FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **9618**
January 16, 1984]

BANK HOLDING COMPANIES

Revision of Regulation Y

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

The Board of Governors of the Federal Reserve System has revised its Regulation Y, "Bank Holding Companies and Change in Bank Control," effective February 6, 1984; the procedural changes in the regulation are effective for applications filed on or after January 1, 1984. The following is quoted from the text of the statement issued by the Board of Governors announcing the revision:

> The Federal Reserve Board has made public a complete revision of its Regulation Y — regulation of bank holding companies — including liberalization of procedures that should reduce by a third the time now required for handling applications.
>
> The Board's revision added five activities to the list of bank-related activities permissible for bank holding companies, and approved incorporation into the regulation of certain standing Board interpretations, including interpretations of definitions of the terms "demand deposit" and "commercial loan" in the Bank Holding Company Act's definition of "bank".
>
> The Board acted after review of some 800 letters of comment received following publication in May of a proposed complete overhaul of Regulation Y. The overhaul is part of the Board's Regulatory Improvement Project for reviewing and modernizing all of its regulations, including simplification and clarification of language, elimination of obsolete provisions, changes in procedures and substance and lightening the burden of compliance.
>
> The Board also approved seeking public comment on the possible addition of a number of activities to the list of activities permissible for bank holding companies, as suggested by commenters on the May proposal, including the scope of permissible insurance activities for bank holding companies under Title VI of the Garn-St Germain Depository Institutions Act of 1982. (A separate *Federal Register* notice containing these proposed new activities will be published in the near future.)

Enclosed — for member banks, bank holding companies, and branches and agencies of foreign banks in the Second Federal Reserve District — is the complete text of the Board's statement. Copies of that statement are available to others upon request directed to the Circulars Division of this Bank (Tel. No. 212-791-5216).

The complete text of the revised Regulation Y, the Board's formal notice of the revision, and a supplementary appendix to that regulation have been published in the *Federal Register* of January 5, 1984. Single copies of that document may also be obtained upon request directed to our Circulars Division.

The revised printed pamphlet of Regulation Y is expected to be available sometime in February, and will be distributed at that time. Questions regarding the revised regulation may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5861).

ANTHONY M. SOLOMON,
President.

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FEDERAL RESERVE press release

December 29, 1983

The Federal Reserve Board today made public a complete revision of its Regulation Y -- regulation of bank holding companies -- including liberalization of procedures that should reduce by a third the time now required for handling applications.

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The principal matters dealt with in revised Regulation Y are:

I. Procedures:

1.--Most requirements for applications or notices to the Board by a bank holding company wishing to open a new office of an existing and approved non-bank subsidiary have been eliminated. The Board reserved the right to require a notice where in its judgment the bank holding company's financial condition requires Board consideration of the proposed expansion. Bank holding companies would also be required to file a one-time notice to expand beyond existing approved geographic areas.

Here, as elsewhere in its revision of procedures, the Board indicated that the adequacy of the bank holding company's capital would be a prime factor in Board decisions to require an application for such de novo expansion. The Board's staff estimated that this provision alone would eliminate some 500 applications a year.

2.--A bank holding company will be permitted to acquire a small going concern (up to $15 million in assets) on the basis of 15 days notice when the concern is (1) engaged in an activity already approved for the bank holding company acquiring it, and (2) the acquiring bank holding company meets the Board's capital guidelines. Notice may be given, at the applicant's option, in the Federal Register or in a newspaper of general circulation within the area to be served.

The staff estimated that this change may be expected to reduce, by as much as 75 percent, the time now required for an application to be prepared and acted upon by the System.

3.--The present notice procedure will be maintained for a bank holding company to establish a new company to commence, de novo, an activity already on Regulation Y's approved list by filing a brief notice with the Federal Reserve of its intention to do so. However, the notice period will be reduced from 45 to 30 days. The Reserve Banks can handle such matters under delegated authority if the condition of the bank holding company meets the Board's financial standards, including adequate capitalization under the Board's guidelines.

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4.--The requirement that a bank holding company file an application if it wishes to acquire the assets of one or more offices of a mortgage or consumer finance company--extended in the revised regulation to industrial banks--will be eliminated if:

--The acquiring company is authorized to engage in the activity.

--Assets acquired in any one year do not exceed the lesser of $25 million or 25 percent of the acquirer's assets.

--The assets relate primarily to the sale of consumer or residential mortgage loans.

--The bank holding company meets the Board's capital adequacy guidelines.

--Notice is given to a Reserve Bank within 30 days after making the acquisition.

