

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 8889]
July 31, 1980]

REGULATION Y

Interpretation Relating to Disposition of Certain Assets

*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 and Change in Bank Control," regarding the holding and disposition of assets acquired in satisfaction of debts previously contracted.

Enclosed is an excerpt from the *Federal Register* of July 28, 1980, containing the text of the interpretation. Questions thereon may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5861).

ANTHONY M. SOLOMON,
President.

Board of Governors of the Federal Reserve System
BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL
INTERPRETATION OF REGULATION Y

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Reg. Y, Docket No. R-0319]

Bank Holding Companies and Change in Bank Control; Disposition of Property Acquired in Satisfaction of Debts Previously Contracted

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: This interpretation delineates the conditions governing the holding and disposition of assets acquired by bank holding companies and their banking or nonbanking subsidiaries in satisfaction of debts previously contracted.

EFFECTIVE DATE: July 22, 1980.

FOR FURTHER INFORMATION CONTACT:

Bronwen M. Mason, Senior Attorney (202/452-3584), or Jennifer J. Johnson, Senior Attorney (202/452-3584), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Pursuant to the Board's authority under sections 4(c)(1)(D), 4(c)(2), 4(c)(8) and 5(b) of the Bank Holding Company Act (12 U.S.C. 1843 (c)(1)(D), (c)(2), (c)(8), and 1844(b)), and section 8 of the Financial Institutions Supervisory Act (12 U.S.C. 1818) 12 CFR Part 225 is amended by adding a new § 225.140 to read as follows:

§ 225.140 Disposition of property acquired in satisfaction of debts previously contracted.

(a) The Board recently considered the permissibility, under section 4 of the Bank Holding Company Act, of a subsidiary of a bank holding company acquiring and holding assets acquired in satisfaction of a debt previously contracted in good faith (a "dpc" acquisition). In the situation presented, a lending subsidiary of a bank holding company made a "dpc" acquisition of assets and transferred them to a wholly-owned subsidiary of the bank holding company for the purpose of effecting an

orderly divestiture. The question presented was whether such "dpc" assets could be held indefinitely by a bank holding company subsidiary as incidental to its permissible lending activity.

(b) While the Board believes that "dpc" acquisitions may be regarded as normal, necessary and incidental to the business of lending, the Board does not believe that the holding of assets acquired "dpc" without any time restrictions is appropriate from the standpoint of prudent banking and in light of the prohibitions in section 4 of the Act against engaging in nonbank activities. If a nonbanking subsidiary of a bank holding company were permitted, either directly or through a subsidiary, to hold "dpc" assets of substantial amount over an extended period of time, the holding of such property could result in an unsafe or unsound banking practice or in the holding company engaging in an impermissible activity in connection with the assets, rather than liquidating them.

(c) The Board notes that section 4(c)(2) of the Bank Holding Company Act provides an exemption from the prohibitions of section 4 of the Act for bank holding company subsidiaries to acquire *shares* "dpc". It also provides that such "dpc" shares may be held for a period of two years, subject to the Board's authority to grant three one-year extensions up to a maximum of five years.¹ Viewed in light of the Congressional policy evidenced by section 4(c)(2), the Board believes that a lending subsidiary of a bank holding company or the holding company itself, should be permitted, as an incident to permissible lending activities, to make acquisitions of "dpc" assets. Consistent with the principles underlying the provisions of section 4(c)(2) of the Act and as a matter of prudent banking practice, such assets may be held for no longer than five years from the date of acquisition. Within the divestiture period it is expected that the company will make good faith efforts to dispose of "dpc" shares or assets at the earliest

practicable date. While no specific authorization is necessary to hold such assets for the five-year period, after two years from the date of acquisition of such assets, the holding company should report annually on its efforts to accomplish divestiture to its Reserve Bank. The Reserve Bank will monitor the efforts of the company to effect an orderly divestiture, and may order divestiture before the end of the five-year period if supervisory concerns warrant such action.

(d) The Board recognizes that there are instances where a company may encounter particular difficulty in attempting to effect an orderly divestiture of "dpc" real estate holdings within the divestiture period, notwithstanding its persistent good faith efforts to dispose of such property. In the Depository Institutions Deregulation and Monetary Control Act of 1980, (Pub. L. 96-221) Congress, recognizing that real estate possesses unusual characteristics, amended the National Banking Act to permit national banks to hold real estate for five years and for an additional five-year period subject to certain conditions. Consistent with the policy underlying the recent Congressional enactment, and as a matter of supervisory policy, a bank holding company may be permitted to hold real estate acquired "dpc" beyond the initial five-year period provided that the value of the real estate on the books of the company has been written down to fair market value, the carrying costs are not significant in relation to the overall financial position of the company, and the company has made good faith efforts to effect divestiture. Companies holding real estate for this extended period are expected to make active efforts to dispose of it, and should keep the Reserve Bank advised on a regular basis concerning their ongoing efforts. Fair market value should be

¹ The Board notes that where the dpc shares or other similar interests represent less than 5 percent of the total of such interests outstanding, they may be retained on the basis of section 4(c)(6), even if originally acquired dpc.

derived from appraisals, comparable sales or some other reasonable method. In any case, "dpc" real estate would not be permitted to be held beyond 10 years from the date of its acquisition.

(e) With respect to the transfer by a subsidiary of other "dpc" shares or assets to another company in the holding company system, including a section 4(c)(1)(D) liquidating subsidiary, or to the holding company itself, such transfers would not alter the original divestiture period applicable to such

shares or assets at the time of their acquisition. Moreover, to ensure that assets are not carried at inflated values for extended periods of time, the Board expects, in the case of all such intracompany transfers, that the shares or assets will be transferred at a value no greater than the fair market value at the time of transfer and that the transfer will be made in a normal arms-length transaction.

(f) With regard to "dpc" assets acquired by a banking subsidiary of a

holding company, so long as the assets continue to be held by the bank itself, the Board will regard them as being solely within the regulatory authority of the primary supervisor of the bank.

By order of the Board of Governors of the Federal Reserve System effective July 22, 1980.

Cathy L. Petryshyn,
Assistant Secretary of the Board.

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