicles that make investments in companies and debt securities and are directly overseen by a variety of government agencies in China, including the National Audit Office and the State Council.

[44] Those regulators are the CBRC, CSRC, and CIRC.

[45] China also is a party to other agreements that address money laundering or terrorist financing, including the U.N. Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the U.N. Convention Against Transnational Organized Crime, the U.N. Convention Against Corruption, and the U.N. International Convention for the Suppression of the Financing of Terrorism.

[46] A commenter alleged that Chinese authorities have failed in the past to supervise Chinese banks operating in Macau SAR with respect to AML matters and referred to sanctions imposed on a Macau bank by the U.S. Department of the Treasury in 2007. The commenter also alleges that money-laundering risks exist in China because the follow-up reports to the mutual evaluation of China's progress in implementing recommendations of the FATF, undertaken by the EAG, rated China to be non-compliant or partially compliant on certain FATF recommendations. On this basis, the commenter requests that the Board delay any action on these applications until China is in full compliance with all recommendations of the FATF. This comment was submitted before the issuance of the most recent evaluation report on China, which found China to be largely compliant with FATF's AML requirements.

[47] FATF, China Mutual Evaluation 8th Follow-up Report, Anti-Money Laundering and Combating the Financing of Terrorism (February 17, 2012), available at www.fatf gafi.org/dataoecd/5/34/49847246.pdf. The report noted that China has made significant progress to address the remaining deficiencies and has "reached a satisfactory level of compliance with all six core Recommendations and eight of the [ten] key Recommendations." *Id*at para. 41. In one of the key Recommendations where China has not attained a satisfactory level of compliance (implementation of international instruments related to terrorist financing), China has substantially addressed part of the deficiency and continues to make progress. With respect to the other key Recommendation (freezing of terrorist-related assets), China has made significant progress since June 2011 to improve its implementation. In particular, China has implemented legislation establishing a legislative framework and

Moreover, the Chinese government issues rules on implementing United Nations sanctions and may take enforcement actions to ensure compliance with those sanctions. The PBOC is also responsible for disseminating information to the banking industry regarding U.N. sanctions and supervising the enforcement of those sanctions.

The PBOC supervises and regulates compliance by ICBC with AML requirements through a combination of on-site examinations and off-site monitoring. On site examinations focus on ICBC's compliance with AML laws and rules. The PBOC's headquarters conducts investigations of a financial institution's head office, and the PBOC's branches conduct investigations of the institution's branch offices in the same locality as the PBOC branches. During the course of an on-site examination, the PBOC will generally review account information, transaction records, and any other relevant materials. Upon completion of an investigation, if AML deficiencies are identified, the PBOC may issue sanctions and propose that remedial measures be imposed by appropriate government agencies or regulators against the financial institution and can refer any suspected money laundering to law enforcement authorities for further investigation. The PBOC performs off site monitoring through periodic reports and has established requirements for Chinese banks to submit such reports. In order to improve off-site supervision and monitoring of large-amount cash transactions, the PBOC developed an interactive information technology system for AML/CFT supervision that has been in operation since October 2010 in both the PBOC and financial institutions.

ICBC has policies and procedures to comply with Chinese laws and rules regarding AML. ICBC states that it has implemented measures consistent with the institution-specific recommendations of the FATF and that it has put in place policies, procedures, and controls to ensure ongoing compliance with all statutory and regulatory requirements, including designating AML compliance personnel and conducting routine employee training at all ICBC branches. ICBC's compliance with AML requirements is monitored by the PBOC and by ICBC's internal and external auditors. On consummation, BEA-USA's operations will be integrated into ICBC's global regulatory compliance system, which includes compliance with U.S. law.

Based on all the facts of record, the Board has determined that the AML efforts by Applicants and their home country supervisors are consistent with approval.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[48] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[49]

administrative authority for enforcement and it has responded to foreign requests to freeze assets. The FATF was of the view that China should enact additional guidance to improve implementation, and Chinese authorities are currently drafting rules to do so. *Id* . at paras. 150-52 and 157-59.

[48] 12 U.S.C.§ 2901 et seq.; 12 U.S.C. § 1842(c)(2).

[49] 12 U.S.C.§ 2903.

The Board has considered all the facts of record, including evaluations of the CRA performance record of BEA-USA, data reported by BEA-USA under the Home Mortgage Disclosure Act ("HMDA"),[50] as well as other information provided by ICBC, confidential supervisory information, and public comments received on the proposal. Several commenters requested that the Board bar ICBC from expanding BEA-USA's existing branch network for a three- to five-year period and require ICBC to develop a comprehensive CRA plan to ensure that BEA-USA effectively serves all minority and underserved communities. Several commenters also requested that the Board require ICBC to submit a CRA plan or enter into commitments that will ensure BEA-USA provides service to all underserved and minority communities in its service areas.[51] In addition, several commenters raised concerns that BEA-USA might exclude African Americans, Hispanics, and Southeast Asians in the provision of its products and services. Other commenters alleged that BEA-USA excludes African Americans and Hispanics with respect to its home mortgage lending.

A. CRA Performance Evaluations

As provided in the CRA, the Board has considered the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance record of the relevant insured depository institutions, including BEA-USA. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[52] As previously noted, CIC and Huijin control Bank of China Limited, which has two grandfathered federal branches whose deposits are insured by the FDIC. The branches received a "satisfactory" rating at their most recent CRA performance evaluation by the FDIC, as of August 18, 2008.[53] BEA-USA received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of January 4, 2010.[54] BEA-USA received an "outstanding" rating under each of the lending and community development tests.[55] Examiners noted that a substantial majority of BEA-USA's loans were originated in its assessment areas, that the distribution of its loans reflects excellent penetration among businesses of different sizes in the assessment areas, and that the geographic distribution of loans reflects excellent dispersion throughout the assessment areas. Examiners also reported that BEA-USA's community development performance demonstrates excellent responsiveness to the needs of the assessment areas through loans, investments, and services.[56] ICBC has represented that it initially intends to maintain BEA-USA's existing business and will be prepared to expand offerings for BEA-USA's customers in the future.

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[50] 12 U.S.C. §§ 2801-2810.

[51] The Board consistently has stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization and that the enforceability of any such third-party pledges, initiatives, and agreements are matters outside the CRA. *See Bank of America Corporation* , 90 *Federal Reserve Bulletin* 217, 232-33 (2004).

[52] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

[53] ICBC's uninsured branch and the uninsured branches of other Chinese banks controlled by CIC and Huijin are not subject to the CRA.

[54] The evaluation period was January 1, 2006, to January 4, 2010.

[55] BEA-USA was evaluated under the intermediate small bank performance criteria, which only include a lending test and a community development test.

[56] For example, in the New York assessment area, BEA-USA made 15 community development loans totaling $18.6 million, including 5 loans for affordable housing, and 22 qualified investments totaling approximately $2.6 million, which consisted of $2.5 million in Fannie Mae investments and $100,000 in charitable donations. BEA-USA's staff also provided community development services during the review period, including financial literacy and homeownership seminars.

B. HMDA and Compliance with Fair Lending and Other Consumer Protection Laws

The Board has considered the HMDA data for 2009, 2010, and 2011 reported by BEA-USA in its combined assessment areas and the fair lending record of BEA-USA in light of public comments received on the proposal.[57] Several commenters alleged, based on HMDA data reported in 2009, that BEA-USA had engaged in disparate treatment of minority individuals in its one- to four-family home mortgage lending. Specifically, the commenters asserted that BEA-USA excludes African Americans and Hispanics in home purchase and refinance lending and that it discriminates against Asian Americans with incomes below 100 percent of the median income of the metropolitan statistical area in its refinance lending.

BEA-USA is predominantly a commercial lender and makes a limited number of one- to four-family mortgage loans. Its one- to four-family mortgage lending largely results from walk-in traffic at the bank's branches, most of which are in Asian American neighborhoods. Throughout its combined assessment areas, BEA-USA made 32 one- to four family mortgage loans in 2009, 26 in 2010, and 20 in 2011. During that same time period, BEA-USA received only one application for a one- to four-family mortgage loan from an African American and four applications from Hispanics. The HMDA data also indicate that BEA-USA made a material percentage of its one- to four-family mortgage loans to LMI borrowers (those with incomes of less than 80 percent of the area median income) in the bank's assessment areas. Between 2009 and 2011, 21 percent of BEA-USA's mortgage refinance loans and 35 percent of BEA-USA's conventional home purchase loans were made to LMI borrowers.[58]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not BEA-USA is excluding or imposing higher costs on any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[59] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates should conduct mortgage lending operations that are free of abusive lending practices and in compliance with all consumer protection laws.

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[57] BEA-USA's combined CRA assessment areas consist of Kings, Manhattan, and Queens Counties, which are in the New York-New Jersey-Long Island, NY-NJ-PA Metropolitan Statistical Area; the entire San Francisco-San Mateo-Redwood City, California Metropolitan Division and the Alameda County portion of the Oakland-Fremont-Hayward, CA Metropolitan Division, both of which are part of the greater San Francisco-Oakland-Fremont, California Metropolitan Statistical Area; and the entire Los Angeles-Long Beach-Glendale Metropolitan Division.

[58] More than one-half of BEA-USA's branches are in low- to moderate-income communities.

[59] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applications than other institutions attract and do not provide for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher cost credit) are not available from HMDA data.

Because of the limitations of HMDA data, the Board has considered these data and taken into account other information, including examination reports that provide evaluations of compliance by BEA-USA with consumer protection laws. The Board also has consulted with the OCC, BEA-USA's primary federal supervisor.

The record of this application, including confidential supervisory information, indicates that BEA-USA has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations. In BEA-USA's most recent CRA Performance Evaluation, examiners noted "no evidence of discriminatory or other illegal credit practices...."[60] In addition, BEA-USA's loan policies include information on prohibited discriminatory lending practices. BEA-USA's advertising and marketing policy contains specific guidance on practices that employees should avoid that would tend to discourage loan applicants on a prohibited basis. Additionally, the bank's employees involved in lending are required to participate in annual training that includes compliance with fair lending laws and other applicable laws and regulations. Moreover, ICBC has stated it intends to conduct a full review of BEA-USA's risk-management program for fair lending compliance after consummation of the proposal.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered all the facts of record, including evaluations of the CRA performance record of BEA-USA and other relevant insured depository institutions, information provided by ICBC and BEA-USA, comments received on the proposal, and confidential supervisory information. Based on a review of the entire record, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval.

Financial Stability

The Dodd-Frank Wall Street Reform and Consumer Protection Act amended section 3 of the BHC Act to require the Board also to consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system." [61]

Financial Stability Standard

In reviewing applications and notices under sections 3 and 4 of the BHC Act, the Board expects that it will generally find a significant adverse effect if the failure of the resulting firm, or its inability to conduct regular-course-of-business transactions, would likely impair financial intermediation or financial market functioning so as to inflict material damage on the broader economy. This kind of damage could occur in a number of ways, including seriously compromising the ability of other financial institutions to conduct regular course-of-business transactions or seriously disrupting the provision of credit or other financial services.

On the other hand, certain types of transactions likely would have only a de minimis impact on an institution's systemic footprint and, therefore, are not likely to raise concerns about financial stability. For example, a proposal that involves an acquisition of less than

[60] The Bank of East Asia, USA, National Association Community Reinvestment Act Performance Evaluation, January 4, 2010, at 5. Moreover, the CRA Performance Evaluation noted that BEA-USA's assessment areas do not arbitrarily exclude LMI areas. *Id* . at 4.

[61] Section 604(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

$2 billion in assets, results in a firm with less than $25 billion in total assets, or represents a corporate reorganization may be presumed not to raise financial stability concerns absent evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factor.

Analysis of the Financial Stability Impact of this Proposal

In this case, the proposal would have a de minimis impact on Applicants' systemic footprint because BEA-USA has consolidated assets of approximately $780 million. The acquisition of BEA-USA would not meaningfully increase ICBC's size. The proposal also would not add any significant complexity to the overall operations of ICBC as BEA USA is a traditional commercial bank that focuses largely on commercial lending. As noted above, ICBC operates subsidiary banks worldwide, including in the United Kingdom and Canada. While BEA-USA would add to ICBC's cross-border activities, BEA-USA operates only in the United States and ICBC already engages in banking and financial services in the United States through its New York branch, which has assets of $1.5 billion, and its subsidiary U.S. broker-dealer.[62] Moreover, neither ICBC nor BEA-USA is a major provider of any product or service that the Board believes has the potential to be critical to the functioning of the U.S. financial system. Finally, the extent of BEA-USA's interconnectedness with the U.S. financial system and its contribution to the complexity of the U.S. financial system are both sufficiently small to be considered de minimis.

Based on these and all the other facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has approved the application by Applicants to acquire up to 80 percent of the voting shares of BEA-USA pursuant to section 3(a)(1) of the BHC Act. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.[63] The Board conditions its decision on Applicants providing to the Board adequate information on their operations and activities as well as those of their affiliates to determine and enforce compliance by Applicants or their affiliates with applicable federal statutes. Should any restrictions on access to information on the operations or activities of Applicants or any of their affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Applicants or their affiliates with applicable federal statutes, the Board may require termination or divestiture of any of Applicants' or their affiliates' direct or indirect activities in the United States.

The Board's approval is specifically conditioned on compliance by Applicants with the conditions imposed in this order and the commitments made to the Board in connection with the application.[64] For purposes of this action, the conditions and commitments are deemed

[62] ICBC has not been designated a global systemically important bank by the Basel Committee on Banking Supervision.

[63] Commenters also requested that the Board extend the comment period on the proposal. The Board already extended the comment period with respect to certain matters for ten days, allowing the commenters more than thirty-six days to submit comments. In the Board's view, the commenters have had ample opportunity to submit their views and, in fact, have provided written submissions that the Board has considered in acting on the proposal. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that further delay in considering the proposal, extension of the comment period, or denial of the proposal on the grounds discussed above, is not warranted.

[64] Commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervi-

to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.[65]

The proposal may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective May 9, 2012.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Orders Issued Under International Banking Act

Agricultural Bank of China Limited
Beijing, People's Republic of China

Order Approving Establishment of a Branch
FRB Order No. 2012–5 (May 9, 2012)

Agricultural Bank of China Limited ("ABC"), Beijing, People's Republic of China, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA[1] to establish a state-licensed branch in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*The New York Post*, October 4, 2010). The time for filing comments has expired, and the Board has considered all comments received.

sory authority for the bank to be acquired makes a timely written recommendation of denial of the application. 12 CFR 225.16(e). The Board has not received such a recommendation from those authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify material factual issues related to the application and to provide an opportunity for testimony. 12 CFR 225.16(e), 262.25(d). The Board has considered the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit their views and, in fact, submitted written comments that the Board has considered in acting on the proposal. The commenters' requests fail to demonstrate why written comments do not present their views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

[65] Commenters asserted that the proposal would raise national security concerns. The Board notes that Congress has provided other U.S. agencies the authority to review national security issues in proposals by foreign companies to acquire U.S. companies. Commenters raised additional concerns that address matters beyond the statutory factors the Board is authorized to consider. *See Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

[1] 12 U.S.C. § 3105(d).

ABC, with total assets of approximately $1.85 trillion, is the fourth largest bank in China.[2] The government of China owns approximately 83 percent of ABC's shares.[3] No other shareholder owns more than 5 percent of the shares of ABC.

