FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8279
February 15, 1978]

BANK HOLDING COMPANIES

—Interpretation of Regulation Y Regarding Transferred Shares or Other Assets

—Resumption of Processing Applications to Underwrite and Deal in Government and Municipal Securities

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," to clarify Section 2(g)(3) of the Bank Holding Company Act relating to the presumption of continued control by bank holding companies over certain transferred shares or other assets. At the same time, the Board of Governors has withdrawn a proposed amendment to Regulation Y regarding this matter. (The text of the proposed amendment was provided in this Bank's Circular No. 8057, dated February 18, 1977.)

Following is the text of a statement issued by the Board of Governors announcing the interpretation of Regulation Y:

> The Board of Governors of the Federal Reserve System today [*January 26, 1978*] issued an interpretation of a section of the Bank Holding Company Act concerning transferred shares or other assets.
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> The Bank Holding Company Act provides that if a bank holding company transfers shares that it owns to a company or other transferee that is (a) indebted to the bank holding company, or (b) has an officer or director interlock with the bank holding company, control of the shares is presumed not to have changed unless the Board determines otherwise.
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> The Board has in effect interpreted this section of the Act—2(g)(3)—in decisions on specific cases. The interpretation issued today:
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> 1. Codifies these past rulings by the Board to the effect that (a) the presumption of continued control arises where the shares or other assets are transferred to a person who is an officer or director of the company making the transfer and (b) the terms "transferor" and "transferee" include parent or subsidiary companies of each (including a transferred company itself).
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> 2. Interprets Section 2(g)(3) as being applicable where (a) all or substantially all of the assets of a company or subsidiary are being transferred, or (b) the asset being transferred is of such significant size or value as to constitute the transfer of an "activity" of a bank holding company; also, that transfers of partnership interests are covered.
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> 3. Interprets the terms "officer" and "director" as including not only persons with such titles but also those with comparable functions, and those holding such offices in honorary or advisory capacities.
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> 4. Provides that in the interests of expediting proceedings under this provision of the Bank Holding Company Act no future Federal Register notice will be published upon receipt of an application under this section, but that no application under Section 2(g)(3) will be denied by the Board without affording the applicant company an opportunity for a hearing. The Board will continue to publish final decisions under this section in the Federal Register.
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> The Board withdrew a proposed rulemaking under Section 2(g)(3) published in February 1977.

Enclosed is a copy of the interpretation. Questions thereon may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5861).

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In another matter relating to Regulation Y, the Board of Governors has announced its decision not to adopt a proposed amendment that would add the activity of underwriting and dealing in Government and municipal securities to the list of activities that 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. The Board has also announced, however, that it is lifting the suspension of processing applications to engage in that activity. The text of the Board's statement is printed below.

> The Board of Governors of the Federal Reserve System announced today [*January 26, 1978*] it will resume the processing of applications from Bank Holding Companies to underwrite and deal in Federal Government and municipal securities.
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> Applications will be processed, however, on a case-by-case basis and no regulatory action will be taken by the Board to add this activity to its Regulation Y as closely related to banking and permissible for bank holding companies.
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> On October 19, 1976, the Board announced that it had deferred action on a rulemaking proposal to make underwriting and dealing in government securities a permissible activity for bank holding companies. It suspended further consideration of applications to engage in this activity to allow time for the newly created Municipal Securities Rulemaking Board to take possible action in this field.
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> A proposal to add this activity to its Regulation Y as permissible for bank holding companies was issued by the Board on April 2, 1974. That proposal has been withdrawn by the Board by the action announced today.

Copies of the Board's order in this matter are available from our Domestic Banking Applications Department upon request.

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

BANK HOLDING COMPANIES

INTERPRETATION OF REGULATION Y

[Reg. Y; Docket No. R-0083]

PART 225—BANK HOLDING COMPANIES

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Interpretation

SUMMARY: In February 1977, the Board 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 (the "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.

EFFECTIVE DATE: January 25, 1978

FOR FURTHER INFORMATION CONTACT: Robert E. Mannion, Associate General Counsel, Board of Governors of the Federal Reserve System, Washington, D. C. 20551 (202-452-3274)

SUPPLEMENTARY INFORMATION: Pursuant to its authority under sections 2(g)(3) and 5(b) of the Bank Holding Company Act, the Board has issued the following interpretation of section 2(g)(3) of the Act:

§ 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.[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

1 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."

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

3 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).

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transferor,[4] 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.

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.[5]

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 per cent 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 per cent 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.[6] 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 per cent 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.[7]

By order of the Board of Governors, effective January 25, 1978.

4 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.

5 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.

6 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.

7 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 section 2(g)(3) are published in the *Federal Register* and in the Federal Reserve *Bulletin*.