The Board specified that it may require an application if in its view the acquiring company is not in sound condition.

5.--The Board sharply reduced the time for processing bank holding company applications by cutting the time allowed for Reserve Bank and Board action. Under the revised procedures:

--The Reserve Bank that receives an application has 10 business days in which to accept the application or ask for more information if the application is incomplete. The Reserve Bank could request further information once only, and must review that information in five business days.

--The Reserve Bank must approve the application within 30 days of acceptance if approval is appropriate under the Board's rules of delegated authority, including the requirement that the applicant must be in sound financial condition.

--The Board must act on the application within 60 days -- in place of the current 90 days -- or inform the applicant of its reasons for delay, such as a substantive problem with the application. Such delay could take place only with the approval of a designated member of the Board.

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6.--With respect to applications asking the Board to publish for comment suggested new lines of bank holding company activity, the Board retained the existing requirement that there must be a reasonable basis for publishing the new nonbank activity. Publication in the Federal Register would take place in 10 days. If any member of the the Board desired it, formal Board action would be required to approve the publication for comment. This would be done within 30 days.

II. Definition of Bank:

In adopting its revised Regulation Y, the Board clarified and incorporated into the regulation its standing interpretations of the terms "demand deposit" and "commercial loan" in the definition of "bank" in the Bank Holding Company Act.

The definition incorporated in the revised regulation essentially reiterates the definition of "bank" in the Bank Holding Company Act as:

> An organization that accepts deposits that the depositor has a legal right to withdraw upon demand and that engages in the business of making commercial loans.

In incorporating its interpretations bearing upon the definition of bank into the regulation, the Board said:

> The bank definition is the key to the Act, because it supplies the basis for effecting the fundamental purposes for which the legislation was enacted: (1) the separation of the business of banking from commerce to assure impartiality in the granting of credit and avoidance of conflicts of interest (2) the limitation of risk to the banking system inherent in the unlimited association of banking and commerce, and (3) the prevention of concentration of banking resources.

The Board specified that industrial banks that take demand deposits and make commercial loans will be regarded under the revised Regulation Y as banks. The powers of industrial banks have recently been substantially expanded and they have become eligible for deposit insurance by the Federal Deposit Insurance Corporation.

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The Board pointed out that in recent years a large number of insurance, securities, industrial and commercial organizations have acquired FDIC-insured national or state chartered banks through the device of divesting the acquired bank's direct commercial loan portfolio and continuing to accept demand deposits, or through giving up the taking of demand deposits but continuing to make direct commercial loans. The Board stated that acquisitions of this nature and in such numbers were not contemplated by the Congress in the Bank Holding Company Act or by the Board in the few instances from 1970 to 1980 when the Board permitted limited and circumscribed acquisitions of this type.

Further, the Board noted that the present situation places bank holding companies subject to the restrictions of the Bank Holding Company Act and Regulation Y at a competitive disadvantage with respect to nonbanking organizations that acquire "nonbank banks" free of the prudential rules of the Act and its implementing regulation. This inequity threatens to undermine the system designed by Congress for regulation of the conduct of nonbanking activities by bank holding companies.

Consequently--and in order to prevent a preemption of Congressional deliberation and decision respecting the delineation between banking and commerce in this country, as well as the permissible limits for interstate banking--the Board has reexamined its interpretation of the terms demand deposits and commercial loans in the definition of bank. These were set forth more than a year earlier in public communication to the Federal Deposit Insurance Corporation and in Board order. In these communications and orders, the Board specified certain characteristics of demand deposits and commercial loans under the Bank Holding

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Company Act and these interpretations have now been incorporated into Regulation Y as follows:

> <u>Demand deposits:</u> The final regulation defines the phrase "deposits that a depositor has a legal right to withdraw upon demand" as
>
> Any deposit with transactional capability that as a matter of practice is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal (NOW) or other similar instrument.

The Board specified in an appendix to the revised regulation that at present it is unnecessary to regard as demand deposits such accounts as money market accounts, preauthorized or telephone transfer accounts, non-checkable savings accounts, accounts accessible through automatic teller machines, bill-payor accounts and credit balance accounts accessible by negotiable check or draft.

> <u>Commercial Loans:</u> The final regulation defines "commercial loan" as a "loan the proceeds of which are used other than for personal, family, household or charitable purposes" including:
>
> The purchase of retail installment loans and such instruments as commercial paper, bankers acceptances, and certificates of deposit and similar money market instruments, as well as the extension of broker call loans, the sale of federal funds and the deposit of interest-bearing funds.