ABC engages primarily in retail and commercial banking throughout China, including Hong Kong SAR and Macau SAR. Outside China, ABC operates a subsidiary in the United Kingdom, branches in Singapore and Korea, and representative offices in Japan, Germany, and Australia. In the United States, ABC operates a representative office in New York City. ABC is a qualifying foreign banking organization under Regulation K.[4]

The proposed New York branch would engage in wholesale deposit taking, lending, trade finance, and other banking services.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisors.[5] In assessing the comprehensive, consolidated supervision standard, the Board has considered the Basel Core

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[2] Asset and ranking data are as of December 31, 2011.

[3] The Ministry of Finance owns approximately 39 percent, and The National Council for Social Security Fund owns approximately 3.9 percent of ABC's shares. Central Huijin Investment Ltd. ("Huijin") owns approximately 40 percent of ABC's shares. Huijin was formed to assist in the restructuring of major Chinese banks. The government transferred shares of several Chinese banks, including ABC, to Huijin at the time of the recapitalization and restructuring of these banks between 2004 and 2006. Huijin also owns a majority interest in China Construction Bank Corporation ("CCB") and Bank of China Limited ("BOC"), and together with the Ministry of Finance, it owns a majority interest in Industrial and Commercial Bank of China Limited ("ICBC"), all of Beijing. CCB and ICBC each operate a branch in New York City, and BOC operates branches in New York City and Los Angeles. The government of China transferred the ownership of Huijin to China Investment Corporation ("CIC"), an investment fund that is also wholly owned by the government of China. CIC owns 9.9 percent of the shares of Morgan Stanley, New York, New York, a bank holding company that owns a bank in Utah and a bank in New York. Both CIC and Huijin are non-operating companies that hold investments on behalf of the government of China. Neither CIC nor Huijin engages directly in commercial or financial activities.

Under the IBA, any company that owns a foreign bank with a branch in the United States is subject to the Bank Holding Company Act ("BHC Act") as if it were a bank holding company. Because of their ownership of CCB, BOC, and ICBC, CIC and Huijin are subject to the BHC Act. The Board has provided certain exemptions to CIC and Huijin under section 4(c)(9) of the BHC Act (12 U.S.C. § 1843(c)(9)), which authorizes the Board to grant exemptions to foreign companies from the nonbanking restrictions of the BHC Act when the exemptions would not be substantially at variance with the purposes of the act and would be in the public interest. The exemptions provided to CIC and Huijin would not extend to ABC or any other banking subsidiary of CIC or Huijin that operates a branch or agency in the United States. *See* Board letter to H. Rodgin Cohen, Esq., dated August 5, 2008.

[4] 12 CFR 211.23(a).

[5] 12 U.S.C. § 3105(d)(2); 12 CFR 211.24. Regulation K provides that a foreign bank is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii). In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is determinative, and other elements may inform the Board's determination. The Board has long held that "the legal systems for supervision and regulation vary from country to country, and comprehensive supervision or regulation on a consolidated basis can be achieved in different ways." 57 *Federal Register* 12992, 12995 (April 15, 1992).

Principles for Effective Banking Supervision ("Basel Core Principles"),[6] which are recognized as the international standard for assessing the quality of bank supervisory systems, including with respect to comprehensive, consolidated supervision.[7] The Board also considers additional standards as set forth in the IBA and Regulation K.[8]

As noted above, ABC engages directly in the business of banking outside the United States. ABC also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

For a number of years, authorities in China have continued to enhance the standards of consolidated supervision to which banks in China are subject, including through additional or refined statutory authority, regulations, and guidance; adoption of international standards and best practices; enhancements to the supervisory system arising out of supervisory experiences; upgrades to the China Banking Regulatory Commission ("CBRC"), the agency with primary responsibility for the supervision and regulation of Chinese banking organizations, in the areas of organization, technological capacity, staffing, and training; and increased coordination between the CBRC and other financial supervisory authorities in China.[9]

The Board has reviewed the record in this case and has determined that the enhancements to standards of bank supervision in China with respect to ABC warrant a finding that ABC is subject to comprehensive, consolidated supervision by its home country supervisors. In making this determination, the Board has considered that the CBRC is the principal supervisory authority of ABC, including its foreign subsidiaries and affiliates, for all matters other than money laundering.[10] The CBRC has primary responsibility and authority for regulating the establishment and activities and the expansion and dissolution of banking institutions, both domestically in China and abroad. The CBRC has no objection to ABC's establishment of the proposed branch. The CBRC monitors Chinese banks' con-

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[6] *See* Bank for International Settlements, Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (October 2006), available at www.bis.org/publ/bcbs129.pdf.

[7] *See e.g.,* 93rd Annual Report of the Board of Governors of the Federal Reserve System (2006), at 76 ("The Core Principles, developed by the Basel Committee in 1997, have become the de facto international standard for sound prudential regulation and supervision of banks.").

[8] 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2)-(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank has provided the Board with adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA and other applicable federal banking statutes; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; the bank's record of operation. The Board also considers, in the case of a foreign bank that presents a risk to the stability of the United States, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk. 12 U.S.C. § 3105(d)(3)(E) .

[9] The Board has previously approved applications from Chinese banks to establish U.S. branches under a lower standard than the comprehensive, consolidated supervision standard. *See China Merchants Bank Co., Limited*, 94 *Federal Reserve Bulletin* C24 (2008); *Industrial and Commercial Bank of China Limited*, 94 *Federal Reserve Bulletin* C114 (2008); *China Construction Bank Corporation*, 95 *Federal Reserve Bulletin* B54 (2009); and *Bank of Communications Co.Ltd.*, (order dated April 8, 2011), 97 *Federal Reserve Bulletin* 49 (2nd Quar. 2011). In each case, the Board made a determination that the bank's home country supervisors were actively working to establish arrangements for the consolidated supervision of the bank. 12 U.S.C. § 3105(d)(6).

[10] Before April 2003, the People's Bank of China ("PBOC") acted as both China's central bank and primary banking supervisor, including with respect to anti-money-laundering matters. In April 2003, the CBRC was established as the primary banking supervisor and assumed the majority of the PBOC's bank regulatory functions. The PBOC maintained its roles as China's central bank and primary supervisor for anti-money-laundering matters.

solidated financial condition, compliance with laws and regulations, and internal controls through a combination of on-site examinations, off-site surveillance through the review of required regulatory reports and external audit reports, and interaction with senior management.

Since its establishment in 2003, the CBRC has augmented its supervisory structure, staffing, and internal operations; enhanced its existing supervisory programs; and developed new policies and procedures to create a framework for the consolidated supervision of the largest banks in China. The CBRC also has strengthened its supervisory regime related to accounting requirements and standards for loan classification, internal controls, risk management, and capital adequacy, and it has developed and implemented a risk focused supervisory framework.

The CBRC has issued additional guidance in various supervisory areas, including stricter prudential requirements for capital, loan-loss allowance coverage, executive compensation, banks' equity investments in insurance companies, and enhanced risk-management requirements for operations, liquidity, derivatives, reputational, and market risk. The guidance is designed to make supervision more risk focused and to strengthen practices consistent with the Basel Core Principles.

The CBRC has its head office in Beijing and branch offices in other provinces. The head office sets policy and directs supervisory activities for the largest banks in China, including ABC. Although some day-to-day supervisory activities are undertaken by the CBRC's branch offices, the head office directs these efforts and ensures consistency of approach through training programs and frequent communication with the branches.

The CBRC head office prepares annual examination plans for the largest Chinese banks, including ABC. The plans encompass both on- and off-site activities. Applicable Chinese law and banking regulation do not require that on-site examinations be conducted at any specified interval. In practice, the CBRC performs on-site examinations of its largest banks frequently, although off-site surveillance is continuous. On-site examinations are scheduled based on the CBRC's continuous off-site monitoring tools, analysis of the institution's periodic filings, results of the institution's internal stress testing, and the institution's overall risk profile and activities. On-site examinations by the CBRC typically cover, among other things, the major areas of operation: corporate governance and senior management responsibilities; capital adequacy; asset structure and asset quality (including structure and quality of loans); off-balance-sheet activities; earnings; liquidity; liability structure and funding sources; expansionary plans; internal controls (including accounting control and administrative systems); legal compliance; accounting supervision and internal auditing; and any other areas deemed necessary by the CBRC. The PBOC examines ABC for compliance with anti-money-laundering laws and requirements.

Examination ratings are based on the CAMELS rating model and emphasize credit-risk management, the quality of the bank's loan portfolio, internal controls, liability structure, capital adequacy, liquidity, and the adequacy of reserves. The areas of emphasis reflect the fact that the largest Chinese banks, including ABC, engage in traditional commercial banking and are not materially engaged in complex derivatives or other activities. Ratings are derived from off-site quantitative and qualitative analysis and on-site risk reviews. Examination findings and areas of concern are discussed with senior management of the bank, and corrective actions taken by the bank are monitored by the CBRC. In 2009, the CBRC developed an information technology system to assist in on-site examinations by improving data analysis and assisting in regulatory information sharing.

Chinese banks are required to report key regulatory indicators to the CBRC periodically on general schedules. All Chinese banks are required to submit monthly, quarterly, semiannual, or annual reports relating to asset quality, lending concentrations, capital adequacy, earnings, liquidity, affiliate transactions, off-balance-sheet exposures, internal controls, and ownership and control.

Banks must report to the CBRC their unconsolidated capital adequacy ratios quarterly and their consolidated ratios semiannually. China's bank capital rules are based on the Basel I Capital Accord, while taking into account certain aspects of the Basel II Capital Accord. In addition, the CBRC, as a member of the Basel Committee on Banking Supervision, has supported the Basel III Capital Accord framework and implementation time frame. The CBRC can take enforcement actions when capital ratios or other financial indicators fall below specified levels. These actions may include issuing supervisory notices, requiring the bank to submit and implement an acceptable capital replenishment plan, restricting asset growth, requiring reduction of higher risk assets, restricting the purchase of fixed assets, and restricting dividends and other forms of distributions. Significantly undercapitalized banks may be required to make changes in senior management or restructure their operations.

ABC, like other large Chinese banks, is required to be audited annually by an external accounting firm that meets the standards of Chinese authorities, including the Ministry of Finance, PBOC, and CBRC, and the audit results are shared with the CBRC and PBOC. The scope of the required audit includes a review of ABC's financial statements, asset quality, capital adequacy, internal controls, and compliance with applicable laws. At its discretion, the CBRC may order a special audit at any time. In addition, in connection with its listing on the Shanghai and Hong Kong stock exchanges, ABC is also required to report financial statements under both International Financial Reporting Standards ("IFRS") and Chinese Accounting Standards ("CAS"). These financial statements are audited by an international accounting firm under applicable IFRS auditing standards.[11]

ABC conducts internal audits of its domestic offices and operations on an annual schedule and of its overseas branches and offices biennially. The internal audit results are shared with the CBRC, PBOC, and ABC's external auditors. The proposed branch would be subject to internal audits.

Chinese law imposes various prudential limitations on banks, including limits on transactions with affiliates and on large exposures.[12] Related-party transactions include credit extensions, asset transfers, and the provision of any type of services. Chinese banks are required to adopt appropriate policies and procedures to manage related-party transactions, and the board of directors must appoint a committee to supervise such transactions

[11] CAS largely conform to IFRS, such that there currently are no material differences between financial statements produced for Hong Kong reporting requirements and Chinese reporting requirements. The International Monetary Fund's ("IMF") financial system stability assessment report and the accompanying detailed assessment report of observance with the Basel Core Principles, discussed in detail below, both found that "[s]ince 2005, [CAS] have substantially converged with [IFRS] and International Standards on Auditing, respectively." IMF, People's Republic of China, Financial System Stability Assessment at 57 (June 24, 2011); IMF and World Bank, People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision at 9 (April 2012). In addition, the World Bank Report on Observance of Standards and Codes determined that CAS and IFRS are basically compatible and that the Chinese authorities and the International Accounting Standards Board have established a continuing convergence mechanism designed to achieve full convergence in 2012. World Bank, Report on Observance of Standards and Codes (ROSC) Accounting and Auditing – People's Republic of China at Executive Summary and at 12 (October 2009), available at www.worldbank.org/ifa/rosc_aa_chn.pdf .

[12] The CBRC definition of an "affiliate" or a "related party" of a bank includes subsidiaries, associates/joint ventures, shareholders holding 5 percent or more of the bank's shares, and key management personnel (and immediate relatives) and those individuals' other business affiliations.

and relationships. Applicable laws require all related-party transactions to be conducted on an arm's-length basis.

Chinese banking law also establishes single-borrower credit limits. Loans to a single borrower may not exceed 10 percent of the bank's total regulatory capital, the aggregate lending to a group of related companies may not exceed 15 percent of the bank's total regulatory capital, and the aggregate amount of credit granted to all related parties may not exceed 50 percent of the bank's total regulatory capital. The status of related-party transactions must be reported to the CBRC quarterly.

In addition, the CBRC has certain operational limitations for commercial banks in China relating to matters such as liquidity and foreign currency exposure. In 2009, the CBRC issued new rules concerning liquidity management and corporate governance. Compliance with these limits is monitored by the CBRC through periodic reports and reviewed during on-site examinations.

The CBRC is authorized to require any bank to provide information and to impose sanctions for failure to comply with such requests. If the CBRC determines that a bank is not in compliance with banking regulations and prudential standards, it may impose various sanctions depending upon the severity of the violation. The CBRC may suspend approval of new products or new offices, suspend part of the bank's operations, impose monetary penalties, and in more serious cases, replace management of the bank. The CBRC also has authority to impose administrative penalties, including warnings and fines for violations of applicable laws and rules. Criminal violations are transferred to the judicial authorities for investigation and prosecution.

ABC is subject to supervision by several other financial regulators, including the State Administration for Foreign Exchange, China Securities Regulatory Commission ("CSRC"), and China Insurance Regulatory Commission ("CIRC"). These agencies receive periodic financial and operations reports, and they may conduct on-site examinations and impose additional reporting requirements. Chinese financial supervisors coordinate supervision and share supervisory information about Chinese financial institutions as appropriate.

The IMF recently concluded a financial system stability assessment of China ("FSSA"), including an assessment of China's compliance with the Basel Core Principles.[13] The FSSA determined that China's overall regulatory and supervisory framework adheres to international standards.[14] The FSSA found that "[t]he laws, rules and guidance that CBRC operates under generally establish a benchmark of prudential standards that is of high quality and was drawn extensively from international standards and the [Basel Core Principles] themselves."[15] The FSSA additionally noted that "[c]onsolidated supervision of banks and

[13] The assessment reflects the regulatory and supervisory framework in place as of June 24, 2011. IMF, *People's Republic of China, Financial System Stability Assessment* (June 24, 2011), available at www.imf.org/external/pubs/ft/scr/2011/cr11321.pdf. The FSSA covers an evaluation of three components: (1) the source, probability, and potential impact of the main risks to macrofinancial stability in the near term; (2) the country's financial stability policy framework; and (3) the authorities' capacity to manage and resolve a financial crisis should the risks materialize. The FSSA is a key input to IMF surveillance. The FSSA is a forward-looking exercise, unlike the Board's assessment of the comprehensive, consolidated supervision of an applicant.

The IMF and World Bank separately publish a detailed assessment of the country's observance of the Basel Core Principles that discusses the country's adherence to the Basel Core Principles in much greater detail. See IMF and World Bank, *People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision* (April 2012) ("DAR"), available at www.imf.org/external/pubs/ft/scr/2012/cr1278.pdf.

[14] FSSA at 39.

