

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 73-198
August 7, 1973

REVISED PROPOSED AMENDMENT TO REGULATION Y (Real and Personal Property Leasing)

To All Banks and Others Concerned
in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System on July 31, 1973 announced for comment a revised proposal to amend Regulation Y "Bank Holding Companies" to permit in certain cases the leasing of both real and personal property. A hearing has also been scheduled for September 12, 1973 on the revised proposal.

If adopted, the proposal would supersede the existing regulatory provision authorizing bank holding companies to engage in personal property leasing, and would place both under a common set of rules.

The Board initially issued a proposal which, as detailed in our Circular No. 72-40, dated February 25, 1972, was concerned with real property leasing only. A revised proposal somewhat similar to the current proposal was transmitted with our Circular No. 72-284 on December 15, 1972.

The Board has considered the comments received on the last proposal and has made certain modifications. The principal changes in the leasing rules, as now proposed, are:

1. The term "residual value" would be substituted for "salvage value", and in computing full payout recovery maximum allowable residual value would be limited to 10 percent of acquisition cost of the property.
2. In computing full payout recovery reasonably anticipated renewal leases can be relied upon with respect to governmental entities, but not private lessees.
3. The proposal would permit a bank holding company to own property to be leased for up to 50 years, but would require full payout recovery within 40 years.
4. The prior proposal would have required bank holding companies to dispose of the property within two years after expiration of the initial full payout lease term. The revised proposal would permit the alternative of re-leasing the property.

Other provisions of the previous proposal, including requirements that the lease constitute the functional equivalent of an extension of credit, that the property to be leased be acquired specifically for the leasing transaction, and that the lease be on a non-operating basis, are unchanged.

Written comments on the revised proposal should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than October 3, 1973.

A hearing will also be held before available members of the Board on September 12, 1973, at 10:00 a.m. in Room 1202 at the Board's building at 20th Street and Constitution Avenue, N. W. Persons interested in participating in the hearing by presenting material orally should inform the Secretary of the Board in writing no later than August 24, 1973. Each person admitted as a party to the hearing proceedings will be given 30 minutes to present his views.

A copy of the Board's press release, revised proposal and hearing order is attached.

Very truly yours,

P. E. Coldwell

President

Attachments



FEDERAL RESERVE

press release

For immediate release

July 31, 1973

The Board of Governors of the Federal Reserve System today published for comment and scheduled a hearing for September 12 on a revised proposal to permit bank holding companies to engage in both real and personal property leasing under a consolidated set of rules.

Today's revision followed Board consideration of comments received on an earlier proposal that was announced last December 6.

The Board scheduled the hearing in view of the complexities of the issues involved and the Board's desire to gather further information prior to final action. The hearing is to be held at the Board's offices before available Board members.

The proposal would supersede the existing regulatory provision authorizing bank holding companies to engage in personal property leasing, and would provide a common set of rules for bank holding companies engaging in personal or real property leasing or both.

The proposal retains the central condition the Board has imposed upon leasing by bank holding companies -- that the leasing transaction serve as the functional equivalent of an extension of credit whereby the lessor recovers its full investment in the leased property during the initial term of the lease.

Principal changes in the leasing rules, as now proposed, are:

1. The term "residual value" would be substituted for "salvage value" and, in computing full payout recovery, maximum allowable residual value would be limited to 10 per cent of the acquisition cost of the property.

2. In computing full payout recovery reasonably anticipated renewal leases can be relied upon with respect to governmental entities only and not private lessees.

3. The proposal would permit a bank holding company to own property to be leased for up to 50 years, but would require full payout recovery within 40 years.

4. The prior proposal would have required bank holding companies to sell the property within two years after expiration of the initial full payout lease term. The revised proposal would permit bank holding companies the alternative of re-leasing the property.

Other provisions of the previous proposal, including requirements that the property to be leased was acquired specifically for the leasing transaction and that the lease is on a non-operating basis, are unchanged.

Written comment on the revised proposal will be received by the Secretary of the Board through October 3, 1973. Persons interested in participating in the hearing should inform the Secretary of the Board in writing not later than August 24, 1973. Each person admitted as a party to the proceeding will be given up to 30 minutes to present his views.

