FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8715
December 21, 1979]

BANK HOLDING COMPANIES

—Policy Statement on Violations of 1980 Divestiture Requirements

—Proposed Policy Statement on Criteria Used in Considering One-Bank Holding Company Formations

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

Violations of 1980 Divestiture Requirements

The Board of Governors of the Federal Reserve System has issued a policy statement emphasizing that any violation of the Bank Holding Company Act as a result of the failure of an affected bank holding company to comply with the December 31, 1980 deadline for divestiture of nonbanking activities will be considered an "extremely serious matter" that will possibly result in civil penalties or referral for prosecution. The following is quoted from the Board of Governors' press statement on this matter:

> The Board's message was contained in a policy statement directed to certain companies that became bank holding companies by virtue of the 1970 amendments to the Bank Holding Company Act. These are one bank holding companies that acquired nonbank activities between June 30, 1968 and December 30, 1970. The 1970 amendments generally require that unless these companies drop their bank they must (1) divest such nonbank subsidiaries or (2) get Board approval to keep them, by December 31, 1980. The policy statement concerns companies that have not yet complied fully with the 1980 requirements of the Act.
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> In earlier statements, the Board advised these companies to submit their plans for complying with the law. The Board said it is concerned about the companies that have failed to respond or have responded only partially, and stressed that it has no authority to extend the 1980 deadline, or make exceptions.
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> Thus, the Board noted, for companies subject to the 1980 divestiture provisions of the Act, retention by a bank holding company of any nonbanking subsidiaries or activities for which the company has not received approval by the Federal Reserve beyond December 31, 1980, will be a violation of the Act.
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> The Board's statement continued:
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> The Board will regard any violation of section 4 of the BHCA resulting from failure to divest or obtain approval for retention prior to December 31, 1980 as an extremely serious matter . . .
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> The Board intends to enforce the provisions of the BHCA by taking appropriate actions, including initiation of cease-and desist proceedings, . . . assessment of civil money penalties, or referral for criminal prosecution . . . against the bank holding company, as well as its officers and directors. Generally, the the severity of a violation will not be mitigated because a bank holding company has an application for retention . . . pending at the Board December 31, 1980, or has appealed the Board's action on an application.
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> The Board said that it would act as expeditiously as possible on all applications and requests concerning the 1980 deadline, but it reminded companies that applications to keep subsidiaries might be denied, and that they should therefore allow sufficient time for divestiture if that occurs.
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> In a related action the Board is sending a letter to the Reserve Banks for transmittal to those bank holding companies that have not responded to the Board's earlier advice for submission of plans to comply with the 1980 deadline. The Board's letter requires each such company to submit by January 31, 1980, a statement of its intent and a timetable for compliance with the 1980 deadline. The letter also emphasizes the contents of the policy statement.

Enclosed—for bank holding companies in this District—is a copy of the Board's policy statement on divestitures. The statement will be published in the *Federal Register,* and copies will also be furnished upon request directed to our Circulars Division. Questions regarding this matter may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5861).

(OVER)

Criteria Used in Considering One-Bank Holding Company Formations

The Board of Governors has invited comment, by January 31, 1980, on a proposed policy statement regarding a change in the criteria to be used in considering applications for formations of one-bank holding companies. The revised policy is designed to help maintain the safety and soundness of the banking system, particularly of small community banks, and to facilitate the change of ownership of such banks. The following is quoted from the Board's press statement on this matter:

> The proposed policy would apply to one-bank holding companies meeting both of the following conditions: total assets of approximately $100 million or less, and no significant nonbank activities that use large amounts of debt in their businesses.
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> It would permit acquisition by one-bank holding companies of small community banks under revised terms. The proposed terms would continue in more flexible form the Board's standing policy of permitting transfer of ownership of such banks on less demanding terms than those the Board applied in considering applications involving larger banks.
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> The Board gave this background to its proposal:
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> > In acting on applications filed under the Bank Holding Company Act, the Board has adopted, and continues to follow, the cardinal principle that bank holding companies should serve as a source of strength for their subsidiary banks . . .
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> > The Board believes that a high level of acquisition debt impairs the ability of a bank holding company to come to the aid of its subsidiary bank in times of need, and in some cases the servicing requirements on such debt may be a drain on the bank's resources. For these reasons, the Board has not favored the use of acquisition debt in bank holding company formations. Nevertheless, the Board has recognized that the transfer of ownership of small community banks, and the maintenance of local ownership in those banks, often requires the use of acquisition debt. The Board, therefore, has permitted the formation of small one-bank holding companies with debt levels higher than would be permitted for larger or multi-bank holding companies.
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> While continuing to adhere to these principles, the Board has re-examined the factors it applies to applications from small one-bank holding companies with a view to improving the flexibility of these companies in dealing with their debt obligations.
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> Present policy calls for repayment of all acquisition debt within 12 years, while maintaining a satisfactory level of capital in the company's bank subsidiary.
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> The revised policy would provide that the holding company's debt-to-equity ratio be reduced to no more than 30 percent within 12 years, which is approximately the level maintained by many multi-bank holding companies.
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> This can be accomplished by direct debt repayment, or by building up equity through the retention of earnings.
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> In any case, the proposed criteria would call for no dividend payments until such time as the company's debt-to-equity ratio had reached 30 percent or less, while maintaining capital at no less than 8 percent of assets.

Enclosed—for commercial banks and bank holding companies in this District—is a copy of the Board's proposed policy statement on this matter. The proposed statement will be published in the *Federal Register*, and copies will also be furnished upon request directed to our Circulars Division. Questions regarding the proposal may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5861).

THOMAS M. TIMLEN,
First Vice President.

FEDERAL RESERVE SYSTEM

Violations of the 1980 Requirements
of the Bank Holding Company Act

Policy Statement

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Statement of Policy.

SUMMARY: This Policy Statement outlines the penalties for violations of the 1980 divestiture requirements by companies that became bank holding companies as a result of the 1970 Amendments to the Bank Holding Company Act.

FOR FURTHER INFORMATION CONTACT: Bronwen Mason, Senior Attorney (202/452-3564), Legal Division, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: The Board has issued the following statement of policy:

Policy Statement Regarding
Violations of the 1980 Requirements
of the Bank Holding Company Act

Pursuant to the provisions of section 4(a)(2) of the Bank Holding Company Act ("BHCA"), bank holding companies that became subject to the BHCA in 1970, as a result of the 1970 Amendments to the BHCA, generally may not retain nonbanking subsidiaries or activities beyond December 31, 1980. In statements dated October 13, 1977, and December 20, 1978, the Board advised bank holding companies to file on or before June 30, 1978, and September 30, 1979, respectively, plans of divestiture with respect to each subsidiary or activity that is subject to the divestiture requirements of section 4(a)(2) of the BHCA. At the same time, the Board urged bank holding companies wishing to retain any of such nonbanking subsidiaries or activities under the provisions of section 4(c)(8) of the BHCA to file applications for retention by these dates in order to allow sufficient time for Board action on applications well before December 31, 1980. While a substantial number of affected bank holding companies have responded to the Board's statements, the Board is concerned about those companies that have failed to respond or have only partially responded.

In its statements the Board stressed that it has no authority to extend the December 31, 1980 divestiture deadline in general, or in particular hardship situations. Thus, absent an approved application under section 4(c)(8) or some other exemption under section 4 of the BHCA, retention by a bank holding company of any nonbanking subsidiaries or activities beyond December 31, 1980 will be a violation of the BHCA.

(OVER)

Moreover, the Board notes that Congress allowed a very liberal period of time for bank holding companies to comply with the provisions of section 4 of the Act. Accordingly, the Board believes that there has been ample time for affected companies to inform themselves of their responsibilities under section 4(a)(2) of the BHCA and take steps to meet those responsibilities in a timely and orderly manner.