[15] *Id*. at 59; DAR at 12.

their direct subsidiaries and branches on the mainland or offshore is of high quality."[16] With respect to the CBRC, the FSSA found as follows: All the banks, auditors, ratings agencies and other market participants that the mission interacted with were unhesitating in their regard for the role that the CBRC has played in driving professionalism, risk management and international recognition of the Chinese banking system. In particular, the mission observed that [the CBRC] has been the key driving force in driving improvements in risk management, corporate governance and internal control and disclosure in Chinese banks.[17] Based on its review, the FSSA rated China's overall compliance with the Basel Core Principles as satisfactory. In giving this overall rating, the FSSA noted several areas that merited improvement and made specific recommendations for continued advances in supervision and regulation.[18] The Chinese authorities noted that some of the recommendations of the FSSA are already being implemented and that others will be taken into account in the CBRC's plans to improve supervisory effectiveness.[19]

The Board has taken into account the FSSA's views that China is, overall, in satisfactory compliance with the Basel Core Principles and that there are areas for further improvement. The Board has also taken into account the responses by Chinese authorities to the FSSA report and the progress made by Chinese authorities to address the issues raised in that report.

Based on all the facts of record, including its review of the supervisory framework implemented by the CBRC for ABC, the Board has determined that ABC is subject to comprehensive supervision on a consolidated basis by its home country supervisors. This determination is specific to ABC.[20] By statute, the Board must review this determination in processing future applications involving ABC and also must make a determination of comprehensive, consolidated supervision in other applications involving different applicants from China.

As part of the Board's supervisory program for foreign banks, the Board actively monitors changes to the supervisory systems in the home countries of foreign banks, as well as differences that may exist in the supervisory framework as it is applied by a home country to

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[16] FSSA at 64; DAR at 16.

[17] DAR at 7.

[18] FSSA at 39-42 and 69-71; DAR at 99-101. China received a materially noncompliant rating in two of the thirty areas assessed by the FSSA. Specifically, the FSSA rated China as materially noncompliant for the Basel Core Principles on independence, accountability and transparency, and risk management process. DAR at 17 and 19. The FSSA stated that "budgeting arrangements, external headcount approval requirements and [the authority for the State Council to override] rules and decisions compromise CBRC effectiveness and could affect operational independence." FSSA at 64; DAR at 17. The FSSA viewed the guidance that the CBRC has issued in risk management to be consistent with international standards but found that banking institutions' compliance with CBRC guidance was lacking (although recognizing that the guidance on some risks "is recent and so could not be expected to be complied with as yet"). FSSA at 61; *see also* DAR at 53. The assessment team also believed that Chinese banks in general do not yet have robust enterprise-wide risk-management systems. FSSA at 66; DAR at 53-54. For comparison, the United Kingdom and Germany received three and two materially noncompliant ratings, respectively, and the United States received one materially noncompliant rating, in their recent financial system stability assessments.

[19] FSSA at 71-73; DAR at 101-103. Chinese authorities responded that, by law in China, the State Council of the People's Republic of China ("State Council") may alter or annul a rule or guideline of the CBRC only if the rule or guideline violates applicable law and that the State Council has never altered or annulled the rules and guidelines issued by the CBRC. Chinese authorities also noted that the State Council has supported the CBRC in undertaking banking regulation and supervision and that the CBRC has upgraded the number and quality of its staff over time. FSSA at 71-72; DAR at 102. In addition, Chinese authorities noted the significant improvements China has made in supervision as well as the relative simplicity of the Chinese banking system. FSSA at 72; DAR at 102-3. Despite the difference in views about the degree to which Chinese banks' risk management is commensurate with the current risk environment, Chinese authorities concurred with the FSSA that "continued improvements in banks' risk management are needed, as financial reform deepens and liberalization creates greater interconnectedness and complexities in the Chinese system." FSSA at 72; DAR at 103.

[20] *See* 58 *Federal Register* 6348, 6349 (January 12, 1993).

institutions of different types or sizes, and would continue to do so with respect to China. The Board also intends to further its relationship with Chinese supervisory authorities and continue to develop its understanding of Chinese banking matters.

The government of China has adopted a statutory regime regarding anti-money laundering ("AML") and suspicious activity reporting and has criminalized money-laundering activities and other financial crimes. The PBOC supervises and examines Chinese banks with respect to AML and coordinates efforts among other agencies. The PBOC collects, monitors, analyzes, and disseminates suspicious transaction reports and large-value transaction reports.

The PBOC over time has increased requirements for its supervised institutions regarding AML compliance. The PBOC issued rules providing clarification of, or further strengthening the implementation of, operating procedures, customer due diligence and risk classification, recordkeeping, AML monitoring and reporting suspicious transactions, and the international remittance agency business. The PBOC also requires the designation of a chief AML compliance officer as a high-level manager to ensure provision of adequate AML resources and timely flow of information to employees responsible for AML compliance throughout the institution. In addition, the PBOC requires the risk rating of customers and the filing of reports on suspicious activity and certain other transactions. Banks are required to (1) establish a customer identification system in accordance with applicable rules jointly promulgated by the PBOC and three functional financial services regulators;[21] (2) record the identities of customers and information relating to each transaction; and (3) retain retail transaction documents and books. Supervised institutions have been encouraged to move beyond a prescriptive-criteria basis to include a more expansive and risk-based approach to suspicious activity detection and reporting.

China participates in international fora that address the prevention of money laundering and terrorist financing. China became a member of the Financial Action Task Force ("FATF") in June 2007. China also is a member of the Eurasian Group ("EAG"), a FATF-style regional body that supports member countries in their efforts to create and maintain an appropriate legal and institutional framework to combat money laundering and terrorist financing in line with FATF standards.[22] EAG evaluates its member states' AML and counter-terrorist financing ("CFT") systems for compliance with international standards. In the most recent mutual evaluation report of China, dated February 17, 2012, the FATF considered China to be fully or largely compliant with almost all of the FATF recommendations and held that China has effective AML and CFT systems in force. As a result, the FATF has removed China from its regular follow-up process.[23]

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[21] Those regulators are the CBRC, CSRC, and CIRC.

[22] China also is a party to other agreements that address money laundering or terrorist financing, including the U.N. Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the U.N. Convention Against Transnational Organized Crime, the U.N. Convention Against Corruption, and the U.N. International Convention for the Suppression of the Financing of Terrorism.

[23] FATF, *China Mutual Evaluation 8th Follow-up Report, Anti-Money Laundering and Combating the Financing of Terrorism* (February 17, 2012), available at www.fatf gafi.org/dataoecd/5/34/49847246.pdf. The report noted that China has made significant progress to address the remaining deficiencies and has "reached a satisfactory level of compliance with all six core Recommendations and eight of the [ten] key Recommendations." Id at para. 41. In one of the key Recommendations where China has not attained a satisfactory level of compliance (implementation of international instruments related to terrorist financing), China has substantially addressed part of the deficiency and continues to make progress. With respect to the other key Recommendation (freezing of terrorist-related assets), China has made significant progress since June 2011 to improve its implementation. In particular, China has implemented legislation establishing a legislative framework and administrative authority for enforcement and has responded to foreign requests to freeze assets. The FATF was of the view that China should enact additional guidance to improve implementation, and Chinese authorities are currently drafting rules to do so. *Id.* at paras. 150-52 and 157-59.

Moreover, the Chinese government issues rules on implementing United Nations sanctions and may take enforcement actions to ensure compliance with those sanctions. The PBOC is also responsible for disseminating information to the banking industry regarding U.N. sanctions and supervising the enforcement of those sanctions.

The PBOC supervises and regulates compliance by ABC with AML requirements through a combination of on-site examinations and off-site monitoring. On site examinations focus on ABC's compliance with AML laws and rules. The PBOC's headquarters conducts investigations of a financial institution's head office, and the PBOC's branches conduct investigations of the institution's branch offices in the same locality as the PBOC branches. During the course of an on-site examination, the PBOC will generally review account information, transaction records, and any other relevant materials. Upon completion of an investigation, if AML deficiencies are identified, the PBOC may issue sanctions and propose that remedial measures be imposed by appropriate government agencies or regulators against the financial institution and can refer any suspected money laundering to law enforcement authorities for further investigation. The PBOC performs off site monitoring through periodic reports and has established requirements for Chinese banks to submit such reports. In order to improve off-site supervision and monitoring of large-amount cash transactions, the PBOC developed an interactive information technology system for AML/CFT supervision that has been in operation since October 2010 in both the PBOC and financial institutions.

ABC has policies and procedures to comply with Chinese laws and rules regarding AML. ABC states that it has implemented measures consistent with the recommendations of the FATF and that it has put in place policies, procedures, and controls to ensure ongoing compliance with all statutory and regulatory requirements, including designating AML compliance personnel and conducting routine employee training at all ABC branches. ABC's compliance with AML requirements is monitored by the PBOC and by ABC's internal and external auditors.

Based on all the facts of record, the Board has determined that the AML efforts by ABC and its home country supervisors are consistent with approval.

The Board has also considered the financial and managerial factors in this case. As noted above, the CBRC requires Chinese banks to follow the Basel I Capital Accord with certain enhancements from the Basel II Capital Accord.[24] The capital levels of ABC exceed the minimum levels that would be required under the Basel I Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization. Managerial and other financial resources of ABC are consistent with approval, and ABC appears to have the experience and capacity to support the proposed branch. In addition, ABC has established controls and procedures for the proposed branch to ensure compliance with U.S. law and for its operations in general. In particular, ABC has stated that it will apply strict AML policies and procedures at the branch consistent with U.S. law and regulation and will establish an internal control system at the branch consistent with U.S. requirements to ensure compliance with those policies and procedures.

With respect to access to information about ABC's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which ABC operates and has communicated with relevant government authorities regarding access to information. ABC has committed to make available to the Board such information on the operations of ABC and any of its affiliates that the Board deems necessary to determine and enforce compliance

[24] The CBRC also requires all large, internationally active banks, such as ABC, to have a minimum risk-based tier 1 capital ratio of 9 percent and total capital ratio of 11.5 percent. ABC's capital ratios exceed these levels.

with the IBA, the BHC Act, and other applicable federal laws. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, ABC also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable it or its affiliates to make such information available to the Board. The Board also has consulted with the CBRC about access to information. The CBRC has represented that it would facilitate the Board's access to information and has entered into a statement of cooperation with the Board and other U.S. banking regulators with respect to the sharing of supervisory information.[25] In light of these commitments and other facts of record, and subject to the condition described below, the Board has determined that ABC has provided adequate assurances of access to any necessary information that the Board may request.

China has made progress toward adopting a system of financial regulation for its financial system to mitigate the risk to financial stability from its banks. The PBOC, CBRC, other financial supervisory agencies, and other agencies in China have taken joint measures to maintain financial stability. China has established a system of preliminary indicators for monitoring financial stability, developed methodology and operational frameworks for monitoring financial risks, and published an annual China Financial Stability Report since 2005. The CBRC has established mechanisms to cooperate with supervisory authorities in at least 25 other countries for the supervision of cross-border banking. In addition, the PBOC and CBRC officially joined the Basel Committee on Banking Supervision on behalf of China and since their accession, have actively participated in the revision of the Basel II Capital Accord, in the formulation of the Basel III Capital Accord, and in other working groups. China also is active in the ongoing work of the Financial Stability Board. U.S. bank regulators and other bank supervisors in pertinent jurisdictions participated in two supervisory colleges hosted by the CBRC: one for ICBC in 2009 and one for CCB in 2011. Moreover, authorities in the United States and China that are responsible for the oversight of auditing services for public companies are engaged in continuing discussions with respect to enhancing cross-border cooperation, and the Board looks forward to timely negotiation of an agreement relating to cooperative actions by these authorities.

On the basis of all the facts of record, and subject to the commitments made by ABC, as well as the terms and conditions set forth in this order, ABC's application to establish a branch is hereby approved. The Board conditions its decision on ABC providing to the Board adequate information on its operations and activities as well as those of its affiliates to determine and enforce compliance by ABC or its affiliates with applicable federal statutes. Should any restrictions on access to information on the operations or activities of ABC or any of its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by ABC or its affiliates with applicable federal statutes, the Board may require termination or divestiture of any of ABC's or its affiliates' direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by ABC with the commitments made to the Board in connection with this application and with the conditions in this order.[26] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. U.S.C. § 1818 against ABC and its affiliates.

By order of the Board of Governors, effective May 9, 2012.

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[25] *See* Memorandum of Understanding between the CBRC and the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, June 17, 2004.

[26] The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the New York State Department of Financial Services to license offices of a foreign bank.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Bank of China Limited
Beijing, People's Republic of China

Order Approving Establishment of a Branch
FRB Order No. 2012–6 (May 9, 2012)

Bank of China Limited ("BOC"), Beijing, People's Republic of China, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA[1] to establish a federal branch in Chicago, Illinois. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in Chicago (*The Chicago Sun-Times*, August 16, 2010). The time for filing comments has expired, and the Board has considered all comments received.

BOC, with total assets of approximately $1.87 trillion, is the third largest bank in China.[2] The government of China owns approximately 71 percent of BOC's shares.[3] No other shareholder owns more than 5 percent of the shares of BOC.[4]

BOC engages primarily in retail and commercial banking throughout China, including Hong Kong SAR and Macau SAR. Outside China, BOC operates a network of bank subsidiaries, branches, and representative offices in 29 countries. In the United States, BOC operates two insured federal branches in New York City and an uninsured limited federal

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1 12 U.S.C.§ 3105(d).

2 Asset and ranking data are as of December 31, 2011.

3 Central Huijin Investment Ltd. ("Huijin") owns approximately 67.6 percent, and The National Council for Social Security Fund holds approximately 3.3 percent of BOC's shares. Huijin was formed to assist in the restructuring of major Chinese banks. The government transferred shares of several Chinese banks, including BOC, to Huijin at the time of the recapitalization and restructuring of these banks between 2004 and 2006. Huijin also owns a majority interest in China Construction Bank Corporation ("CCB"), and together with the Chinese Ministry of Finance, it owns a majority interest in Industrial and Commercial Bank of China Limited ("ICBC") and Agricultural Bank of China Limited ("ABC"), all of Beijing. CCB and ICBC each operate a branch in New York City. The government of China transferred the ownership of Huijin to China Investment Corporation ("CIC"), an investment fund that is also wholly owned by the government of China. CIC owns 9.9 percent of the shares of Morgan Stanley, New York, New York, a bank holding company that owns a bank in Utah and a bank in New York. Both CIC and Huijin are non operating companies that hold investments on behalf of the government of China. Neither CIC nor Huijin engages directly in commercial or financial activities.

Under the IBA, any company that owns a foreign bank with a branch in the United States is subject to the Bank Holding Company Act ("BHC Act") as if it were a bank holding company. Because of their ownership of BOC, CCB, and ICBC, CIC and Huijin are subject to the BHC Act. The Board has provided certain exemptions to CIC and Huijin under section 4(c)(9) of the BHC Act (12 U.S.C. § 1843(c)(9)), which authorizes the Board to grant exemptions to foreign companies from the nonbanking restrictions of the BHC Act when the exemptions would not be substantially at variance with the purposes of the act and would be in the public interest. The exemptions provided to CIC and Huijin would not extend to BOC or any other banking subsidiary of CIC or Huijin that operates a branch or agency in the United States. *See* Board letter to H. Rodgin Cohen, Esq., dated August 5, 2008.

