

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-38

March 3, 1980

REVISED INTERPRETATION OF
REGULATION Y

(Bank Holding Companies and Change in Bank Control)

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:

The Board of Governors of the Federal Reserve System has revised its interpretation issued in January 1978 concerning Section 2(g)(3) of the Bank Holding Company Act. The revised interpretation, effective February 7, 1980, is enclosed.

An excerpt of the Board's Order, as published in the Federal Register, is printed on the reverse of this circular. The excerpt summarizes the revised interpretation and presents supplementary information relating to it.

Any questions concerning the enclosed material should be directed to the Attorney's Section of our Holding Company Supervision Department, Ext. 6182. Additional copies of the interpretation 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: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FOR FURTHER INFORMATION CONTACT: Robert E. Mannion, Deputy General Counsel (202/452-3274) or Bronwen Mason, Senior Attorney (202/452-3504), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Section 2(g)(3) of the Bank Holding Company Act (the "Act") establishes a presumption that, among other situations, where a transferee of shares is indebted to the transferor on the date of transfer, the transferor is presumed to continue to own or control indirectly the transferred shares. The presumption arises by operation of law, and may be terminated only by issuance of a Board determination, "that the transferor is not in fact capable of controlling the transferee." Therefore, the transfer will not be regarded as an effective divestiture of control of the shares unless the parties involved are able to satisfy the Board that the transferor/creditor cannot use the indebtedness to retain control of the shares in the hands of the transferee/debtor.

In its January 25, 1978, interpretation of section 2(g)(3) (12 CFR 225.139) the Board stated that indebtedness giving rise to the presumption of continued control is not limited to debt incurred in connection with the transfer, but includes any debt outstanding at the time of transfer from the transferee (including an individual) to the transferor and its subsidiaries. In the course of administering section 2(g)(3), questions have arisen concerning the operation of the presumption in cases where the transferee is a business with a small amount of routine commercial borrowing or an individual who has personal borrowing, such as a credit card balance, a home mortgage loan or an automobile loan outstanding to the transferor or a lending subsidiary. While the presumption might literally apply to transfers of property in these situations, the Board's interpretation of section 2(g)(3) of the Act is that the presumption should not apply in these situations. The revised interpretation reflects that position.

As a result of this interpretation, a transferor whose situation falls within the interpretation will be relieved of the burden of an administrative proceeding to seek a favorable determination. Hence, the Board's action should facilitate divestitures. Of course, while a statutory presumption may not apply in these situations, the Board would not be precluded from examining a particular transfer and finding that the divestiture was ineffective based on the facts of record; however, unless the Board made

such a finding, the parties could treat the divestiture as effective.

In taking this action, the Board has not followed its expanded rulemaking procedures (44 FR 3957) nor the procedures of 5 U.S.C. 553(b) regarding notice, public participation, and deferred effective date because: (1) the action relaxes a requirement, and (2) rulemaking procedures do not apply to interpretive rules.

Board of Governors of the Federal Reserve System, January 31, 1980.

Theodore E. Allison,
Secretary of the Board.

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FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Reg. Y, Docket No. R-0273]

Indebtedness That Does Not Give Rise to Presumption of Continued Control Under Section 2(g)(3) of the Bank Holding Company Act

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Revision of interpretation.

SUMMARY: The Board is revising an interpretation issued in January 1978 (12 CFR 225.139), in order to amplify its views regarding the nature of indebtedness that gives rise to the presumption of continued control established by section 2(g)(3) of the Bank Holding Company Act. Under the revised interpretation, the statutory presumption does not apply in a case where the transferee of property is indebted to the transferor if the indebtedness involves certain routine business credit of limited amounts or certain loans for personal or household purposes. This action is being taken because questions have arisen in the administration of the Act since the Board issued its 1978 interpretation. The action is intended to relieve a regulatory burden and facilitate transfers of divested assets by obviating the need for an administrative proceeding in cases falling within the interpretation.

EFFECTIVE DATE: February 7, 1980.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

INTERPRETATION OF REGULATION Y

SECTION 225.139—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.¹ 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."²

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.³

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, 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.

¹The 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."

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

³It 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).

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.⁴

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.⁵ 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.

4. The term "indebtedness" giving rise to the presumption of continued control under section 2(g)(3) of the Act is not limited to debt incurred in connection with the transfer; it includes any debt outstanding at the time of transfer from the transferee to the transferor of its subsidiaries. However, the Board believes that not every kind of indebtedness was within the contemplation of the Congress when section 2(g)(3) was adopted. Routine business credit of limited amounts and loans for personal or household purposes are generally not the kinds of indebtedness that, standing alone, support a presumption that the creditor is able to control the debtor. Accordingly, the Board does not regard the presumption of section 2(g)(3) as applicable to the following categories of credit, provided the extensions of credit are not secured by the transferred property and are made in the ordinary course of business of the transferor (or its subsidiary) that is regularly engaged in the business of extending credit: (i) consumer credit extended for personal or household use to an individual transferee; (ii) student loans made for the education of the individual transferee or a spouse or child of the transferee; (iii) a home mortgage loan made to an individual transferee for the purchase of a residence for the individual's personal use and secured by the residence; and (iv) loans made to companies (as defined in section 2(b) of the Act) in an aggregate amount not exceeding ten per cent of the total purchase price (or if not sold, the fair market value) of the transferred property. The amounts and terms of the preceding categories of credit should not differ substantially from similar credit extended in comparable circumstances to others who are not transferees. It should be understood that, while the statutory presumption in situations involving these categories of credit may not apply, the Board is not

⁴It 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.

⁵Of 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.

precluded in any case from examining the facts of a particular transfer and finding that the divestiture of control was ineffective based on the facts of record.

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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 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 could 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.⁶

⁶It 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*.

FEDERAL RESERVE BANK OF DALLAS
TELEPHONE INFORMATION CARD
FOR REQUESTING TRANSFERS OF FUNDS

For initial transfers of funds requests from member banks *within* the Dallas metropolitan service area:

Call **214 651-6156**

For initial transfers of funds requests from member banks *outside* of the Dallas metropolitan service area:

Call Toll-free* **800 442-7276 (Texas banks only)**

For requests for adjustments or corrections involving initial transfers of funds requests:

Call Collect ** **214 651-6130**

If the toll-free WATS number is not accessible within a reasonable time or,
If there is difficulty in reaching us concerning corrections or adjustments:

Call Collect ** **214 651-6417**

In the unlikely event that you experience any unnecessary delay in contacting our Transfers of Funds area using the above numbers, it would be appreciated if you would:

Call Collect ** **214 651-6416**

It is suggested that this card be kept near the telephone in the appropriate using areas. Of course, the telephone numbers listed above are dedicated exclusively to transfers of funds. However, you are reminded that the toll-free number for other categories of inquiries to this Bank may be placed TOLL-FREE* to the main Bank number **800-442-7140** (Texas banks only).

*For out of Texas banks, Call TOLL-FREE to the main Bank number **800-527-9200**.

**Member banks located within the Dallas metropolitan service area should not call these numbers collect since they are considered local calls.