FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7777
December 17, 1975]

BANK HOLDING COMPANIES

Purchases by Bank Holding Companies of Their Own Stock

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

Following is the text of a statement issued December 11 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today proposed for comment a change in its Regulation Y—regulation of bank holding companies—to require prior notification by bank holding companies planning to purchase their own stock.

Comment will be received through January 15, 1976.

The proposed amendment is designed to deter "bootstrapping" operations, by which a bank holding company goes significantly into debt to purchase its own stock. In "bootstrapping" cases the stock redemption is typically followed by a transfer of ownership.

The Board is aware that there are legitimate reasons for a bank holding company to buy its own stock. Its proposal resulted, however, from concern about redemptions that result in circumstances such as the following:

—The "bootstrapped" bank holding company is left with heavy debts and much reduced (perhaps very little or no) equity.

—Repayment and servicing of the debt depends mainly upon dividends the holding company receives from its subsidary bank or banks, resulting in substantial pressure on them to pay excessive dividends to the parent company, possibly creating an unsafe or unsound bank condition.

—The need of the holding company to meet heavy debt service obligations may encourage undue risk-taking aimed at increasing the earnings of its subsidiary bank or banks.

The proposal for prior notice of "bootstrapping" stock redemptions was made in order to avoid difficulties that may be encountered in unwinding or remedying the effects of such transactions once they have been concluded.

The Board therefore proposed that prior notification is necessary when:

—The amount to be paid for the redeemed shares, plus the amounts paid for all other such redemptions or purchases in the last five years, equals 10 per cent or more of the holding company's current net worth.

The Board proposed that 60 days prior notice should be given to the appropriate Federal Reserve Bank, and the proposal also specified what information would be required.

The Board said that if a notice of a proposed transaction indicated a possibly unsafe or unsound condition might result, it would use its cease-and-desist authority, if necessary, to prevent consummation.

Printed on the reverse side is the text of the proposed amendment to Regulation Y. Comments thereon should be submitted by January 15, 1976, and may be sent to our Domestic Banking Applications Department.

PAUL A. VOLCKER,
President.

(OVER)

(Reg. Y)

BANK HOLDING COMPANIES

Notice of Proposed Rulemaking Concerning Purchase or Redemption by Bank Holding Companies of Their Own Shares

The Board of Governors has become aware of a number of instances in which bank holding companies have redeemed or repurchased a substantial portion of their outstanding voting shares in connection with a transfer of control of the holding company. Typically, such cases involve closely held holding companies, and the funds used to repurchase the outstanding shares are borrowed by the holding company, either from a third party or from the selling shareholder himself. Following the repurchase or redemption, the selling shareholder transfers the few remaining shares he holds to a new purchaser for nominal or minimum consideration. The new purchaser thus acquires control of a holding company encumbered with indebtedness that substantially represents the cost of acquisition of the holding company itself.

In such cases, the repurchase or redemption of shares by the holding company serves no corporate purpose; rather, it is intended solely to facilitate a transfer of control by the controlling shareholder or shareholder group. In certain cases that have come to the Board's attention, moreover, the volume of debt incurred by the holding company involved in such a "bootstrapping" transaction has rendered the holding company insolvent or has caused it to be in unsafe or unsound condition. The Board recognizes that there are many legitimate reasons why bank holding companies may wish to repurchase or redeem their own shares, and believes that a requirement that holding companies obtain prior Board approval for all such transactions may be unduly burdensome and unnecessary to cure the "bootstrapping" problem. For this reason, the Board has determined to initiate this rulemaking proceeding to propose a requirement that bank holding companies give prior notification to the appropriate Federal Reserve Bank of an intention to repurchase or redeem shares where the consideration to be paid, when aggregated with the consideration paid for all other repurchases or redemptions during the preceding five years, would equal 10 per cent of the holding company's current net worth. The Board may, as an alternative, consider imposing such a prior notice requirement with respect to all proposed repurchases or redemptions by bank holding companies, or, alternatively, with respect to those involving the incurring of debt or a transfer of control.

Where such notice discloses that consummation of the proposed repurchase or redemption would violate applicable law or would create an unsafe or unsound condition in the holding company, the Board would, in appropriate cases, invoke its authority under the Financial Institutions Supervisory Act of 1966 (section 8(b) of the Federal Deposit Insurance Act) to institute cease-and-desist proceedings against the company in order to prevent the repurchase or redemption.

For the foregoing reasons, the Board proposes to amend Regulation Y as follows:

Part 225 of Regulation Y is amended by adding thereto a new section 225.6, as follows:

SECTION 225.6—CORPORATE PRACTICES

(a) **Purchase or redemption by a bank holding company of its own shares.** No bank holding company shall purchase or redeem any shares of its outstanding voting securities without giving at least 60 days prior notice thereof to its Federal Reserve Bank if the consideration to be paid for such purchase or redemption, when aggregated with the consideration paid for all other such purchases or redemptions over the preceding five-year period, would equal 10 per cent or more of said holding company's consolidated net worth as of the date of such notice. The 60-day period shall begin to run from the date such notice is received by the Reserve Bank, which shall promptly acknowledge receipt thereof in writing. Each notice filed hereunder shall furnish the following information: (i) the title of the security to be purchased or redeemed, (ii) the number of shares of that security to be purchased or redeemed, the total number of such shares outstanding as of the date of the notice, and the number of all other such shares purchased or redeemed over the preceding five-year period, (iii) the consideration to be paid for the shares to be purchased or redeemed, and the consideration paid for all other such shares purchased or redeemed over the preceding five-year period, (iv) the date upon which or the period of time during which the purchase or redemption will occur, (v) the names of the persons from whom the shares are to be purchased or redeemed, and the names of persons from whom all other such shares were purchased, (vi) if debt is to be incurred or has been incurred by the company or a subsidiary in connection with the purchase or redemption or any other such purchase or redemption over the preceding five years, a description of the terms of the debt, including the identity of the obligee, and the interest rate, maturity and repayment schedule of the debt, (vii) if a transfer of control is involved, a description of the terms of the transfer, including the identity of the transferee and a copy of any agreements relating to such transfer, and (viii) a current and pro forma consolidated balance sheet of the holding company. The Reserve Bank may permit a purchase or redemption to be accomplished prior to the expiration of the 60-day period if it determines that the repurchase or redemption would not constitute an unsafe or unsound practice and would not violate any applicable law, rule, regulation or order, or any condition imposed by, or written agreement with, the Board.

This notice of proposed rulemaking is issued under the authority of sections 5(b) and 5(c) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. §§ 1844(c) and (d)), and section 8(b) of the Federal Deposit Insurance Act, as amended (12 U.S.C. § 1818(b)).

To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, or arguments in writing on the proposal and the alternatives described above, to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than January 15, 1976. Such material will be made available for inspection and copying upon request except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR § 261.6(a)).

By order of the Board of Governors, December 10, 1975.