4 HKSCC Nominees Limited holds an additional approximately 29 percent of the shares of BOC as the registered nominee of several shareholders, each of which owns less than 5 percent of the shares of BOC.

branch in Los Angeles, as well as nonbanking activities under section 4(c)(8) of the BHC Act.[5] BOC is a qualifying foreign banking organization under Regulation K.[6]

The proposed Chicago branch would engage in wholesale deposit taking, lending, trade finance, and other banking services.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisors.[7] In assessing the comprehensive, consolidated supervision standard, the Board has considered the Basel Core Principles for Effective Banking Supervision ("Basel Core Principles"),[8]which are recognized as the international standard for assessing the quality of bank supervisory systems, including with respect to comprehensive, consolidated supervision.[9] The Board also considers additional standards as set forth in the IBA and Regulation K.[10]

As noted above, BOC engages directly in the business of banking outside the United States. BOC also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

For a number of years, authorities in China have continued to enhance the standards of consolidated supervision to which banks in China are subject, including through additional

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[5] 12 U.S.C. § 1843(c)(8). BOC also controls a wholly owned subsidiary bank, Nanyang Commercial Bank, Limited, Hong Kong SAR, People's Republic of China, that operates a federal branch in San Francisco.

[6] 12 CFR 211.23(a).

[7] 12 U.S.C. § 3105(d)(2); 12 CFR 211.24. Regulation K provides that a foreign bank is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii). In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is determinative, and other elements may inform the Board's determination. The Board has long held that "the legal systems for supervision and regulation vary from country to country, and comprehensive supervision or regulation on a consolidated basis can be achieved in different ways." 57 *Federal Register* 12992, 12995 (April 15, 1992).

[8] *See* Bank for International Settlements, Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision*(October 2006), available at www.bis.org/publ/bcbs129.pdf .

[9] *See e.g.,* 93rd Annual Report of the Board of Governors of the Federal Reserve System (2006), at 76 ("The Core Principles, developed by the Basel Committee in 1997, have become the de facto international standard for sound prudential regulation and supervision of banks.").

[10] 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2)-(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank has provided the Board with adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA and other applicable federal banking statutes; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; the bank's record of operation. The Board also considers, in the case of a foreign bank that presents a risk to the stability of the United States, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk. 12 U.S.C. § 3105(d)(3)(E).

or refined statutory authority, regulations, and guidance; adoption of international standards and best practices; enhancements to the supervisory system arising out of supervisory experiences; upgrades to the China Banking Regulatory Commission ("CBRC"), the agency with primary responsibility for the supervision and regulation of Chinese banking organizations, in the areas of organization, technological capacity, staffing, and training; and increased coordination between the CBRC and other financial supervisory authorities in China.[11]

The Board has reviewed the record in this case and has determined that the enhancements to standards of bank supervision in China with respect to BOC warrant a finding that BOC is subject to comprehensive, consolidated supervision by its home country supervisors. In making this determination, the Board has considered that the CBRC is the principal supervisory authority of BOC, including its foreign subsidiaries and affiliates, for all matters other than money laundering.[12] The CBRC has primary responsibility and authority for regulating the establishment and activities and the expansion and dissolution of banking institutions, both domestically in China and abroad. The CBRC has no objection to BOC's establishment of the proposed branch. The CBRC monitors Chinese banks' consolidated financial condition, compliance with laws and regulations, and internal controls through a combination of on-site examinations, off-site surveillance through the review of required regulatory reports and external audit reports, and interaction with senior management.

Since its establishment in 2003, the CBRC has augmented its supervisory structure, staffing, and internal operations; enhanced its existing supervisory programs; and developed new policies and procedures to create a framework for the consolidated supervision of the largest banks in China. The CBRC also has strengthened its supervisory regime related to accounting requirements and standards for loan classification, internal controls, risk management, and capital adequacy, and it has developed and implemented a risk focused supervisory framework.

The CBRC has issued additional guidance in various supervisory areas, including stricter prudential requirements for capital, loan-loss allowance coverage, executive compensation, banks' equity investments in insurance companies, and enhanced risk-management requirements for operations, liquidity, derivatives, reputational, and market risk. The guidance is designed to make supervision more risk focused and to strengthen practices consistent with the Basel Core Principles.

The CBRC has its head office in Beijing and branch offices in other provinces. The head office sets policy and directs supervisory activities for the largest banks in China, including BOC. Although some day-to-day supervisory activities are undertaken by the CBRC's branch offices, the head office directs these efforts and ensures consistency of approach through training programs and frequent communication with the branches.

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[11] The Board has previously approved applications from Chinese banks to establish U.S. branches under a lower standard than the comprehensive, consolidated supervision standard. *See China Merchants Bank Co., Limited*, 94 *Federal Reserve Bulletin* C24 (2008); *Industrial and Commercial Bank of China Limited*, 94 *Federal Reserve Bulletin* C114 (2008); *China Construction Bank Corporation,* 95 *Federal Reserve Bulletin* B54 (2009); and *Bank of Communications Co., Ltd.*(order dated April 8, 2011), 97 *Federal Reserve Bulletin* 49 (2nd Quar. 2011). In each case, the Board made a determination that the bank's home country supervisors were actively working to establish arrangements for the consolidated supervision of the bank. 12 U.S.C. § 3105(d)(6).

[12] Before April 2003, the People's Bank of China ("PBOC") acted as both China's central bank and primary banking supervisor, including with respect to anti-money-laundering matters. In April 2003, the CBRC was established as the primary banking supervisor and assumed the majority of the PBOC's bank regulatory functions. The PBOC maintained its roles as China's central bank and primary supervisor for anti-money-laundering matters.

The CBRC head office prepares annual examination plans for the largest Chinese banks, including BOC. The plans encompass both on- and off-site activities. Applicable Chinese law and banking regulation do not require that on-site examinations be conducted at any specified interval. In practice, the CBRC performs on-site examinations of its largest banks frequently, although off-site surveillance is continuous. On-site examinations are scheduled based on the CBRC's continuous off-site monitoring tools, analysis of the institution's periodic filings, results of the institution's internal stress testing, and the institution's overall risk profile and activities. On-site examinations by the CBRC typically cover, among other things, the major areas of operation: corporate governance and senior management responsibilities; capital adequacy; asset structure and asset quality (including structure and quality of loans); off-balance-sheet activities; earnings; liquidity; liability structure and funding sources; expansionary plans; internal controls (including accounting control and administrative systems); legal compliance; accounting supervision and internal auditing; and any other areas deemed necessary by the CBRC. The PBOC examines BOC for compliance with anti-money-laundering laws and requirements.

Examination ratings are based on the CAMELS rating model and emphasize credit-risk management, the quality of the bank's loan portfolio, internal controls, liability structure, capital adequacy, liquidity, and the adequacy of reserves. The areas of emphasis reflect the fact that the largest Chinese banks, including BOC, engage in traditional commercial banking and are not materially engaged in complex derivatives or other activities. Ratings are derived from off-site quantitative and qualitative analysis and on site risk reviews. Examination findings and areas of concern are discussed with senior management of the bank, and corrective actions taken by the bank are monitored by the CBRC. In 2009, the CBRC developed an information technology system to assist in on site examinations by improving data analysis and regulatory information sharing.

Chinese banks are required to report key regulatory indicators to the CBRC periodically on general schedules. All Chinese banks are required to submit monthly, quarterly, semiannual, or annual reports relating to asset quality, lending concentrations, capital adequacy, earnings, liquidity, affiliate transactions, off-balance-sheet exposures, internal controls, and ownership and control.

Banks must report to the CBRC their unconsolidated capital adequacy ratios quarterly and their consolidated ratios semiannually. China's bank capital rules are based on the Basel I Capital Accord, while taking into account certain aspects of the Basel II Capital Accord. In addition, the CBRC, as a member of the Basel Committee on Banking Supervision, has supported the Basel III Capital Accord framework and implementation time frame. The CBRC can take enforcement actions when capital ratios or other financial indicators fall below specified levels. These actions may include issuing supervisory notices, requiring the bank to submit and implement an acceptable capital replenishment plan, restricting asset growth, requiring reduction of higher risk assets, restricting the purchase of fixed assets, and restricting dividends and other forms of distributions. Significantly undercapitalized banks may be required to make changes in senior management or restructure their operations.

BOC, like other large Chinese banks, is required to be audited annually by an external accounting firm that meets the standards of Chinese authorities, including the Ministry of Finance, PBOC, and CBRC, and the audit results are shared with the CBRC and PBOC. The scope of the required audit includes a review of BOC's financial statements, asset quality, capital adequacy, internal controls, and compliance with applicable laws. At its discretion, the CBRC may order a special audit at any time. In addition, in connection with its listing on the Shanghai and Hong Kong stock exchanges, BOC is also required to report financial statements under both International Financial Reporting Standards ("IFRS") and

Chinese Accounting Standards ("CAS"). These financial statements are audited by an international accounting firm under applicable IFRS auditing standards.[13]

BOC conducts internal audits of its offices and operations, including its overseas operations, generally on an annual schedule. The internal audit results are shared with the CBRC, the PBOC, and BOC's external auditors. The proposed branch would be subject to internal audits.

Chinese law imposes various prudential limitations on banks, including limits on transactions with affiliates and on large exposures.[14] Related-party transactions include credit extensions, asset transfers, and the provision of any type of services. Chinese banks are required to adopt appropriate policies and procedures to manage related-party transactions, and the board of directors must appoint a committee to supervise such transactions and relationships. Applicable laws require all related-party transactions to be conducted on an arm's-length basis.

Chinese banking law also establishes single-borrower credit limits. Loans to a single borrower may not exceed 10 percent of the bank's total regulatory capital, the aggregate lending to a group of related companies may not exceed 15 percent of the bank's total regulatory capital, and the aggregate amount of credit granted to all related parties may not exceed 50 percent of the bank's total regulatory capital. The status of related-party transactions must be reported to the CBRC quarterly.

In addition, the CBRC has certain operational limitations for commercial banks in China relating to matters such as liquidity and foreign currency exposure. In 2009, the CBRC issued new rules concerning liquidity management and corporate governance. Compliance with these limits is monitored by the CBRC through periodic reports and reviewed during on-site examinations.

The CBRC is authorized to require any bank to provide information and to impose sanctions for failure to comply with such requests. If the CBRC determines that a bank is not in compliance with banking regulations and prudential standards, it may impose various sanctions depending upon the severity of the violation. The CBRC may suspend approval of new products or new offices, suspend part of the bank's operations, impose monetary penalties, and in more serious cases, replace management of the bank. The CBRC also has authority to impose administrative penalties, including warnings and fines for violations of applicable laws and rules. Criminal violations are transferred to the judicial authorities for investigation and prosecution.

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[13] CAS largely conform to IFRS, such that there currently are no material differences between financial statements produced for Hong Kong reporting requirements and Chinese reporting requirements. The International Monetary Fund's ("IMF") financial system stability assessment report and the accompanying detailed assessment report of observance with the Basel Core Principles, discussed in detail below, both found that "[s]ince 2005, [CAS] have substantially converged with [IFRS] and International Standards on Auditing, respectively." IMF, *People's Republic of China, Financial System Stability Assessment* at 57 (June 24, 2011); IMF and World Bank, *People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision* at 9 (April 2012). In addition, the World Bank Report on Observance of Standards and Codes determined that CAS and IFRS are basically compatible and that the Chinese authorities and the International Accounting Standards Board have established a continuing convergence mechanism designed to achieve full convergence in 2012. World Bank, *Report on Observance of Standards and Codes (ROSC) Accounting and Auditing – People's Republic of China*at Executive Summary and at 12 (October 2009), available at www.worldbank.org/ifa/rosc_aa_chn.pdf.

[14] The CBRC definition of an "affiliate" or a "related party" of a bank includes subsidiaries, associates/joint ventures, shareholders holding 5 percent or more of the bank's shares, and key management personnel (and immediate relatives) and those individual's other business affiliations.

BOC is subject to supervision by several other financial regulators, including the State Administration for Foreign Exchange, China Securities Regulatory Commission ("CSRC"), and China Insurance Regulatory Commission ("CIRC"). These agencies receive periodic financial and operations reports, and they may conduct on-site examinations and impose additional reporting requirements. Chinese financial supervisors coordinate supervision and share supervisory information about Chinese financial institutions as appropriate.

The IMF recently concluded a financial system stability assessment of China ("FSSA"), including an assessment of China's compliance with the Basel Core Principles.[15] The FSSA determined that China's overall regulatory and supervisory framework adheres to international standards.[16]The FSSA found that "[t]he laws, rules and guidance that CBRC operates under generally establish a benchmark of prudential standards that is of high quality and was drawn extensively from international standards and the [Basel Core Principles] themselves."[17] The FSSA additionally noted that "[c]onsolidated supervision of banks and their direct subsidiaries and branches on the mainland or offshore is of high quality."[18] With respect to the CBRC, the FSSA found as follows:

All the banks, auditors, ratings agencies and other market participants that the mission interacted with were unhesitating in their regard for the role that the CBRC has played in driving professionalism, risk management and international recognition of the Chinese banking system. In particular, the mission observed that [the CBRC] has been the key driving force in driving improvements in risk management, corporate governance and internal control and disclosure in Chinese banks.[19]

Based on its review, the FSSA rated China's overall compliance with the Basel Core Principles as satisfactory. In giving this overall rating, the FSSA noted several areas that merited improvement and made specific recommendations for continued advances in supervision and regulation.[20] The Chinese authorities noted that some of the recommendations of

[15] The assessment reflects the regulatory and supervisory framework in place as of June 24, 2011. IMF, *People's Republic of China, Financial System Stability Assessment* (June 24, 2011), available at www.imf.org/external/pubs/ft/scr/2011/cr11321.pdf. The FSSA covers an evaluation of three components: (1) the source, probability, and potential impact of the main risks to macrofinancial stability in the near term; (2) the country's financial stability policy framework; and (3) the authorities' capacity to manage and resolve a financial crisis should the risks materialize. The FSSA is a key input to IMF surveillance. The FSSA is a forward-looking exercise, unlike the Board's assessment of the comprehensive consolidated supervision of an applicant.

The IMF and World Bank separately publish a detailed assessment of the country's observance of the Basel Core Principles that discusses the country's adherence to the Basel Core Principles in much greater detail. *See* IMF and World Bank, *People's Republic of China: Detailed Assessment Report of Observance with Basel Core Principles for Effective Banking Supervision* (April 2012) ("DAR"), available at www.imf.org/external/pubs/ft/scr/2012/cr1278.pdf.

[16] FSSA at 39.

[17] Id. at 59; DAR at 12.

[18] FSSA at 64; DAR at 16.

[19] DAR at 7.

[20] FSSA at 39-42 and 69-71; DAR at 99-101. China received a materially noncompliant rating in two of the thirty areas assessed by the FSSA. Specifically, the FSSA rated China as materially noncompliant for the Basel Core Principles on independence, accountability and transparency, and risk management process. DAR at 17 and 19. The FSSA stated that "budgeting arrangements, external headcount approval requirements and [the authority for the State Council to override] rules and decisions compromise CBRC effectiveness and could affect operational independence." FSSA at 64; DAR at 17. The FSSA viewed the guidance that the CBRC has issued in risk management to be consistent with international standards but found that banking institutions' compliance with CBRC guidance was lacking (although recognizing that the guidance on some risks "is recent and so could not be expected to be complied with as yet"). FSSA at 61; *see also* DAR at 53. The assessment team also believed that Chinese banks in general do not yet have robust enterprise-wide risk-management systems. FSSA at 66; DAR at 53-54. For comparison, the United Kingdom and Germany received three and two materially noncompliant ratings, respectively, and the United States received one materially noncompliant rating, in their recent financial system stability assessments.

the FSSA are already being implemented and that others will be taken into account in the CBRC's plans to improve supervisory effectiveness.[21]

The Board has taken into account the FSSA's views that China is, overall, in satisfactory compliance with the Basel Core Principles and that there are areas for further improvement. The Board has also taken into account the responses by Chinese authorities to the FSSA report and the progress made by Chinese authorities to address the issues raised in that report.