The Board will regard a violation of section 4 of the BHCA resulting from failure to divest or obtain approval for retention prior to December 31, 1980, as an extremely serious matter. With respect to such violations, the Board intends to enforce the provisions of the BHCA through appropriate actions, including initiation of cease-and-desist proceedings under the Financial Institutions Supervisory Act, and assessment of civil money penalties or referral for criminal prosecution pursuant to section 8 of the BHCA, against the bank holding company as well as its officers and directors. Generally, the severity of a violation will not be mitigated because a bank holding company has an application for retention under section 4(c)(8) pending at the Board on December 31, 1980, or has appealed the Board's action on an application.

Finally, the Board recognizes that efforts by most bank holding companies to comply with the provisions of section 4(a)(2) will necessitate some Board action. In its previous statements the Board has emphasized the need for prompt filing of all retention applications and requests concerning 1980 divestitures, in order to ensure timely Board action. While the Board intends to act as expeditiously as possible on such applications and requests, companies are also reminded to allow sufficient time for divestiture in the event of denial of retention applications. Moreover, the Board wishes to call attention to the fact that under the provisions of the Bank Holding Company Tax Act of 1976, a bank holding company would forfeit its tax benefits for <u>all</u> divestitures in the event of its failure to make one timely divestiture. (5 U.S.C. 1101(e)).

Board of Governors of the Federal Reserve System, effective December 12, 1979.

Theodore E. Allison
Secretary of the Board

FEDERAL RESERVE SYSTEM

POLICY STATEMENT
FOR ASSESSING FINANCIAL FACTORS IN
THE FORMATION OF SMALL ONE-BANK HOLDING COMPANIES
PURSUANT TO THE BANK HOLDING COMPANY ACT
[Docket No. R-0265]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed policy statement.

SUMMARY: In the interest of helping to maintain the safety and soundness of the banking system and, in particular, of small community banks, as well as to improve the transferability of ownership of such institutions and facilitate local ownership of these banks, the Federal Reserve Board is proposing for public comment a policy statment for assessing financial factors in the formation of small one-bank holding companies.

DATE: Comments must be received on or before January 31, 1980.

ADDRESS: Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All materials submitted should include the Docket Number R-0265.

FOR FURTHER INFORMATION: James I. Garner, Division of Banking Supervision and Regulation (202-452-2415), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

POLICY STATEMENT
OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
FOR ASSESSING THE FINANCIAL FACTORS IN
THE FORMATION OF SMALL ONE-BANK HOLDING COMPANIES
PURSUANT TO THE BANK HOLDING COMPANY ACT

In acting on applications filed under the Bank Holding Company Act, the Board has adopted, and continues to follow, the cardinal principle that bank holding companies should serve as a source of strength for their subsidiary banks. When bank holding companies incur debt and rely upon the earnings of their subsidiary banks as the means of repaying such debt, a question arises as to the probable effect upon the financial condition of the company and its subsidiary bank or banks. Incurring debt under these circumstances is of particular concern when the debt proceeds are used for acquisitions rather than for internal purposes such as meeting the capital needs of a subsidiary bank.

The Board believes that a high level of acquisition debt impairs the ability of a bank holding company to come to the aid of its subsidiary bank in times of need and in some cases the servicing requirements on such

debt may be a drain on the bank's resources. For these reasons, the Board has not favored the use of acquisition debt in bank holding company formations. Nevertheless, the Board has recognized that the transfer of ownership of small community banks and the maintenance of local ownership in those banks often requires the use of acquisition debt. The Board, therefore, has permitted the formation of small one-bank holding companies with debt levels higher than would be permitted for larger or multi-bank holding companies. Approval of these applications has been given on the condition that the small one-bank holding companies demonstrate the ability to service the acquisition debt without straining the capital of their subsidiary bank and, further, that such companies restore their ability to serve as a source of strength for their subsidiary bank within a relatively short period of time.

