

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 74-84

March 27, 1974

AMENDMENTS TO REGULATION Y
(Revising Rules Under Which Bank Holding Companies
May Engage in the Leasing of Personal Property, and
Extending the Activity to the Leasing of Real Property)

To All Banks, Bank Holding Companies, and Others
Concerned in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System has revised its rules under which bank holding companies may engage in the leasing of personal property, and extended the activity to the leasing of real property under a separate, nearly identical rule.

The amendments to Regulation Y (regulating bank holding companies) are to become effective April 17, 1974. Both rules retain the central condition the Board has imposed upon leasing by bank holding companies: that the leasing transaction be the functional equivalent of a loan, whereby the leasing company recovers its full investment in the property during the initial term of the lease.

The Board issued the amendments to Regulation Y after consideration of comment on a proposal detailed in our Circular No. 72-284, dated December 15, 1972, and revised as outlined in our Circular No. 73-198, dated August 7, 1973, and consideration of the record of a public hearing held September 12, 1973, and further comment received following the hearing.

The amendments permit bank holding companies to engage in leasing personal and real property or acting as agent, broker or advisor in such leasing, subject to certain conditions.

Enclosed is a copy of the Amendments.

Yours very truly,

P. E. Coldwell,

President

Enclosures

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BANK HOLDING COMPANIES

AMENDMENT TO REGULATION Y †

The text of the amendments to section 225.4(a)(6), effective April 17, 1974, which supersede existing section 225.4(a)(6) and 12 CFR 225.123 reads as follows:

SECTION 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)(a) Leasing personal property or acting as agent, broker or advisor 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 ⁴) will yield a return 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, ⁵ 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 ef-

fect); (3) the estimated residual value of the property at the expiration of the initial term of the lease, which in no case shall exceed 20 per cent of the acquisition cost of the property to the lessor; and (4) in the case of a lease of not more than 7 years in duration, such additional amount, which shall not exceed 60 per cent of the acquisition cost of the property, as may be provided by an unconditional guarantee by a lessee, independent third party or manufacturer, which has been determined by the lessor to have the financial resources to meet such obligation, that will assure the lessor of recovery of its investment and cost of financing;

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

(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, ⁶ however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

(6)(b) Leasing real property or acting as agent, broker or advisor 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 ⁴) will yield a return 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, ⁵ 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 20 per cent of the acquisition cost of the property to the lessor.

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

(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, ⁶ however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

* * * * *

⁴ 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) (6) may also engage in 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.

⁵ 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.

⁶ 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(a), 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.

† For this Regulation to be complete as amended effective April 17, 1974, retain:

- 1) Printed Regulation pamphlet as amended effective December 1, 1971.
- 2) Amendment effective June 6, 1972.
- 3) Amendment effective December 11, 1972.
- 4) Amendment effective November 15, 1973.
- 5) Amendment effective February 26, 1974.
- 6) Amendment effective March 14, 1974.
- 7) This slip sheet.

NOTE.—As an incident to this amendment the footnotes in § 225.4(a) which are denoted by asterisks and numbers are hereby redesignated as follows for clarity and ease of reference: the footnote in § 225.4(a)(1) designated as * to footnote 1; footnotes 1 and 2 in § 225.4(a)(5) to footnotes 2 and 3; footnote 3 in § 225.4(a)(10) to footnote 7; footnote 3a in § 225.4(a)(11) to footnote 8; the footnotes in § 225.4(a)(12) designated as * and ** to footnotes 9 and 10; footnote 1 in § 225.4(b)(1) to footnote 11; and footnote 2 in § 225.4(d) to footnote 12.