Based on all the facts of record, including its review of the supervisory framework implemented by the CBRC for BOC, the Board has determined that BOC is subject to comprehensive supervision on a consolidated basis by its home country supervisors. This determination is specific to BOC.[22] By statute, the Board must review this determination in processing future applications involving BOC and also must make a determination of comprehensive, consolidated supervision in other applications involving different applicants from China.

As part of the Board's supervisory program for foreign banks, the Board actively monitors changes to the supervisory systems in the home countries of foreign banks, as well as differences that may exist in the supervisory framework as it is applied by a home country to institutions of different types or sizes, and would continue to do so with respect to China. The Board also intends to further its relationship with Chinese supervisory authorities and continue to develop its understanding of Chinese banking matters.

The government of China has adopted a statutory regime regarding anti money laundering ("AML") and suspicious activity reporting and has criminalized money laundering activities and other financial crimes. The PBOC supervises and examines Chinese banks with respect to AML and coordinates efforts among other agencies. The PBOC collects, monitors, analyzes, and disseminates suspicious transaction reports and large-value transaction reports.

The PBOC over time has increased requirements for its supervised institutions regarding AML compliance. The PBOC issued rules providing clarification of, or further strengthening the implementation of, operating procedures, customer due diligence and risk classification, recordkeeping, AML monitoring and reporting suspicious transactions, and the international remittance agency business. The PBOC also requires the designation of a chief AML compliance officer as a high-level manager to ensure provision of adequate AML resources and timely flow of information to employees responsible for AML compliance throughout the institution. In addition, the PBOC requires the risk rating of customers and the filing of reports on suspicious activity and certain other transactions. Banks are required to (1) establish a customer identification system in accordance with applicable rules jointly promulgated by the PBOC and three functional financial services regulators;[23]

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[21] FSSA at 71-73; DAR at 101-103. Chinese authorities responded that, by law in China, the State Council of the People's Republic of China ("State Council") may alter or annul a rule or guideline of the CBRC only if the rule or guideline violates applicable law and that the State Council has never altered or annulled the rules and guidelines issued by the CBRC. Chinese authorities also noted that the State Council has supported the CBRC in undertaking banking regulation and supervision and that the CBRC has upgraded the number and quality of its staff over time. FSSA at 71-72; DAR at 102. In addition, Chinese authorities noted the significant improvements China has made in supervision as well as the relative simplicity of the Chinese banking system. FSSA at 72; DAR at 102-3. Despite the difference in views about the degree to which Chinese banks' risk management is commensurate with the current risk environment, Chinese authorities concurred with the FSSA that "continued improvements in banks' risk management are needed, as financial reform deepens and liberalization creates greater interconnectedness and complexities in the Chinese system." FSSA at 72; DAR at 103.

[22] *See* 58 *Federal Register* 6348, 6349 (January 12, 1993).

[23] Those regulators are the CBRC, CSRC, and CIRC.

(2) record the identities of customers and information relating to each transaction; and (3) retain retail transaction documents and books. Supervised institutions have been encouraged to move beyond a prescriptive-criteria basis to include a more expansive and risk-based approach to suspicious activity detection and reporting.

China participates in international fora that address the prevention of money laundering and terrorist financing. China became a member of the Financial Action Task Force ("FATF") in June 2007. China also is a member of the Eurasian Group ("EAG"), a FATF-style regional body that supports member countries in their efforts to create and maintain an appropriate legal and institutional framework to combat money laundering and terrorist financing in line with FATF standards.[24] EAG evaluates its member states' AML and counter-terrorist financing ("CFT") systems for compliance with international standards. In the most recent mutual evaluation report of China, dated February 17, 2012, the FATF considered China to be fully or largely compliant with almost all of the FATF recommendations and held that China has effective AML and CFT systems in force. As a result, the FATF has removed China from its regular follow-up process.[25]

Moreover, the Chinese government issues rules on implementing United Nations sanctions and may take enforcement actions to ensure compliance with those sanctions. The PBOC is also responsible for disseminating information to the banking industry regarding U.N. sanctions and supervising the enforcement of those sanctions.

The PBOC supervises and regulates compliance by BOC with AML requirements through a combination of on-site examinations and off-site monitoring. On site examinations focus on BOC's compliance with AML laws and rules. The PBOC's headquarters conducts investigations of a financial institution's head office, and the PBOC's branches conduct investigations of the institution's branch offices in the same locality as the PBOC branches. During the course of an on-site examination, the PBOC will generally review account information, transaction records, and any other relevant materials. Upon completion of an investigation, if AML deficiencies are identified, the PBOC may issue sanctions and propose that remedial measures be imposed by appropriate government agencies or regulators against the financial institution and can refer any suspected money laundering to law enforcement authorities for further investigation. The PBOC performs off site monitoring through periodic reports and has established requirements for Chinese banks to submit such reports. In order to improve off-site supervision and monitoring of large amount cash transactions, the PBOC developed an interactive information technology system for AML/CFT supervision that has been in operation since October 2010 in both the PBOC and financial institutions.

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[24] China also is a party to other agreements that address money laundering or terrorist financing, including the U.N. Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the U.N. Convention Against Transnational Organized Crime, the U.N. Convention Against Corruption, and the U.N. International Convention for the Suppression of the Financing of Terrorism.

[25] *FATF, China Mutual Evaluation 8th Follow-up Report, Anti-Money Laundering and Combating the Financing of Terrorism*(February 17, 2012), available at www.fatf-gafi.org/dataoecd/5/34/49847246.pdf. The report noted that China has made significant progress to address the remaining deficiencies and has "reached a satisfactory level of compliance with all six core Recommendations and eight of the [ten] key Recommendations." Id at para. 41. In one of the key Recommendations where China has not attained a satisfactory level of compliance (implementation of international instruments related to terrorist financing), China has substantially addressed part of the deficiency and continues to make progress. With respect to the other key Recommendation (freezing of terrorist-related assets), China has made significant progress since June 2011 to improve its implementation. In particular, China has implemented legislation establishing a legislative framework and administrative authority for enforcement and has responded to foreign requests to freeze assets. The FATF was of the view that China should enact additional guidance to improve implementation, and Chinese authorities are currently drafting rules to do so. Id. at paras. 150-52 and 157-59.

BOC has policies and procedures to comply with Chinese laws and rules regarding AML. BOC states that it has implemented measures consistent with the recommendations of the FATF and that it has put in place policies, procedures, and controls to ensure ongoing compliance with all statutory and regulatory requirements, including designating AML compliance personnel and conducting routine employee training at all BOC branches. BOC's compliance with AML requirements is monitored by the PBOC and by BOC's internal and external auditors.

Based on all the facts of record, the Board has determined that the AML efforts by BOC and its home country supervisors are consistent with approval.

The Board has also considered the financial and managerial factors in this case. The CBRC requires Chinese banks to follow the Basel I Capital Accord with certain enhancements from the Basel II Capital Accord.[26] The capital levels of BOC exceed the minimum levels that would be required under the Basel I Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization. Managerial and other financial resources of BOC are consistent with approval, and BOC appears to have the experience and capacity to support the proposed branch. In addition, BOC has established controls and procedures for the proposed branch to ensure compliance with U.S. law and for its operations in general. In particular, BOC has stated that it will apply strict AML policies and procedures at the branch consistent with U.S. law and regulation and will establish an internal control system at the branch consistent with U.S. requirements to ensure compliance with those policies and procedures.

With respect to access to information about BOC's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which BOC operates and has communicated with relevant government authorities regarding access to information. BOC has committed to make available to the Board such information on the operations of BOC and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the BHC Act, and other applicable federal laws. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, BOC also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable it or its affiliates to make such information available to the Board. The Board also has consulted with the CBRC about access to information. The CBRC has represented that it would facilitate the Board's access to information and has entered into a statement of cooperation with the Board and other U.S. banking regulators with respect to the sharing of supervisory information.[27] In light of these commitments and other facts of record, and subject to the condition described below, the Board has determined that BOC has provided adequate assurances of access to any necessary information that the Board may request.

China has made progress toward adopting a system of financial regulation for its financial system to mitigate the risk to financial stability from its banks. The PBOC, CBRC, other financial supervisory agencies, and other agencies in China have taken joint measures to maintain financial stability. China has established a system of preliminary indicators for monitoring financial stability, developed methodology and operational frameworks for monitoring financial risks, and published an annual China Financial Stability Report since 2005. The CBRC has established mechanisms to cooperate with supervisory authorities in at least 25 other countries for the supervision of cross-border banking. In addition, the

[26] The CBRC also requires all large, internationally active banks, such as BOC, to have a minimum risk-based tier 1 capital ratio of 9 percent and total capital ratio of 11.5 percent. BOC's capital ratios exceed these levels.

[27] *See* Memorandum of Understanding between the CBRC and the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, June 17, 2004.

PBOC and CBRC officially joined the Basel Committee on Banking Supervision on behalf of China and since their accession, have actively participated in the revision of the Basel II Capital Accord, in the formulation of the Basel III Capital Accord, and in other working groups. China also is active in the ongoing work of the Financial Stability Board. U.S. bank regulators and other bank supervisors in pertinent jurisdictions participated in two supervisory colleges hosted by the CBRC: one for ICBC in 2009 and one for CCB in 2011. Moreover, authorities in the United States and China that are responsible for the oversight of auditing services for public companies are engaged in continuing discussions with respect to enhancing cross-border cooperation, and the Board looks forward to timely negotiation of an agreement relating to cooperative actions by these authorities.

The IBA establishes criteria that must be met before the Board can approve the establishment of a branch outside the foreign bank's home state. BOC's home state is New York. Under section 5(a)(1) of the IBA, as amended by section 104 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994,[28] a foreign bank, with the approval of the Board and the Office of the Comptroller of the Currency ("OCC"), may establish and operate a federal branch in any state outside its home state to the extent that a national bank with the same home state as the foreign bank could do so under section 36(g) of the National Bank Act. Section 36(g), which previously authorized states to "opt-in" to interstate de novo branching, was amended by section 613 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to permit national banks to establish interstate de novo branches nationwide.[29] The Board has determined that all the other criteria referred to in sections 5(a)(1) and 5(a)(3) of the IBA, including the criteria in section 7(d) of the IBA, have been met.[30] In view of all the facts of record, the Board is permitted to approve the establishment of an interstate de novo federal branch by BOC under section 5(a) of the IBA.

On the basis of all the facts of record, and subject to the commitments made by BOC, as well as the terms and conditions set forth in this order, BOC's application to establish a branch is hereby approved. The Board conditions its decision on BOC providing to the Board adequate information on its operations and activities as well as those of its affiliates to determine and enforce compliance by BOC or its affiliates with applicable federal statutes. Should any restrictions on access to information on the operations or activities of BOC or any of its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by BOC or its affiliates with applicable federal statutes, the Board may require termination or divestiture of any of BOC's or its affiliates' direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by BOC with the commitments made to the Board in

[28] 12 U.S.C. § 3103(a)(1).

[29] 12 U.S.C. § 36(g)(1)(A).

[30] Section 36(g) of the National Bank Act and section 5(a) of the IBA require that certain conditions of section 44 of the Federal Deposit Insurance Act ("FDI Act") be met in order for the Board to approve a de novo interstate federal branch. *See* 12 U.S.C. § 36(g)(2) and 12 U.S.C.§ 3103(a)(3)(C) (referring to sections 44(b)(1), 44(b)(3), and 44(b)(4) of the FDI Act, 12 U.S.C. §§ 1831u(b)(1), (b)(3), and (b)(4)). The Board has determined that BOC is in compliance with state filing requirements. Community reinvestment considerations are also consistent with approval, as BOC's two insured New York City branches received a Community Reinvestment Act ("CRA") rating of "satisfactory" from the OCC at their most recent CRA performance evaluation dated August 18, 2008. BOC was adequately capitalized as of the date the application was filed, and on consummation of this proposal, BOC would continue to be adequately capitalized and adequately managed.

In accordance with section 5(a)(3)(B)(ii) of the IBA (12 U.S.C. § 3103(a)(3)(B)(ii)) and section 211.24(c)(3)(i)(B) of Regulation K (12 CFR 211.24(c)(3)(i)(B)), the Board has consulted with the Department of the Treasury regarding capital equivalency.

connection with this application and with the conditions in this order.[31] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against BOC and its affiliates.

By order of the Board of Governors, effective May 9, 2012.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Final Enforcement Decision Issued by the Board

In the Matter of Louis A. DeNaples, An Institution-Affiliated Party of First National Community Bancorp, Dunmore, Pennsylvania, and Urban Financial Group, Inc., Bridgeport, Connecticut

FRB Docket No. 09-191-B-I

This is an administrative proceeding pursuant to the Federal Deposit Insurance Act ("the FDI Act") in which the Enforcement Counsel for the Board seeks an order requiring Respondent, Louis A. DeNaples, to cease and desist from his alleged continuing violation of section 19 of the FDI Act, 12 U.S.C. § 1829.

Under section 19, an individual who has agreed to enter into a pretrial diversion or similar program in connection with certain criminal charges must seek the Board's consent in order to continue as an institution-affiliated party of a bank holding company. Here, it is undisputed that Respondent did not seek that consent after he entered into an agreement with a state district attorney withdrawing charges of perjury in exchange for promises by the Respondent, but he did continue to be an institution-affiliated party at two bank holding companies. Respondent argues that no consent is required and that he may continue to serve as an institution-affiliated party because the withdrawal agreement was not an "agree[ment] to enter into a pretrial diversion or similar program" as that term is defined under section 19. As discussed below, however, the Board determines that the withdrawal agreement does constitute the type of program covered by section 19, and that by failing to seek the Board's consent to his continued service as an institution-affiliated party, the Respondent has deprived the Board of its statutorily-mandated opportunity to review whether to permit his continued involvement with those companies. The Board also rejects other procedural and substantive arguments raised by Respondent. Therefore, upon review of the administrative record and additional filings made to the Board, the Board issues this Final Decision adopting the Recommended Decision ("Recommended Decision") of Administrative Law Judge C. Richard Miserendino (the "ALJ"), except as modified herein, and orders the issuance of the attached Order to Cease and Desist.

[31] The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the OCC to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the OCC to license the proposed office of BOC in accordance with any terms or conditions that it may impose.

I. Statement of the Case

A. Statutory and Regulatory Framework

A number of provisions of the FDI Act are implicated in this administrative enforcement action. Section 19 of the FDI Act ("section 19"), 12 U.S.C. § 1829, makes it illegal for any person to become or continue to be an institution-affiliated party with respect to any bank holding company ("BHC"), own or control a BHC, or participate in the conduct of the affairs of a BHC without the consent of the Board if that person has been convicted of a criminal offense involving dishonesty or a breach of trust or money laundering, or has agreed to enter into a pretrial diversion or similar program in connection with such an offense. 12 U.S.C. § 1829(a)(1)(A), (d)(1).[1] A person is an institution-affiliated party of a bank holding company if, among other things, he or she is an officer, director, employee, or controlling stockholder of the BHC, or has filed or is required to file a change in control notice under the Change in Bank Control Act, 12 U.S.C. § 1817(j). 12 U.S.C. § 1813(u), 1818(b)(3) (applying the penalty provisions of section 1818 to bank holding companies in the same way as they apply to state member banks); In re Pharaon, 83 Federal Reserve Bulletin 347, 348 n.2 (1997).