The Board continues to subscribe to these principles. In the interest of furthering its policy of encouraging local transfer and ownership of banks in the one-bank holding company format, without diluting bank safety and soundness, the Board has reexamined the analytical framework and the criteria it applies when considering small one-bank holding company formations. To these ends, it proposes certain revisions in its procedures and standards described below.

The proposed criteria shift the focus from debt repayment contained in existing criteria to the relationship between debt and equity at the parent holding company. The holding company would have the option of improving the relationship of debt to equity by either repaying the principal amount of its debt or through the retention of earnings. Under these procedures, newly organized small one-bank holding companies would be expected to reduce the relationship of their debt to equity over a reasonable period of time to a level comparable to that maintained by many large and multi-bank holding companies.

In general, this policy is intended to apply only to one-bank holding companies that do not have significant leveraged nonbank activities and whose subsidiary bank would have total assets of approximately $100 million or less at the time the application is filed.

The proposed criteria are as follows:

General

In evaluating applications filed pursuant to Section 3(a)(1) of the Bank Holding Company Act, as amended, where the applicant intends to incur debt to finance the acquisition of a small bank, the Board will take into account a full range of financial and other information, including the recent trend and stability of earnings of the bank; the past and prospective growth of the bank; the quality of the bank's assets; the ability of the applicant to meet debt servicing requirements without placing an undue strain on the bank's resources; and the record and competency of management of the applicant and the bank. In addition, the Board will use the following criteria in assessing acquisition debt:

(1) Minimum Down Payment

The amount of acquisition debt should not exceed 75 percent of the purchase price of the bank to be acquired.

(2) Maintenance of Adequate Capital

An applicant proposing to use acquisition debt must demonstrate to the satisfaction of the Board that any debt servicing requirements to which the bank holding company may be subject would not cause the bank's ratio of gross capital to assets to fall below 8.0 percent during the 12-year period following consummation of the acquisition. 1/ Gross capital is defined as the sum of total stockholders' equity, the allowance for possible loan losses and subordinated capital notes and debentures.

(3) Reduction in Parent Company Leverage

The applicant must demonstrate to the satisfaction of the Board that the holding company's ratio of debt to equity would decline to 30 percent within 12 years after consummation of the acquisition.

The term "debt", 2/ as used in the ratio of debt to equity, means any borrowed funds (exclusive of short-term borrowings which arise out of current transactions, the proceeds of which have been or are to be used for current transactions), and any securities issued by, or obligations of, the holding company that are the functional equivalent of long-term debt.

The term "equity", 2/ as used in the ratio of debt to equity, means the total stockholders' equity of the bank holding company adjusted to reflect the periodic amortization of "goodwill" (i.e., the excess of cost of any acquired company over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed) in accordance with generally accepted accounting principles. In determining the total amount of stockholders' equity, the bank holding company should account for its investments in the common stock of subsidiaries by the equity method of accounting.

1/ The applicant will be required to submit projected financial statements covering the 12-year period for the bank holding company (parent only) and the bank to be acquired. Such financial statements may be condensed but should identify principal groups of balance sheet and income statement items.

2/ Redeemable preferred stock will be treated as equity if, by its terms, it is not redeemable until after the ratio of debt to equity at the holding company is below 30 percent and would remain at 30 percent or less subsequent to the redemption. If the preferred stock is redeemable under other conditions, it will normally be treated as the functional equivalent of debt. Preferred stock that is convertible into common stock of the holding company will be treated as equity.

(4) Dividend Restrictions

The bank holding company is not expected to pay any corporate dividends until such time as its debt to equity ratio is below 30 percent.

Board of Governors of the Federal Reserve System,
December 13, 1979.

Theodore E. Allison
Secretary of the Board