FEDERAL RESERVE BANK
OF NEW YORK

[ Circular No. 7302 ]
[ December 21, 1973 ]

# INTERPRETATION OF REGULATION Y

## Sale of "Thrift Notes" by Bank Holding Companies

*To All Bank Holding Companies, and Others Concerned,*
*in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has issued an interpretation of its Regulation Y, "Bank Holding Companies," regarding the distinction between the issuance and sale of "thrift notes" and the issuance and sale of "commercial paper" by bank holding companies.

In its interpretation, the Board concluded that the issuance and sale of "thrift notes" by a bank holding company for the purpose of supplying capital to its wholly owned nonbanking subsidiaries (in the manner described in the interpretation) would constitute a principal activity of a bank holding company within the meaning of section 20 of the Banking Act of 1933, which prohibits the affiliation of a member bank with a company "engaged principally in the issue, flotation, underwriting, public sale or distribution . . . of . . . notes, or other securities." The Board distinguished this activity from the issuance and sale of short-term notes, commonly known as "commercial paper," which is a recognized form of financing for bank holding companies, and concluded that the issuance and sale of such paper is not an activity intended to be included within the scope of section 20 of the Banking Act of 1933.

Enclosed is a copy of the interpretation, which has been printed in a form that will allow it to be maintained with your copies of Regulation Y and its amendments. Future interpretations printed by this Bank will also be sent to you in that form.

Additional copies of the enclosure will be furnished upon request.

ALFRED HAYES,
*President.*

# BANK HOLDING COMPANIES

## INTERPRETATION OF REGULATION Y

### §225.130 — Issuance and sale of short-term debt obligations by bank holding companies

For text of interpretation, see §250.221 of this Chapter.

### §250.221 — Issuance and sale of short-term debt obligations by bank holding companies

The opinion of the Board of Governors of the Federal Reserve System has been requested recently with respect to the proposed sale of "thrift notes" by a bank holding company for the purpose of supplying capital to its wholly-owned nonbanking subsidiaries.

The thrift notes would bear the name of the holding company, which in the case presented, was substantially similar to the name of its affiliated banks. It was proposed that they be issued in denominations of $50 to $100 and initially be of 12-month or less maturities. There would be no maximum amount of the issue. Interest rates would be variable according to money market conditions but would presumably be at rates somewhat above those permitted by Regulation Q ceilings. There would be no guarantee or indemnity of the notes by any of the banks in the holding company system and, if required to do so, the holding company would place on the face of the notes a negative representation that the purchase price was not a deposit, nor an indirect obligation of banks in the holding company system, nor covered by deposit insurance.

The notes would be generally available for sale to members of the public, but only at offices of the holding company and its nonbanking subsidiaries. Although offices of the holding company may be in the same building or quarters as its banking offices, they would be physically separated from the banking offices. Sales would be made only by officers or employees of the holding company and its nonbanking subsidiaries. Initially, the notes would only be offered in the State in which the holding company was principally doing business, thereby complying with the exemption provided by section 3(a)(11) of the Securities Act of 1933 (15 U.S.C. 77c) for "intra-state" offerings. If it was decided to offer the notes on an interstate basis, steps would be taken to register the notes under the Securities Act of 1933. Funds from the sale of the notes would be used only to supply the financial needs of the nonbanking subsidiaries of the holding company. These nonbank subsidiaries are, at present, a small loan company, a mortgage banking company and a factoring company. In no instance, would the proceeds from the sale of the notes be used in the bank subsidiaries of the holding company nor to maintain the availability of funds in its bank subsidiaries.

The sale of the thrift notes, in the specific manner proposed, is an activity described in section 20 of the Banking Act of 1933 (12 U.S.C. 377), that is, "the issue, flotation, underwriting, public sale or distribution . . . of . . . notes, or other securities". Briefly stated, this statute prohibits a member bank to be affiliated with a company "engaged principally" in such activity. Since the continued issuance and sale of such securities would be necessary to permit maintenance of the holding company's activities without substantial contraction and would be an integral part of its operations, the Board concluded that the issuance and sale of such notes would constitute a principal activity of a holding company within the spirit and purpose of the statute. (For prior Board decisions in this connection, see 1934 *Federal Reserve Bulletin* 485, 12 CFR 218.104, 12 CFR 218.105 and 12 CFR 218.101.)

In reaching this conclusion, the Board distinguished the proposed activity from the sale of short-term notes commonly known as "commercial paper", which is a recognized form of financing for bank holding companies. For purposes of this interpretation, "commercial paper" may be defined as notes, with maturities not exceeding nine months, the proceeds of which are to be used for current transactions, which are usually sold to sophisticated institutional investors, rather than to members of the general public, in minimum denominations of $10,000 (although sometimes they may be sold in minimum denominations of $5,000). Commercial paper is exempt from registration under the Securities Act of 1933 by reason of the exemption provided by section 3(a)(3) thereof (15 U.S.C. 77c). That exemption is inapplicable where the securities are sold to the general public (17 CFR 231.4412). The reasons for such exemption, taken together with the abuses that gave rise to the passage of the Banking Act of 1933 ("the Glass-Steagall Act") have led the Board to conclude that the issuance of commercial paper by a bank holding company is not an activity intended to be included within the scope of section 20.

(Interprets and applies 12 U.S.C. 377 and 1843.)

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