Section 8(b) of the FDI Act, 12 U.S.C. § 1818(b), spells out the substantive requirements for issuing a cease-and-desist order. A cease-and-desist order may be imposed when the agency has reasonable cause to believe that the respondent has engaged or is about to engage in an unsafe or unsound practice in conducting the business of a depository institution, or that the respondent has violated or is about to violate a law, rule, or regulation or condition imposed in writing by the agency. 12 U.S.C. § 1818(b)(1). A cease-and-desist order may require the respondent to take affirmative action the agency determines to be appropriate to correct or remedy any conditions resulting from the violation or practice with respect to which such order is issued. 12 U.S.C. § 1818(b)(6)(F). The power to issue cease-and-desist orders includes the authority to place limitations on the activities of the respondent. 12 U.S.C. § 1818(b)(7).

Under section 8(b) and the Board's regulations, the ALJ is responsible for conducting proceedings on a notice of charges relating to a proposed order to cease and desist. 12 U.S.C. § 1818(b). The ALJ issues a recommended decision that is referred to the Board together with any exceptions to those recommendations filed by the parties. The Board makes the final findings of fact, conclusions of law, and determination whether to issue the requested orders. 12 CFR 263.38.

Respondent asserts that an additional section of the FDI Act is relevant to this proceeding. Section 8(g) of the Act sets forth a separate procedure and substantive basis for addressing certain misconduct by bank officials and employees. Under section 8(g), a federal banking agency may issue a pre-hearing order of removal or prohibition against a bank official or employee if (1) a judgment of conviction or an agreement to enter a pretrial diversion or other similar program is entered against the respondent in connection with certain specified crimes or any crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year; and (2) continued service or participation by the respondent would threaten the interests of depositors or impair public confidence in a depository institution. 12 U.S.C. § 1818(g)(1)(C). Section 8(g)(3) sets out a procedure for post-deprivation process in the case of an order issued under section 8(g)(1), in which the respondent may seek to show that his or her continued participation in the institution's

[1] The same conduct is proscribed for institution-affiliated parties of insured depository institutions absent the approval of the Federal Deposit Insurance Corporation. 12 U.S.C. § 1829(a)(1).

affairs would not pose a threat to the institution's depositors or impair public confidence in the institution. 12 U.S.C. §1818(g)(3).

B. Facts[2]

First National Community Bancorp ("First National"), Dunmore, Pennsylvania, and Urban Financial Group, Inc. ("Urban Financial"), Bridgeport, Connecticut, are registered bank holding companies. Respondent is currently chairman and a director of First National, owns 10.26 percent of its voting shares, and is a member of a group that owns approximately 19.87 percent of its voting shares. Respondent is the largest shareholder of Urban Financial, owning approximately 45 percent of its shares. Accordingly, Respondent is an institution-affiliated party of both First National and Urban Financial. 12 U.S.C. § 1813(u).

On January 30, 2008, the District Attorney of Dauphin County, Pennsylvania ("District Attorney") filed a criminal complaint against Respondent that charged him with four counts of perjury in connection with testimony Respondent gave to the Pennsylvania Gaming Control Board while in the process of obtaining a gaming license for a casino he owned. Respondent took a leave of absence from his position as chairman and director of First National shortly after the charges were filed and to date remains on leave of absence.

On April 15, 2009, after months of negotiations, Respondent and the District Attorney entered into an Agreement for Withdrawal of Charges ("Withdrawal Agreement"). Under the written terms of the Agreement, the District Attorney agreed to withdraw all of the criminal charges but reserved the right to reinstate the charges upon a material breach of any term of the Withdrawal Agreement by Respondent. Respondent in turn agreed, among other things, to transfer his interest in the casino to a trust for the benefit of his daughter, transfer to the trust any profits accrued in the casino during the period of suspension of his gaming license, pay the cost of prosecution, and provide quarterly reports to the District Attorney regarding his compliance with the Withdrawal Agreement for two years following execution. Based on the Withdrawal Agreement, the Board initiated this enforcement proceeding against Respondent.

Following the ALJ's issuance of his Recommended Decision, the Court of Common Pleas of Dauphin County, Pennsylvania, at Respondent's request, issued two Orders relevant to this matter. The first, issued May 18, 2011 ("Expungement Order"), was a form order providing that Respondent's "arrest record regarding these charges shall be expunged" and directing "all criminal justice records upon whom this order is served" to "expunge and destroy" documents pertaining to the proceedings. The Expungement Order did not mention the Withdrawal Agreement. The second, issued September 19, 2011 ("Clarifying Order"), "clarified" the prior order by stating, in part: "Encompassed within the Expungement Order was the Agreement for Withdrawal of Charges ('Withdrawal Agreement'). Since it has been completely and forever expunged, the Withdrawal Agreement is of no force or effect."

C. Procedural History

On November 23, 2009, the Board issued a Notice of Charges and of Hearing Issued Pursuant to section 8(b) of the FDI Act ("Notice") alleging that Respondent had not sought or received the Board's permission to continue to be an institution-affiliated party within

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[2] Except where specifically noted, the stated facts are undisputed by the parties. *See* Enforcement Counsel's Statement of Material Facts Not in Dispute ("FRB SOF"), filed March 25, 2010, and Respondent's Statement of Undisputed Material Facts ("Resp. SOF"), filed April 5, 2010.

the meaning of section 19(a)(1)(A)(ii), despite the fact that he entered into a pretrial diversion agreement to resolve criminal charges. The Notice sought a cease-and-desist order requiring Respondent to resign his position as director of First National and submit an acceptable plan to the Board for the prompt divestiture of his controlling shareholdings in First National and Urban Financial.[3] Respondent timely filed an answer to the Notice, admitting that he is the chairman (albeit on a leave of absence) of First National; that he owns 10.26 percent of the voting shares of First National and has been a member of a control group that filed a notice of change in bank control with the Federal Reserve; and that he owns 45 percent of the voting shares of Urban Financial. Respondent further admitted that he has not sought or received the Board's permission to be an institution-affiliated party of First National or Urban Financial after entering into the agreement. Respondent denied that he has violated section 19, asserting that the agreement into which he entered was not a "pretrial diversion or similar program" within the meaning of section 19.

On February 12, 2010, Enforcement Counsel filed a Motion to Strike Respondent's Request for Production of Documents. Respondent's production request had generally sought discovery concerning whether Respondent's continued participation in First National and Urban Financial would cause harm to the institutions. The ALJ granted Enforcement Counsel's Motion to Strike on the grounds that discovery concerning harm to the financial institutions was not materially relevant to a proceeding brought under section 8(b).

Enforcement Counsel and Respondent each filed motions for summary disposition accompanied by statements of material facts not in dispute. On July 23, 2010, Respondent filed a Motion for Leave to File a Notice of Supplemental Authority in Support of his Cross-Motion for Summary Disposition and the corresponding Notice of Supplemental Authority ("First Notice of Supplemental Authority"), which was denied by the ALJ on August 11, 2010.

On February 18, 2011, the ALJ issued a Recommended Decision advising that Enforcement Counsel's Motion for Summary Disposition be granted and that Respondent's Cross-Motion for Summary Disposition be denied, and recommending the issuance of the cease and-desist order against Respondent.[4] Respondent subsequently filed exceptions to the ALJ's Recommended Decision and the matter was referred to the Board for final decision. *See*12 CFR 263.38-39. On March 29, 2011, the Board issued a notice acknowledging that the complete record of the matter had been submitted to the Board. *See*12 CFR 263.40.

Nonetheless, on April 4, 2011, Respondent filed with the Board a Request to Reopen the Record and Notice of Supplemental Authority in Support of his Exceptions ("Second Notice of Supplemental Authority"), which was opposed by Enforcement Counsel. On April 27, 2011, Respondent filed a Reply in Support of Notice of Supplemental Authority ("Third Notice of Supplemental Authority") which contained further new documentary evidence in support of Respondent's exceptions. Enforcement Counsel duly opposed that supplemental filing as well. On May 25, 2011, Respondent filed a Motion for Immediate Dismissal of Cease and Desist Proceedings based on the issuance of a state court order

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[3] On November 24, 2009, the Office of the Comptroller of the Currency ("OCC") issued a substantially similar Notice of Charges seeking a cease-and-desist order requiring Respondent's resignation from his position as chairman and director of First National Community Bank ("Bank"). In his Recommended Decision, the ALJ consolidated the proceedings for the Board's Notice and the OCC's Notice of Charges. On March 23, 2012, the OCC entered order requiring Respondent to cease and desist from his continuing violation of section 19, including by resigning from all positions that he holds as an institution-affiliated party.

[4] The ALJ's Recommended Decision also recommended that the OCC grant the OCC Enforcement Counsel's motion for summary disposition and issue the OCC Enforcement Counsel's requested cease-and-desist order. As noted earlier, the OCC issued its final decision adopting this recommendation on March 23, 2012.

granting his petition for expungement of his criminal record ("First Motion for Immediate Dismissal"). This was followed by a second Motion for Immediate Dismissal of Cease and Desist Proceedings based on a clarification of the state court expungement order ("Second Motion for Immediate Dismissal"). Enforcement Counsel opposed both motions. Despite the fact that these various filings were made after the Board notified parties that the record was closed, the Board has considered them in its final decision.

II. Discussion

This proceeding raises several novel issues for the Board. First, the Board must consider Respondent's argument that a cease-and-desist proceeding under section 8(b) of the FDI Act is improper procedurally, and that the only way the Board could obtain the relief sought would have been to proceed under section 8(g). Second, the Board must decide whether by entering into the Withdrawal Agreement, Respondent entered into a "pretrial diversion or similar program" within the meaning of section 19 of the FDI Act. Finally, the Board must address the effect of the Expungement Order and the Clarifying Order on that determination.

Most of these issues were raised before the ALJ,[5] who recommended issuance of a cease and-desist order against Respondent under section 8(b) based on Respondent's violations of section 19.[6] The ALJ's recommended decision held that the Board had authority to proceed under section 8(b) to address violations of section 19. It also held that the Withdrawal Agreement was a "pretrial diversion or similar program" under section 19, and that state law did not govern the interpretation of that phrase. For the reasons set forth below, the Board affirms the ALJ's recommended decision and determines that the subsequent expungement of Respondent's criminal record does not divest the Board of authority to proceed to remedy a violation of section 19. The Board therefore issues the attached cease-and-desist order against Respondent.

A. The Board may enforce Section 19 through a cease-and-desist proceeding under Section 8(b)

Under section 8(b), the Board has the authority to serve on an institution-affiliated party within its regulatory jurisdiction a notice of charges seeking a cease-and-desist order if, in the Board's opinion, the institution-affiliated party "is violating or has violated . . . a law." 12 U.S.C. § 1818(b)(1). In the present case, after Respondent entered into the Withdrawal Agreement, the Board initiated a notice of charges against Respondent because it believed Respondent was violating section 19 of the FDI Act by continuing, without the consent of the Board, to be an institution-affiliated party of First National and Urban Financial after entering into a pretrial diversion or similar program. Section 19 is "a law" and, moreover, is within the same statute as section 8(b). The statutory language thus clearly supports the Board's authority to pursue a cease-and-desist order under section 8(b) to remedy a violation of section 19.

Despite the apparently clear statutory language, Respondent contends that section 8(b) cannot be used to enforce section 19 because he claims that section 19 is only a criminal statute. Respondent also argues that, to the extent the Board can address the involvement in bank-

[5] The ALJ did not address the effect of the Expungement Order or the Clarifying Order, which were issued after the issuance of the Recommended Decision.

[6] Respondent did not argue, either before the ALJ or in his Exceptions, that he was not an institution-affiliated party of First National or of Urban Financial or that his Withdrawal Agreement was not entered into in connection with a prosecution for an offense involving dishonesty within the meaning of section 19(a)(1). Accordingly, these issues are waived. 12 CFR 263.39(b).

ing of an individual who enters into a "pretrial diversion or other similar program," Section 8(g) governs because it is more specific than section 8(b) and because using section 8(b) for this purpose essentially renders the bank officer removal provision of section 8(g) superfluous. Respondent cites Feinberg v. FDIC, 420 F.Supp. 109 (D.D.C. 1976), to argue that only section 8(g) can be used for removal because it provides constitutionally guaranteed substantive and procedural safeguards that are lacking in section 8(b).

Respondent's first argument fails because the structure of section 19 alone shows that it is not purely a criminal statute, and because, even if it were, it would support an administrative enforcement action under section 8 of the FDI Act. Subsection 19(a)(1) prohibits certain conduct, including serving, without the appropriate regulator's consent, as an institution-affiliated party after agreeing to enter into a pretrial diversion or similar program related to a crime of dishonesty. 12 U.S.C. § 1829(a)(1). Subsection 19(b) creates a criminal penalty for "[w]hoever knowingly violates subsection (a)." 12 U.S.C. § 1829(b) (emphasis added). While the statute thus provides that a subset of the conduct prohibited in subsection 19(a)(1), namely "knowing" violations, may be criminally punished, this by no means limits the breadth or administrative enforceability of the prohibition contained in subsection 19(a)(1). Moreover, even assuming section 19 were purely a criminal statute, section 8(b) allows for the Board to require compliance with it through a cease-and-desist proceeding under section 8(b). *See* Cousin v. OTS, 73 F.3d 1242, 1251 (2d Cir. 1996) (criminal bribery charge is sufficient to support removal under the analogous provision of the Home Owners' Loan Act).

Respondent's second argument is based on what he sees as a conflict between section 8(g) of the FDI Act, which sets forth a procedure for suspension or prohibition of institution-affiliated parties involved in certain crimes, and the approach taken by Board Enforcement Counsel here, which used the more general authority in section 8(b) of the FDI Act to issue a cease-and-desist order for a violation of section 19 of that Act, which in turn refers to similar crimes. In short, Respondent argues that the Board may not use section 8(b) to remove Respondent from his position, but may only use the procedures set forth in section 8(g); to hold otherwise, argues Respondent, would render section 8(g) superfluous. In support of this argument, Respondent cites a general canon of statutory interpretation which states "[w]hen both specific and general provisions cover the same subject, the specific provision will control, especially if applying the general provision would render the specific provision superfluous." Norwest Bank Minn. Nat. Ass'n v. FDIC, 312 F.3d 447, 451 (D.C. Cir. 2002). Respondent's argument fails, however, because section 8(g) and section 19 do not "cover the same subject." Section 19 covers cases in which a respondent has been convicted of, or has agreed to enter a pretrial diversion or similar program in connection with a prosecution for, any crimes involving "dishonesty or a breach of trust or money laundering." By contrast, section 8(g) limits its reference to crimes of dishonesty or breach of trust to those crimes punishable by imprisonment of at least a year.

Additionally, as Respondent correctly notes, section 8(g) calls for different procedures than section 8(b). This difference in procedures does not, however, make it impermissible for Enforcement Counsel to proceed under section 8(b), as Respondent argues. Rather, so long as the procedures provided for in each subsection comply with constitutional standards of due process, the decision on how to proceed is entirely within the discretion of the Board.[7]

[7] Respondent argues that the permissive term "may" in section 8(b) (providing that if an institution-affiliated party "is violating . . . a law," the agency "may issue . . . a notice of charges" in respect thereof) means only that "while Enforcement Counsel can decide whether to bring an action to remove a banking official, such an action, if pursued[,] must be prosecuted under section 8(g)." Respondent's Brief in Support of Exceptions at 11. There is nothing in the statutory language of section 8(b) that compels or even permits this interpretation, and the Board declines to adopt it.