The Board specified that it does not at this time regard repurchase agreements involving government securities as commercial loans. However, the Board directed the staff to return to it within a short time with a discussion of the question whether repurchase agreements should be included as commercial loans.

In discussing incorporation of its interpretations of commercial loan and demand deposits in Regulation Y, Board Members emphasized that the Board hopes Congress will legislate on this matter in the near future.

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Under the revised regulation, companies that own institutions, including industrial banks or industrial loan companies, that both make commercial loans and offer demand or checking NOW accounts must within 180 days register with the Board as bank holding companies and within two years must either divest the bank subsidiary (or terminate its demand or NOW accounts or commercial loan activity) or conform the holding company's activities to thos permissible for bank holding companies.

The same will be true of savings and loan associations the accounts of which are not insured by the Federal Savings and Loan Insurance Corporation and that offer NOW accounts and make commercial loans.

The revised regulation establishes a procedure under which companies that acquired nonbank banks prior to December 10, 1982, on the basis of a narrow interpretation of the commercial loan or demand deposit definitions in effect before that time, may petition the Board for relief on grounds of hardship or unfairness. The Board will consider whether an exception is consistent with the purposes of the Bank Holding Company Act and will act promptly on such petitions.

III. New Bank Holding Company Activities and Proposals for New Activities:

The Board approved, as proposed in May, the addition of five new activities to the list of permissible nonbanking activities in Regulation Y. These are:

Issuing money orders, arranging commercial real estate equity financing, underwriting and dealing in government obligations and certain money market obligations, providing foreign exchange advisory and transactional services, and acting as a futures commission merchant (expanded to include options on futures). All these activities have previously been approved by order for particular companies.

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Certain conditions proposed in May for the futures commission merchant activity were deleted by the Board in its final action, but conditions proposed respecting equity financing were adopted.

The Board also approved seeking public comment respecting possible addition to the list of permissible nonbanking activities of several activities previously approved by order, or that are similar to such approved activities. These are check guaranty services, consumer financial counselling, brokerage of options on government securities and money market instruments, futures commission merchant for stock index futures, commodity trading advisory services and portfolio advice on financial futures.

The Board deferred for 30 days action on proposals by commenters that the Board seek comment on a number of other activities for bank holding companies that the Board has not previously considered and in which there has been little previous indication of interest, including tax planning and tax preparation, appraisal of personal property, operating a collection agency, credit bureau, armored car service, financial advertising, the operation of public relations agency and provision of job training and conducting an employment agency for financial personnel.

The Board also deferred publication for comment of a number of securities, real estate and financial activities, including the operation of thrift institutions, that are the subject of pending legislation.

The Board directed the staff to prepare a proposed rule, to be published for comment, delineating the scope of permissible insurance activities for bank holding companies under the provisions of Title VI of the Garn-St Germain Depository Institutions Act of 1982.

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IV. Bank Holding Company Stock Redemptions:

The following chart gives the current and adopted provisions of Regulation Y respecting the redemption of bank holding company stock:

REDEMPTION OF BANK HOLDING COMPANY STOCK

	CURRENT REG. Y	FINAL ACTION
Required Notice Or Application	45-day prior notice if redemption exceeds 10% of bhc's net worth in a 12-month period	Retain existing notice requirement but with 30-day prior notice instead of 45 days if redemption exceeds 10 percent of a bank holding company's net worth in a 12-month period
Standard Applied	Whether redemption constitutes an unsafe or unsound practice or violates an order, rule, or enforcement agreement	In considering redemption notices the Board will apply: Financial standards that are applied in bank holding applications, including the Board's capital guidelines and its policy statement on formation of small one-bank holding companies
Procedure to Prevent Redemption	Board must institute a cease-and-desist proceeding	Board may disapprove a proposed redemption within the notice without a cease-and-desist proceeding
Remedies of BHC	Bhc must request administrative hearing and thereafter challenge any final cease-and-desist order in court	The Bhc may request a hearing, or petition for judicial review of an adverse decision, as in any Board action on a bank holding company application.

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V. The Board also approved:

--Modification of the proposed definition in Regulation Y of voting securities to exclude from the definition preferred securities and limited partnership interests with certain limited voting rights.

--Retention without change of the Board's outstanding interpretations concerning the exemption in the Bank Holding Company Act permitting a bank holding company to provide services to its bank and nonbanking subsidiaries without obtaining Board approval.

--Deletion from Regulation Y of the statement that the Board may take competitive effects into account in considering convenience and needs in acting on applications to acquire banks under Section 3 of the Bank Holding Company Act.

