

**FEDERAL RESERVE BANK OF DALLAS**

**DALLAS, TEXAS 75222**

**Circular No. 78-21**

**February 23, 1978**

**INTERPRETATION OF REGULATION Y**

**Presumption of Continued Control of  
Transferred Assets and Activities**

**TO ALL MEMBER BANKS,  
BANK HOLDING COMPANIES,  
AND OTHERS CONCERNED IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:**

In February 1977, the Board of Governors of the Federal Reserve System published for comment a proposed amendment to its Regulation Y that would have codified certain rulings made by the Board under Section 2(g) (3) of the Bank Holding Company Act, and would also have established certain regulatory presumptions relating to the continued control by bank holding companies of shares or assets divested by such companies. The Board has now determined to withdraw the proposed amendment and to issue instead an interpretation of Section 2(g) (3) of the Act. The interpretation is enclosed.

If you have any questions regarding this interpretation, please contact our Holding Company Supervision Department, Ext. 6182.

Additional copies of the interpretation of Regulation Y will be furnished upon request to the Secretary's Office of this Bank, Ext. 6267.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

---

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-492-4403 (intrastate) and 1-800-527-4970 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

# BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## BANK HOLDING COMPANIES

### INTERPRETATION OF REGULATION Y

#### SECTION 225.138 — PRESUMPTION OF CONTINUED CONTROL UNDER §2(g)(3) OF THE BANK HOLDING COMPANY ACT

Section 2(g) (3) of the Bank Holding Company Act (the "Act") establishes a statutory presumption that where certain specified relationships exist between a transferor and transferee of shares, the transferor (if it is a bank holding company, or a company that would be such but for the transfer) continues to own or control indirectly the transferred shares.<sup>1</sup> This presumption arises by operation of law, as of the date of the transfer, without the need for any order or determination by the Board. Operation of the presumption may be terminated only by the issuance of a Board determination, after opportunity for hearing, "that the transferor is not in fact capable of controlling the transferee."<sup>2</sup>

The purpose of section 2(g)(3) is to provide the Board an opportunity to assess the effectiveness of divestitures in certain situations in which there may be a risk that the divestiture will not result in the complete termination of a control relationship. By presuming control to continue as a matter of law, section 2(g) (3) operates to allow the effectiveness of the divestiture to be assessed before the divesting company is permitted to act on the assumption that the divestiture is complete. Thus, for example, if a holding company divests its banking interests under circumstances where the presumption of continued control arises, the divesting company must continue to consider itself bound by the Act until an appropriate order is entered by the Board dispelling the presumption. Section 2(g) (3) does not establish a substantive rule that invalidates

transfers to which it applies, and in a great many cases the Board has acted favorably on applications to have the presumption dispelled. It merely provides a procedural opportunity for Board consideration of the effect of such transfers in advance of their being deemed effective. Whether or not the statutory presumption arises, the substantive test for assessing the effectiveness of a divestiture is the same—that is, the Board must be assured that all control relationships between the transferor and the transferred property have been terminated and will not be reestablished.<sup>3</sup>

In the course of administering section 2(g) (3) the Board has had several occasions to consider the scope of that section. In addition, questions have been raised by and with the Board's staff as to coverage of the section. Accordingly, the Board believes it would be useful to set forth the following interpretations of section 2(g) (3):

1. The terms "transferor" and "transferee," as used in section 2(g) (3), include parents and subsidiaries of each. Thus, for example, where a transferee is indebted to a subsidiary of the transferor,<sup>4</sup> or where a specified interlocking relationship exists between the transferor or transferee and a subsidiary of the other (or between subsidiaries of each), the presumption arises. Similarly, if a parent of the transferee is indebted to a parent of the transferor, the presumption arises. The presumption of continued control also arises where an interlock or debt relationship is retained between the divesting company and the company being divested, since the divested company will be or may be viewed as a "subsidiary" of the transferee or group of transferees.

<sup>1</sup>The presumption arises where the transferee "is indebted to the transferor, or has one or more officers, directors, trustees, or beneficiaries in common with or subject to control by the transferor."

<sup>2</sup>The Board has delegated to its General Counsel the authority to issue such determinations. 12 C.F.R. §265.2(b)(1).