Feinberg, cited by Respondent, does not suggest otherwise. In that case, the district court struck down on due process grounds an earlier version of section 8(g) (not section 8(b)) because it did not provide for any hearing, either before or after issuance of a prohibition order, substantially limited judicial review, and would likely result in a permanent loss of property of the individual being suspended. Feinberg, 420 F.Supp. at 112, 119-21. But section 8(b), under which Enforcement Counsel proceeded, already has all of the constitutional protections identified by the Feinberg court, so Feinberg provides no basis for challenging Enforcement Counsel's choice of enforcement mechanism.[8] Moreover, section 8(b) provides for a pre-deprivation notice and hearing, rather than the post-deprivation mechanism provided in section 8(g), so from a constitutional standpoint its protections are even greater. *See* 12 U.S.C. § 1818(b)(1), (h).

Respondent makes much of the fact that section 8(g) describes an additional "harm" factor as necessary to remove an institution-affiliated party, while neither section 19 nor section 8(b) contains such a requirement.[9] However, Congress could reasonably have decided, as the FDI Act indicates, that before initiating an action under section 8(g) to deprive an individual of his or her position without a prior hearing, the banking agencies must have a strong interest in proceeding, based on the potential for harm to the public interest. This heightened harm requirement acts as a check on an agency's ability to remove individuals without a prior hearing except where the public interest is at its highest. In contrast, a cease-and-desist order under section 8(b) serves occasions where the agency determines it is unnecessary to act against an individual immediately and chooses to provide pre-deprivation procedures instead. This may be because the agency sees less immediate harm, such as when, as here, the institution-affiliated party has already taken a leave of absence from his banking positions. Rather than rendering section 8(g) superfluous, the provisions of section 8(b) simply provide a different tool for agencies to use under certain circumstances where the agency decides it is more appropriate. The fact that Enforcement Counsel availed itself of one enforcement tool over another is not impermissible.

Moreover, the Board's decision to use the pre-deprivation hearing procedures of section 8(b), which unlike section 8(g) does not contain an explicit harm standard, does not negate the strong public interest in requiring agency review before an individual with a history of crimes involving dishonesty or breach of trust is permitted to continue as an institution-affiliated party. Congress, by prohibiting such involvement absent agency approval, has already determined that individuals whose conduct is among the offenses listed in section 19 cause continuing harm to the public confidence in financial institutions. Because under section 8(b) the individual has an opportunity to challenge the basis for a cease-and-desist order before it is issued, the agency need not make a special showing of harm beyond the fact that the requirements of section 19 have been met. As Feinberg noted, "[t]he fundamental requisite of due process of law is the opportunity to be heard." 420 F.Supp. at 119 (quoting Grannis v. Ordean, 234 U.S. 385, 394 (1914)). In reviewing section 8(b) and

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[8] Section 8(g) has since been amended, and the Supreme Court has found it to be constitutionally sound. *See* FDIC v. Mallen, 486 U.S. 230, 248 (1988).

[9] The Board notes that Respondent appears to misconstrue section 8(g) by suggesting the Board must show harm to the institution or the public in order to remove an individual under section 8(g). Section 8(g) actually places the burden on respondents to disprove harm. The Board must initially determine that an individual's continued service as an institution-affiliated party would cause harm before issuing a prohibition notice, but to challenge this notice, the respondent must "show that the continued service to or participation in the conduct of the affairs of the depository institution by such party does not, or is not likely to, pose a threat to the interests of the bank's depositors or threaten to impair public confidence in the depository institution." 12 U.S.C.§ 1818(g)(1)(A), (3).

the Board's regulations, and how they were applied in these proceedings, the Board sees no reason to find Respondent has been denied his constitutional right to be heard.[10]

B. The Withdrawal Agreement as executed is an agreement "to enter into a pretrial diversion or similar program."

Respondent asserts that the ALJ erred in finding that Respondent "agreed to enter into a pretrial diversion or similar program" within the meaning of section 19 when he signed the Withdrawal Agreement. *See* 12 U.S.C. § 1829. Section 19 does not define "pretrial diversion or similar program." Respondent contends that state law should govern this question, and that under the law of Pennsylvania the Withdrawal Agreement does not constitute a pretrial diversion program.

Respondent argues in this regard that the Board must follow the interpretation in the FDIC Statement of Policy for section 19 of the FDI Act ("FDIC Policy Statement"). *See* www.fdic.gov/regulations/laws/rules/5000-1300.html. That Policy Statement provides in part that "[w]hether a program constitutes a pretrial diversion is determined by relevant federal, state, or local law, and will be considered by the FDIC on a case-by-case basis." The FDIC Policy Statement is, however, just that — a statement of policy of the FDIC. It is not legally binding on any party (save, perhaps, for the FDIC itself), *see*Ctr. for Auto Safety v. NHTSA, 452 F.3d 798, 807 (D.C. Cir. 2006) (general statements of policy "neither determine rights or obligations nor occasion legal consequences"). In any case, the FDIC Policy Statement is certainly not binding on the Board, which has sole interpretive and policy authority over section 19 with respect to bank holding companies.[11] The Board has never formally adopted the FDIC Policy Statement or any other policy interpreting "pretrial diversion or similar program" in section 19. Therefore, the Board is not bound by the FDIC Policy Statement and may exercise its own authority to interpret the term.

Though not authoritative for the Board, the FDIC Policy Statement contains a useful description of features that are generally part of a pretrial diversion or similar program.[12] The Board takes a similar view and will look for two characteristics in determining whether an agreement to enter a pretrial diversion or similar program exists: the agreement provides for (1) a suspension or eventual dismissal of charges or criminal prosecution, and (2) a voluntary agreement by the accused to treatment, rehabilitation, restitution or other noncriminal or nonpunitive alternatives. This is in line with the "ordinary" meanings of the term discussed in the Recommended Decision.

In making this determination, the Board is not bound, as Respondent has asserted, to follow state or local law definitions of "pretrial diversion." *See* Taylor v. United States, 495 U.S. 447, 451 (1990) (absent a plain indication to the contrary, federal laws are not construed so that their application depends on state law) (citing Dickerson v. New Banner Institute, Inc., 460 U.S. 103, 119-120 (1983); Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989). The phrase "pretrial diversion or similar program" is found in

[10] As a related matter, the Board also affirms the ALJ's Order Granting Motion to Strike Production of Documents. Respondent had sought discovery related to the harm to the institution posed by his remaining as a director. For the reasons discussed above, the ALJ was correct in ruling such discovery was not relevant to this matter.

[11] *See* Collins v. NTSB, 351 F.3d 1246, 1254 (D.C. Cir. 2003) (where expert enforcement agencies have mutually exclusive authority over separate sets of regulated persons, each expert agency is entitled to deference in its interpretation of the statute). Section 19 is such a statute, with the FDIC having exclusive authority over participation in insured depository institutions, and the Board having exclusive authority over participation in bank holding companies and savings and loan holding companies.

[12] The FDIC Policy Statement states that a pretrial diversion or similar program "is characterized by a suspension or eventual dismissal of charges or criminal prosecution upon agreement by the accused to treatment, rehabilitation, restitution, or other noncriminal or nonpunitive alternatives." 63 *Federal Register* 66184-85.

a federal statute setting standards to be applied by federal banking agencies regarding parties who may be associated with federally-regulated depository institutions and holding companies. By requiring prior consent, section 19 ensures that the Board, as the federal regulator of bank holding companies, has an opportunity to scrutinize individuals when certain conduct —including the individual agreeing to enter into a pretrial diversion or similar program—has occurred, and make a judgment as to the benefits and risks of their continued involvement in banking. State law definitions of "pretrial diversion" are not meant to address this concern. Thus, the phrase must be interpreted as a matter of federal law.

However, state or local law may be relevant in some circumstances. For example, a program referred to by state authorities as a "pretrial diversion" program would likely meet the characteristics of a pretrial diversion or similar program under section 19. Nonetheless, the terminology used by a state— or the parties to an agreement – is not dispositive of whether a program is a "pretrial diversion or similar program" as that phrase is used in section 19. Accordingly, Respondent's contention that only state law definitions should govern the Board's interpretation of section 19 is rejected.

Similarly, Respondent's contention that the parties' subjective intent governs is also rejected. Under federal common law of contracts, although the parties' intent is the "paramount goal" in construing a contract, "[c]ourts are to consider 'not the inner, subjective intent of the parties, but rather the intent a reasonable person would apprehend in considering the parties' behavior.'" Baldwin v. Univ. of Pittsburgh Med. Ctr., 636 F.3d 69, 75 (3d Cir. 2011) (quoting Am. Eagle Outfitters v. Lyle & Scott Ltd., 584 F.3d 575, 582 (3d Cir. 2009)). The words of a contract "clearly manifest the parties' intent if they are capable of only one objectively reasonable interpretation." Baldwin, 636 F.3d at 76. Moreover, the results would not differ under Pennsylvania law. *See* Mellon Bank, N.A. v. Aetna Business Credit, Inc., 619 F2.d 1001, 1009-10 (3d Cir. 1980) (quoting Best v. Realty Management Corp., 101 A.2d 438, 440 (Pa. Super. 1953)) (finding that Pennsylvania courts do not psychically delve into the minds of the parties; rather, "[w]hen a written contract is clear and unequivocal, its meaning must be determined by its contents alone.").

In this case, the Withdrawal Agreement unequivocally states that the District Attorney would withdraw charges against Respondent but retained the right to reinstate charges upon material breach of any term of the Withdrawal Agreement by Respondent. *See* Answer ¶ 9 10, Resp. SOF ¶ 11. In exchange, Respondent was required to transfer his ownership interest in his casino to his daughter, transfer any profits that accrued from the casino to his daughter's trust, provide quarterly reports to the District Attorney regarding his compliance with the Withdrawal Agreement, and pay the cost of the prosecution of the case. *See* Resp. SOF ¶ 13. Thus, the Withdrawal Agreement on its face contains the characteristics of an agreement to enter a pretrial diversion or similar program: the District Attorney withdrew criminal perjury charges against Respondent conditioned on Respondent agreeing to certain noncriminal alternatives. Notwithstanding any subjective intent the signatories may have had (or have now) to avoid implication of section 19, the terms of the Withdrawal Agreement constitute an agreement to enter a pretrial diversion or similar program.

As an additional matter, Respondent has excepted to the ALJ's denial of his First Notice of Supplemental Authority, which proffered evidence meant to show the Respondent did not admit guilt to the charges underlying the Withdrawal Agreement and that the claims lacked

prosecutorial merit.[13] The Board agrees with the ALJ that this evidence would not aid in the determination of whether the Withdrawal Agreement constitutes an agreement to enter a pretrial diversion or similar program. Contrary to Respondent's assertions, an admission of guilt is not a standard prerequisite for all pretrial diversion programs. *See* National Association of Pretrial Services Agencies, Performance Standards and Goals for Pretrial Diversion/Intervention, Standard Commentary to Standard 4.4, p. 13 (Nov. 2008) (hereinafter "NAPSA Standards") ("Those potential participants who maintain their innocence should not be denied enrollment [in a pretrial diversion] if, after an opportunity to consult with counsel, they make an informed decision to take the diversion option."). Thus, evidence that Respondent did not admit guilt would not raise a dispute as to whether the Withdrawal Agreement was an agreement to enter into a pretrial diversion or similar program.

Respondent's argument that the Withdrawal Agreement could not be a pretrial diversion or similar program because cases that lack prosecutorial merit cannot be funneled into pretrial diversion or similar programs is also rejected. *See* Respondent DeNaples' Notice of Supplemental Authority in Support of His Cross-Motions for Summary Judgment at 4-5; *see also* NAPSA Standards, Standard 1.4 ("All cases considered for pretrial diversion/intervention should have prosecutorial merit."). The Withdrawal Agreement on its face indicates that the District Attorney agreed to withdraw charges based upon Respondent's agreeing to the terms therein and with the explicit understanding that the District Attorney could refile charges if Respondent materially breached the Withdrawal Agreement. This alone suggests that the District Attorney did not consider the case to lack prosecutorial merit. Cf. NAPSA Standards, Commentary to Standard 1.4 ("One of the underpinnings of diversion is that if defendant fails to comply with the program, he or she will be returned to the court for prosecution."). While Respondent's evidence may be relevant in evaluating a request for consent filed with the Board under section 19, should Respondent choose to submit one, it is not relevant in determining whether the Withdrawal Agreement is an agreement to enter into a pretrial diversion or similar program and whether Respondent is therefore required by section 19 to file such a request before continuing as an institution-affiliated party of a bank holding company, which is the subject of this proceeding.[14] Accordingly, the ALJ did not err in excluding Respondent's evidence.

For the reasons discussed above, the Board finds that by entering the Withdrawal Agreement, Respondent "agreed to enter into a pretrial diversion or similar program" within the meaning of section 19.[15]

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[13] The evidence submitted with the First Notice of Supplemental Authority consists of filings in the matter of United States v. D'Elia before the United States District Court for the Middle District of Pennsylvania. Respondent was not a party to this matter, which concerned whether Mr. D'Elia could receive a reduction of his current sentence based on information he provided regarding the criminal charges against Respondent that are the basis for the section 19 violation. In his First Notice of Supplemental Authority, Respondent cites language in an order by the district court which states in a summary of facts that the criminal charges against Respondent were withdrawn with no admission of guilt. Respondent also refers to language in the government's motion for reduction of sentence that he argues indicates the prosecutor withdrew the case against him because it was non-meritorious.

[14] Moreover, contrary to Respondent's assertions, the evidence he presented to the ALJ does not indicate that the District Attorney's case lacked prosecutorial merit. *See*First Notice of Supplemental Authority, Ex. B. The evidence is equivocal at best. It consists of a motion for sentence reduction filed in a matter to which neither the Respondent nor the District Attorney was a party. Moreover, although the motion states at one point that the "District Attorney decided the case could not be successfully prosecuted," the basic purpose of the motion is to argue that a different defendant's sentence should be reduced because information that the defendant provided was instrumental in helping the District Attorney secure the Withdrawal Agreement against Respondent.

[15] For the reasons discussed above, the Board also rejects Respondent's claim that he was inappropriately denied oral argument and an evidentiary hearing before the ALJ. Because Respondent did not deny the existence or validity of the relevant terms of the Withdrawal Agreement, the ALJ correctly determined that additional evi-

C. Respondent's Post-Record Notices of Supplemental Authority and Motions for Immediate Dismissal

After the Board notified parties that the record of these proceedings was complete, Respondent made two filings seeking to reopen the record to include additional affidavits and other materials: the Second and Third Notices of Supplemental Authority. He subsequently submitted two separate Motions for Immediate Dismissal, to which Enforcement Counsel responded. The Board has considered these filings and for the reasons discussed below rejects Respondent's submissions of additional material for the record, and denies his motions for immediate dismissal.

First, Respondent has not adequately explained why he did not raise the issues presented in these supplemental filings in the proceedings below. Respondent contends that "he repeatedly pressed for a hearing and the opportunity to present the affiants' live testimony" and only "learned that he would not receive the hearing to which he was entitled" when the ALJ issued his Recommended Decision. Third Notice of Supplemental Authority at 3. However, Respondent does not explain why the affidavits and other materials were not presented in support of his Cross-Motion for Summary Disposition and Opposition to the FRB's Motion for Summary Disposition. Under the Board's rules, motions and oppositions for summary disposition "must be supported by documentary evidence, which may take the form of . . . affidavits and any other evidentiary materials that the moving party contends support his or her position." 12 CFR 263.29. Respondent cannot now complain that he did not have an opportunity to present these materials merely because he did not receive a hearing.[16]

More importantly, none of the materials provided with the Second and Third Notice of Supplemental Authority are relevant to these proceedings. The exhibits to the Second Notice of Supplemental Authority and Exhibits A and C to the Third Notice of Supplemental Authority aim at establishing the subjective intent of the parties to the Withdrawal Agreement.[17] However, as explained above, the parties' subjective intent is not relevant to interpreting an unequivocal agreement.