--Submission to the Congress of a proposal authorizing waiver of the 30-day waiting period for consummation of a bank holding company proposal following Board approval.

--Requiring prior Board approval for investments by a bank holding company under the Bank Service Corporation Act (as amended by the Garn-St Germain Act), as is the case for investments by banks under that statute.

The procedural changes in Regulation Y are effective for applications filed on or after January 1, 1984. Other changes will be effective 30 days after publication in the Federal Register, expected during the first week in January.

The Board's notice is available from the Federal Reserve Banks and from the Board's Publications Office.

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federal register

Thursday
January 5, 1984

Part IV

Federal Reserve System

12 CFR Part 225

Bank Holding Companies and Change in Bank Control; Revision of Regulation Y

[Ref. Cir. No. 9618]

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FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Docket No. R-0470]

Bank Holding Companies and Change in Bank Control; Revision of Regulation Y

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: On May 19, 1983, the Board proposed for comment a revision of 12 CFR Part 225, Regulation Y, its regulation implementing the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*) and the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)). The Bank Holding Company Act requires prior Board approval for a company to become a bank holding company or for a bank holding company to acquire more than five percent of the voting shares of a bank or a bank holding company. The Act also regulates the nonbanking activities of bank holding companies and of foreign banking organizations that control U.S. banks or have U.S. offices. The Change in Bank Control Act requires generally that persons and certain companies give notice to the Board prior to acquiring shares representing control of a bank holding company or state member bank.

After considering the comments received, the Board is adopting the revision of Regulation Y with some significant modifications. The final regulation reduces regulatory burden by eliminating various application requirements, particularly in the nonbanking area, and by accelerating the processing schedules for all applications. In addition, the final regulation incorporates Board interpretations of significant provisions of the Bank Holding Company Act and Change in Bank Control Act to improve understanding of the Board's policies. The regulation also has been comprehensively reorganized and rewritten for clarity in order to enhance the usefulness of the regulation to the reader.

Finally, the Board has amended the regulation to add five nonbanking activities to the list of those permissible for bank holding companies. The Board will publish a separate **Federal Register** notice seeking public comment on amendments to Regulation Y regarding the scope of permissible insurance activities for bank holding companies under Title VI of the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97-320, 96 Stat. 1469, 1536-38). The Board will also seek comment on a number of other nonbanking activities that were suggested by commenters on the proposed revision.

EFFECTIVE DATE: February 6, 1984, except for the procedural provisions of §§ 225.14 and 225.23, which will be effective for all applications and notices submitted to the Board on and after January 1, 1984.

FOR FURTHER INFORMATION CONTACT: J. Virgil Mattingly, Associate General Counsel (202/452-3430), Bronwen Mason Chaiffetz, Senior Counsel (202/452-3564), or Carl V. Howard, Senior Counsel (202/452-3786), Legal Division; David Kulig, Senior Counsel (202/452-2347) or Lily T. Pilgrim, Senior Attorney (202/452-2421) Regulatory Improvement Project; Don E. Kline, Associate Director (202/452-3421), or Sidney M. Sussan, Assistant Director (202/452-2638), Division of Banking Supervision and Regulation.

SUPPLEMENTARY INFORMATION: The Bank Holding Company Act of 1956, as amended ("BHC Act"), governs the acquisition of control of banks by companies and regulates the nonbanking activities of bank holding companies or covered foreign banking organizations. It was enacted to prevent the undue concentration of banking resources, to separate banking and commerce, and to ensure that the performance of nonbanking activities of bank holding companies is consistent with certain basic prudential limitations in the Act regarding risk, safety and soundness, conflicts of interest, and the maintenance of impartiality in the granting of credit. Section 5(b) of the BHC Act (12 U.S.C. 1844(b)) authorizes the Board to adopt regulations to effect the purposes of the BHC Act and to prevent evasions of its provisions.

The Change in Bank Control Act of 1978 ("Bank Control Act") imposes a 60-day prior notice requirement on persons seeking to acquire control of a bank holding company or an insured state-chartered bank that is a member of the Federal Reserve System ("state member bank"). The Board is authorized to adopt regulations to implement the Bank Control Act (12 U.S.C. 1817(j)(13)).