A copy of the Board's revised proposal and hearing order is attached.

FEDERAL RESERVE SYSTEM

[12 CFR Part 225]

BANK HOLDING COMPANIES

Nonbanking Activities

The Board of Governors has considered the comments received on its proposal (37 F.R. 26534) to permit bank holding companies, under the authority of section 4(c)(8) of the Bank Holding Company Act, to engage in real and personal property leasing under substantially the same conditions and has made certain modifications of such proposal, which are set forth hereinafter. Due to the number and complexity of the issues involved in the proposal, the Board believes it in the public interest to gather more information about the proposal at a hearing. Accordingly, the Board has directed that a hearing be held before available members of the Board in Room 1202 of its building at 20th Street and Constitution Avenue, N.W., Washington, D. C., on September 12, 1973, at 10:00 a.m.

The proposed amendment, as modified, reads as follows:

§ 225.4 Nonbanking Activities

(a) Activities closely related to banking or managing or controlling banks. * * * The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

(6) Leasing real and personal property or acting as agent, broker or adviser in leasing such property provided:

(i) the lease is to serve as the functional equivalent of an extension of credit to the lessee of the property;

(ii) the property to be leased is acquired specifically for the leasing transaction under consideration or was acquired specifically for an earlier leasing transaction;

(iii) the lease is on a nonoperating basis;

(iv) at the inception of the initial lease the effect of the transaction (and, with respect to governmental entities only, reasonably anticipated future transactions*) will yield a return from (1) rentals, (2) estimated tax benefits (investment tax credit, net economic gain from tax deferral from accelerated depreciation, and other tax benefits with a substantially similar effect), and (3) the estimated residual value of the property at the expiration of the initial term of the lease, which in no case shall exceed 10 per cent of the acquisition cost of the property to the lessor, that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease;**

* The Board understands that some Federal, State and local governmental entities may not enter into a lease for a period in excess of one year. Such an impediment does not prohibit a company authorized under § 225.4(a) from entering into a lease with such governmental entities if the company reasonably anticipates that such governmental entities will renew the lease annually until such time as the company is fully compensated for its investment in the leased property plus its costs of financing the property. Further, a company authorized under § 225.4(a) may also engage in a so-called "bridge" lease financing of personal property, but not real property, where the lease is short term pending completion of long term financing, by the same or another lender.

** The estimate by the lessor of the total cost of financing the property over the term of the lease should reflect, among other factors, the term of the lease, the modes of financing available to the lessor, the credit rating of the lessor and/or the lessee, if a factor in the financing, and prevailing rates in the money and capital markets.

(v) the maximum lease term during which the lessor must recover the lessor's full investment in the property plus the estimated cost of financing the property shall be 40 years;

(vi) at the expiration of the lease (including any renewals or extensions with the same lessee), all interest in the property shall be either liquidated or re-leased on a nonoperating basis as soon as practicable but in no event later than two years from the expiration of the lease,*** however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

In connection with the hearing, the Board notes that BankAmerica Corporation, San Francisco, California, has requested an opportunity for a hearing with regard to the effect the proposal would have upon the Board's existing personal property leasing regulation (225.4(a)(6) of Regulation Y). Other interested persons are invited to participate by presenting their views on issues raised by the pending proposal. Interested persons need not participate in the hearing through oral presentation in order to have their views considered. All views previously expressed in writing on the pending proposal are under consideration by the Board and are available for inspection and copying in Room 1020 of the Board's building.

*** In the event of a default on a lease agreement prior to the expiration of the lease term, the lessor shall either re-lease such property, subject to all the conditions of this subsection 6, or liquidate such property as soon as practicable but in no event later than two years from the date of default on a lease agreement.

Persons interested in participating in the hearing by presenting material orally should inform the Secretary of the Board in writing not later than August 24, 1973. Each person admitted as a party to the proceeding will be given up to 30 minutes to present his views.

Anyone wishing to submit written comments on issues raised at the hearing may do so at any time before the close of business October 3, 1973.

By order of the Board of Governors, July 27, 1973.

(Signed) Chester B. Feldberg

Chester B. Feldberg
Secretary of the Board

[SEAL]