In Respondent's Third Notice of Supplemental Authority, he further argues that the proffered Superseding Addendum to Agreement for Withdrawal of Charges ("Superseding Addendum") is dispositive evidence because it ostensibly makes its provisions retroactive to the effective date of the Withdrawal Agreement and states "[t]here are no prohibitions or

dence or a hearing were not necessary to decide whether the Withdrawal Agreement was an agreement to enter into pretrial diversion or similar program. For the same reasons, the Board denies Respondent's request for oral argument at this stage of the proceedings.

[16] The Board observes that the affidavits contained in the First and Second Notice of Supplemental Authority were only obtained after the ALJ issued his Recommended Decision. The affidavits relate primarily to the negotiation and signing of the Withdrawal Agreement that occurred in 2008 and 2009, however, and there is no reason given for Respondent failing to obtain these affidavits earlier during the proceedings below if he considered them to be relevant.

[17] Exhibit A of Respondent's Second Notice of Supplemental Authority and Exhibit C of Respondent's Third Notice of Supplemental Authority are both affidavits by the District Attorney in which he states he has no interest in Respondent entering into a pretrial diversion or similar program. Exhibits B and C of Respondent's Second Notice of Supplemental Authority are affidavits from Respondent's defense attorneys explaining that Respondent did not intend to enter into a pretrial diversion or similar program and that the defense counsel's investigation for the criminal case revealed no wrongdoing by Respondent. Exhibit A in Respondent's Third Notice of Supplemental Authority is the Superseding Addendum to Agreement for Withdrawal of Charges, discussed below. Exhibits B and D in the Third Notice of Supplemental Authority do not relate to the issues of this case. Exhibit C is a Pennsylvania Supreme Court opinion concerning grand jury secrecy violations which mentions in passing that the District Attorney had entered a nolle prosequi in connection with the perjury charges against Respondent. Exhibit D in Respondent's Third Notice of Supplemental Authority is a report by a special prosecutor which described flaws the grand jury proceedings but ultimately recommended investigation of the grand jury proceedings be abandoned.

restrictions placed on Mr. DeNaples, nor is any action by him required." The Board notes, however, that the Superseding Addendum does not directly rescind or modify the original Withdrawal Agreement or any of its provisions. Because where specific contract provisions conflict with more general ones, the specific provisions control, *see* Southwestern Elec. Coop., Inc. v. FERC, 347 F.3d 975, 982 (D.C. Cir. 2003), the Board interprets the quoted sentence as simply stating that on the date the Superseding Addendum was executed, no prohibitions or restrictions remained on Respondent.[18] *See also* Lesko v. Frankford Hospital, 11 A.3d 917, 923 (Pa. 2011). Thus, the Superseding Addendum is irrelevant to the issue of whether Respondent agreed to enter into a pretrial diversion or similar program.

The Board also denies Respondent's motions for immediate dismissal. These motions, filed after the Board notified parties that the record of these proceedings was complete, related to a state court order expunging the criminal records pertaining to the withdrawn criminal charges against Respondent. The Board has considered these motions and denies them for the reasons discussed below.

Respondent's motions are based on orders he obtained from the Court of Common Pleas of Dauphin County, Pennsylvania. As noted above, on May 18, 2011 that court issued an Expungement Order expunging the criminal records pertaining to the withdrawn criminal charges against Respondent. That order was clarified on September 14, 2011, in the Clarification Order, which explained that pursuant to the Expungement Order, Respondent's arrest record had been expunged "such that no one, including law enforcement, state licensing authorities, or other governmental officials, is permitted access to the record even by court order under Pennsylvania law." The Clarification Order stated any information nonetheless maintained pursuant to Pennsylvania law should be considered residual in nature and not as a record of the proceeding. Finally, the Clarification Order asserted that "encompassed within the Expungement Order was the Agreement for Withdrawal of Charges ('Withdrawal Agreement') . . . . Since it has been completely expunged, the Withdrawal Agreement is of no force or effect."

Respondent contends that because of the Expungement Order, as explained by the Clarification Order, the Board may no longer enforce section 19 against him. In support, he cites language in the FDIC Policy Statement which states a section 19 application for consent is not required for an individual who has had a criminal conviction expunged. FDIC Policy Statement, section B(2) ("A conviction which has been completely expunged is not considered a conviction of record and will not require an application [under section 19].").

The Board rejects this argument. In the first place, as noted above, the Board is not bound by the FDIC Policy Statement. Under section 19, the Board, not the FDIC, must consent to an individual continuing as an institution-affiliated party of a bank holding company. 12 U.S.C.§ 1829(d). The Board has not adopted the FDIC Policy Statement, and the Board's lack of a formal policy of its own does not entitle Respondent to rely instead on the FDIC Policy Statement.[19]

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[18] Even if Respondent had presented a document purporting, in 2011, to rescind the Withdrawal Agreement executed in 2009, the Board does not believe such a document would affect the outcome here. At the time Board Enforcement Counsel initiated this action and the ALJ issued his recommended decision, Respondent was in violation of section 19 because he had entered into pretrial diversion or similar program and did not have the Board's authorization to remain as an institution-affiliated party of First National or Urban Financial. A later rescission of the pretrial diversion agreement would not change that history.

[19] Even if the FDIC's legal interpretation of section 19 could have some preclusive effect on the Board, the section of the Policy Statement that relates to expungement is not a legal interpretation, since the statutory provision never uses the term "expungement" or refers to the concept. The FDIC's position in this regard is therefore purely one of its own policy, which the Board need not follow. The parties have also disputed whether or

In the second place, the FDIC Policy Statement itself does not address the question presented here, which is whether an individual's agreement to enter into a pretrial diversion or similar program is negated, for purposes of section 19, by the later expungement of the underlying criminal charge. The FDIC Policy Statement, like section 19 itself, treats convictions and pretrial diversions separately. *See* 12 U.S.C. §1829(a)(1)(A) (requiring prior agency approval for "any person who has been convicted of any criminal offense involving dishonesty . . . or has agreed to enter into a pretrial diversion or similar program . . . " (emphasis added); FDIC Policy Statement at B(1) (discussing, in connection with whether an application under section 19 is required, convictions and the effect of complete expungement thereof), B(2) (discussing pretrial diversion programs without mention of expungement). Thus, nothing in the FDIC Policy Statement suggests that an application under section 19 would not be required by the FDIC if an individual who had agreed to enter into a pretrial diversion or similar program had later had his or her underlying criminal charge expunged.

The plain language of section 19 provides that prior Board approval is required of "any person who has . . . agreed to enter into a pretrial diversion or similar program." As the Supreme Court determined in a similar context in holding that an expunged state criminal conviction could continue to be a predicate offense for federal firearms prohibitions, "So far as the face of the [federal] statute is concerned, . . . expunction under state law does not alter the historical fact of the conviction . . . ." Dickerson v. New Banner Institute, Inc., 460 U.S. 103, 115 (1983).[20] Likewise, a subsequent expungement of a criminal charge does not alter the historical fact that Respondent agreed to the Withdrawal Agreement, i.e. that Respondent "has agreed to enter into a pretrial diversion or similar program." *See*12 U.S.C. § 1829(a)(1)(A) (emphasis added).

There are important reasons why expungement of a criminal charge should not affect the consequences of a respondent's agreement to enter into a pretrial diversion or similar program. Pretrial diversion is a method to avoid a full criminal prosecution by agreeing to explicit conditions; in many states, expungement of the criminal record is the automatic or at least the expected conclusion of this process once the program's conditions have been fulfilled. *See* Pretrial Justice Institute, Pretrial Diversion and the Law: A Sampling of Four Decades of Appellate Court Rulings, V-2-6 (2006) available at www.napsa.org/publications/ptdivcaselaw.pdf. Respondent's interpretation would mean that at the point where the individual's involvement in the pretrial diversion program concludes, its existence would in effect be nullified for purposes of section 19; it would be as though the individual had never "agree[d] to enter into" the program at all. This appears inconsistent with the clearly-expressed intent of Congress, which was to require the FDIC or the Board, as appropriate, to pass on the fitness of any individual who has agreed to enter into such a program to participate in the affairs of federally-regulated financial institutions. While the existence of an expungement order may be relevant in evaluating an individual when that individual applies for consent under section 19, it does not, as Respondent argues, eliminate the prior approval requirement clearly stated in that section. In addition, some states do not permit expungement even upon successful conclusion of a pretrial diversion program. Id. It would be anomalous for a federal agency to require a prior application from an individual who had entered into a pretrial diversion program in a non-expungement state, but to permit,

not Respondent's expungement is "complete" as used in the recent amendments to the FDIC Policy Statement. *See* 76 *Federal Register*28033. Because the Board is not following the FDIC Policy Statement, the Board need not resolve this issue.

[20] Subsequent Congressional action to overturn this ruling and provide that expunged convictions should generally not be considered in connection with firearms limitations, *see* Pub. L. 99-408, § 101(5), 100 Stat. 449, only underscores the fact that Congress knows how to address the issue of expungement if it so chooses. It has not done so in section 19.

without review, the involvement in banking of an individual whose state permits expungement.

Section 19 grants the Board the right, and the obligation, to scrutinize individuals who have entered into a pretrial diversion or similar program before permitting their continued involvement in banking. Absent clear statutory language indicating otherwise, the Board does not believe Congress intended to make this right dependent on a given state's policy regarding expungement and will not interpret section 19 to apply in such a non-uniform manner. *See* Holyfield, 490 U.S. at 43 ("federal statutes are generally intended to have uniform nationwide application"). Thus, despite the recent Expungement Order and Clarification Order, Respondent remains in violation of section 19 for the simple reason that in April 2009 he signed the Withdrawal Agreement, thereby entering into a pretrial diversion or similar program as those terms are defined in section 19, and he has not sought or obtained Board approval for his continued activities as an institution-affiliated party of First National or Urban Financial.

Conclusion

For these reasons, the Board orders the issuance of the attached Order to Cease and Desist.

By Order of the Board of Governors, this 10th day of April, 2012.

Jennifer J. Johnson
Secretary of the Board

In the Matter of Louis A. DeNaples, An Institution-Affiliated Party of First National Community Bancorp, Dunmore, Pennsylvania, and Urban Financial Group, Inc., Bridgeport, Connecticut

FRB Docket No. 09-191-B-I

Order to Cease and Desist

WHEREAS, pursuant to section 8(b) of the Federal Deposit Insurance Act, as amended, (the "FDI Act") (12 U.S.C. § 1818(b)), the Board of Governors of the Federal Reserve System (the "Board") is of the opinion, for the reasons set forth in the accompanying Final Decision, that a final Order to Cease and Desist should issue against Louis A. DeNaples ("DeNaples"), an institution-affiliated party, as defined in section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), of First National Community Bancorp, Dunmore, Pennsylvania, a registered bank holding company ("First National"), and Urban Financial Group, Inc., Bridgeport, Connecticut, a registered bank holding company ("Urban Financial").

NOW, THEREFORE, IT IS HEREBY ORDERED, pursuant to section 8(b) of the FDI Act, 12 U.S.C. § 1818(b), that:

1. DeNaples shall not violate section 19 of the FDI Act, 12 U.S.C. § 1829.
2. Upon the effective date of this Order, DeNaples shall unconditionally resign as a director of First National.
3. Within 30 days of the effective date of this Order, DeNaples shall submit an acceptable written plan to divest his controlling interests in First National and Urban Financial. An acceptable divestiture plan shall, at a minimum, including the following:
   a. Statements setting forth the number of voting shares and any other equity interests of:
      i. First National; and

ii. Urban Financial,
that are owned or controlled by DeNaples, as of the date of this Order;

b. Statements setting forth the number of voting shares and any other equity interests of:
   i. First National; and
   ii. Urban Financial,
   that are owned or controlled by any person acting in concert with DeNaples, within the meaning of 12 CFR 225.41(a)(2) of the Board's Regulation Y, as of the date of this Order.

c. Statements disclosing the number of voting shares and any other equity interests of:
   i. First National; and
   ii. Urban Financial,
   that are owned or controlled by any member of DeNaples' immediate family, within the meaning of 12 CFR 225.41(a)(3) of the Board's Regulation Y, as of the date of this Order.

d. A schedule for the divestiture of First National voting shares owned or controlled by DeNaples such that after the divestiture DeNaples would not own or control personally or acting in concert with other persons shares that would require prior notice under 12 CFR 225.41(c), as if the shares owned or controlled personally or acting in concert with other persons had been acquired after the divestiture.

e. A schedule for the divestiture of Urban Financial voting shares owned or controlled by DeNaples such that after the divestiture DeNaples would not own or control personally, or acting in concert with other persons, shares that would require prior notice under 12 CFR 225.41(c), as if the shares owned or controlled personally or acting in concert with other persons had been acquired after the divestiture.

f. The plan shall include a schedule such that the divestitures shall be completed within 180 days after the effective date of the Order.

g. The plan shall provide that the divestiture of the shares shall be:
   i. to third parties unrelated to DeNaples in arms-length transactions; or
   ii. if to any person who has previously acted in concert with DeNaples with respect to First National or Urban Financial, or would be considered to be acting in concert with DeNaples at the time of the divestiture (including persons presumed to be acting in concert with DeNaples as set forth in 12 CFR 225.41(d)), the plan shall include adequate assurances (through a trust or otherwise) such that DeNaples would not have the ability to act in concert with, or exercise any control or controlling influence over the shares of First National or Urban Financial, respectively. The mechanism and the individuals or entities who control the shares in any manner through a trust or otherwise shall be subject to the approval of the Board.

h. The plan shall further provide for disclosure of any financial or personal relationships between DeNaples, and his related interests (as defined in 12 CFR 215.3(n), on the one hand, and each acquirer and his or her related interests, on the other hand, of any shares of First National or Urban Financial divested pursuant to the plan.

4. Respondent shall fully comply with all of the terms of any acceptable divestiture plan submitted.

5. Respondent shall submit his written divestiture plan and other correspondence with respect to this Order to:
   a. Richard M. Ashton
   Deputy General Counsel
   Board of Governors of the Federal Reserve System

20th & C Sts., NW
Washington, DC 20551

b. Thomas Baxter
General Counsel
Federal Reserve Bank of New York
33 Liberty Street
New York, New York 10045
(with respect to Urban Financial)

c. Jeanne Rentezelas
Federal Reserve Bank of Philadelphia
10 Independence Mall
Philadelphia, PA 19106-1574
(with respect to First National)

6. Any violation of this Order shall subject Respondent to appropriate penalties under 12 U.S.C. § 1818(i).
7. The Board delegates to the Board's General Counsel (or his delegee), with the concurrence of the Director of the Division of Banking Supervision and Regulation (or his delegee), the authority to determine the acceptability of any divestiture plan submitted by Respondent pursuant to this Order, to accept modifications to any previously accepted divestiture plan, and to grant extensions of time.
8. This Order, and each and every provision hereof, is and shall remain fully effective and enforceable until expressly stayed, modified, terminated or suspended in writing by the Board.

This Order is effective 30 days after service on the Respondent.

By Order of the Board of Governors, this 10th day of April, 2012.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

Jennifer J. Johnson
Secretary of the Board