<sup>3</sup>It should be noted, however, that the Board will require termination of any interlocking management relationships between the divesting company and the transferee or the divested company as a precondition of finding that a divestiture is complete. Similarly, the retention of an economic interest in the divested company that would create an incentive for the divesting company to attempt to influence the management of the divested company will preclude a finding that the divestiture is complete. (See the Board's Order in the matter of *International Bank*, 1977 Federal Reserve Bulletin 1106, 1113).

<sup>4</sup>The indebtedness giving rise to the presumption is not limited to debt incurred in connection with the transfer; it includes any debt running to the transferor or its subsidiaries.

2. The terms "officers," "directors," and "trustees," as used in section 2(g) (3), include persons performing functions normally associated with such positions (including general partners in a partnership and limited partners having a right to participate in the management of the affairs of the partnership) as well as persons holding such positions in an advisory or honorary capacity. The presumption arises not only where the transferee or transferred company has an officer, director, or trustee "in common with" the transferor, but where the transferee himself holds such a position with the transferor.<sup>5</sup>

It should be noted that where a transfer takes the form of a pro-rata distribution, or "spinoff," of shares to a company's shareholders, officers and directors of the transferor company are likely to receive a portion of such shares. The presumption of continued control would, of course, attach to any shares transferred to officers and directors of the divesting company, whether by "spinoff" or outright sale. However, the presumption will be of legal significance — and will thus require an application under section 2(g) (3) — only where the total number of shares subject to the presumption exceeds one of the applicable thresholds in the Act. For example, where officers and directors of a one-bank holding company receive in the aggregate 25 percent or more of the stock of a bank subsidiary being divested by the holding company, the holding company would be presumed to continue to control the "divested" bank. In such a case it would be necessary for the divesting company to demonstrate that it no longer controls either the divested bank or the officer/director transferees. However, if officers and directors were to receive in the aggregate less than 25 percent of the bank's stock (and no other shares were subject to the presumption), section 2(g) (3) would not have the legal effect of presuming continued control of the bank.<sup>6</sup> In the case of a divestiture of nonbank shares, an application under section 2(g) (3) would be required whenever officers and directors of the divesting company received in the

aggregate more than 5 percent of the shares of the company being divested.

3. Although section 2(g) (3) refers to transfers of "shares," it is not, in the Board's view, limited to disposition of corporate stock. General or limited partnership interests, for example, are included within the term "shares." Furthermore, the transfer of all or substantially all of the assets of a company, or the transfer of such a significant volume of assets that the transfer may in effect constitute the disposition of a separate activity of the company, is deemed by the Board to involve a transfer of "shares" of that company.

\* \* \* \* \*

Section 2(g) (3) provides that a Board determination that a transferor is not in fact capable of controlling a transferee shall be made after opportunity for hearing. It has been the Board's routine practice since 1966 to publish notice in the **Federal Register** of applications filed under section 2(g) (3) and to offer interested parties an opportunity for a hearing. Virtually without exception no comments have been submitted on such applications by parties other than the applicant and, with the exception of one case in which the request was later withdrawn, no hearings have been requested in such cases. Because the Board believes that the hearing provision in section 2(g) (3) was intended as a protection for applicants who are seeking to have the presumption overcome by a Board order, a hearing would not be of use where an application is to be granted. In light of the experience indicating that the publication of **Federal Register** notice of such applications has not served a useful purpose, the Board has decided to alter its procedures in such cases. In the future, **Federal Register** notice of section 2(g) (3) applications will be published only in cases in which the Board's General Counsel, acting under delegated authority, has determined not to grant such an application and has referred the matter to the Board for decision.<sup>7</sup>

<sup>5</sup>It has been suggested that the words "in common with" in section 2(g) (3) evidence an intent to make the presumption applicable only where the transferee is a *company* having an interlock with the transferor. Such an interpretation would, in the Board's view, create an unwarranted gap in the coverage of section 2(g) (3). Furthermore, because the presumption clearly arises where the transferee is an individual who is indebted to the transferor such an interpretation would result in an illogical internal inconsistency in the statute.

<sup>6</sup>Of course, the fact that section 2(g) (3) would not operate to presume continued control would not necessarily mean that control had in fact been terminated if control could be exercised through other means.

<sup>7</sup>It should be noted that in the event a third party should take exception to a Board order under section 2(g) (3) finding that control has been terminated, any rights such party might have would not be prejudiced by the order. If such party brought facts to the Board's attention indicating that control had not been terminated, the Board would have ample authority to revoke its order and take necessary remedial action. Orders issued under 2(g) (3) are published in the *Federal Register* and in the *Federal Reserve Bulletin*.