I. Background and Summary

The proposed revision of Regulation Y was issued under the Board's Regulatory Improvement Project, which conducts periodic reviews of the Board's regulations (See Statement of Policy Regarding Expanded Rulemaking Procedures. 44 *Fed. Reg.* 3957 (1979)), and under the Financial Regulation Simplification Act of 1980 (12 U.S.C. 3521). The review of Regulation Y focused on reducing regulatory burden and on clarifying and simplifying the regulation consistent with the terms and purposes of the BHC Act and the Bank Control Act. Specifically, the Board reexamined all of its current requirements concerning transactions for which applications must be filed to identify those application requirements that could be eliminated from the current regulation. In addition, the Board's formal and informal procedures and schedules for processing applications were reviewed to determine ways in which applications might be acted on more promptly and processing delays eliminated. Finally, the current regulation, which was initially adopted in 1971 and has been amended only infrequently since that time, was reviewed to determine whether it accurately reflected the Board's current interpretations of the provisions of the BHC Act.

As a result of this analysis, the proposed revision contained a number of provisions that were designed to reduce or eliminate regulatory burden. The regulation was also reorganized to reflect the provisions of the BHC Act, and a number of Board interpretations of provisions of the Act were incorporated in the regulation, including the terms "deposits that a depositor has the legal right to withdraw on demand" and "commercial loan" contained in the definition of "bank" in section 2(c) of the BHC Act. The Board requested comment on the proposed revision of Regulation Y, including the definitions of terms, as well as five proposed new nonbanking activities for addition to the Regulation Y list of permissible nonbanking activities. The Board also requested suggestions for other nonbanking activities that might be considered to be closely related to banking and that should be added to the Regulation Y list of permissible nonbanking activities.

The Board has also reviewed its application forms to simplify them by eliminating duplicative information and information already available to the Board. The Board expects these measures to reduce by 40 to 60 percent the number of pages contained in applications required under this regulation.

The comments generally favored the procedural aspects of the proposed revision designed to reduce burden, eliminate unnecessary applications and avoid duplication and delay. Commenters particularly favored the provisions: a) eliminating most applications for *de novo* expansion of approved nonbanking activities; b)

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exempting certain nonbank asset acquisitions from prior approval under the Act; c) providing a 15-day notice procedure for small acquisitions of nonbanking concerns; d) establishing expedited processing schedules for all applications; and e) adding the five proposed new nonbanking activities. The commenters urged the Board to implement these improvements as rapidly as possible.

The Board agrees with the commenters that the procedural changes would result in substantial benefits and should be implemented immediately. Accordingly, the provisions of section 553 of the Administrative Procedure Act (5 U.S.C. 553) relating to deferred effective date have not been followed in connection with adoption of the procedures set forth in sections 225.14 and 225.23. Most of the procedures, particularly the new processing schedules contained in §§ 225.14 and 225.23, will become effective for applications and notices submitted to the Board on and after January 1, 1984, while the remainder of the provisions will become effective within 30 days of publication of this notice in the **Federal Register.**

On the other hand, a number of commenters opposed the incorporation into the proposed regulation of the Board's interpretation of the terms "demand deposit", "commercial loan", and "voting securities" in the BHC Act; the proposed revised interpretation of the servicing exemption in section 4 of the Act; the proposed revision of the stock redemption rules; the reaffirmation of the provisions governing the nonbanking activities of subsidiary banks of a bank holding company and the nonbank subsidiaries of such banks; and certain other provisions of the proposed regulation.

The issues raised by the commenters together with the changes made in the final regulation (except for technical and editorial changes) are discussed later in this notice under the relevant provisions of the revised regulation. The following is a summary of the major issues that were raised and the Board's determination on each issue:

(1) *De novo expansion of nonbanking activities.* The current Regulation Y requires prior Board approval each time a bank holding company seeks to open a new office of a nonbank subsidiary or to expand the service area of such a subsidiary. The Board proposed two alternative approaches with respect to *de novo* expansion of nonbanking activities. Under the first approach, a bank holding company would be allowed to open offices *de novo* without the Board's prior approval within any state or states where the company had previously received approval to engage in the specified nonbanking activity. Alternatively, the Board proposed to eliminate all application requirements for *de novo* expansion in the United States once the bank holding company received initial Board approval to engage in the nonbanking activity. Most comments favored the alternative proposal, although there were objections to both proposals.

The Board's experience with the administration of the BHC Act and Regulation Y has indicated that *de novo* expansion is procompetitive and that there is no evidence of any significant adverse effects associated with *de novo* expansion. Accordingly, and in view of the absence of any requirement in the BHC Act for an application in such cases, the Board is adopting the alternative to eliminate all applications for *de novo* expansion of previously approved nonbanking activities in the United States. Thus, once a bank holding company has received approval to engage in a nonbanking activity, it may expand that activity anywhere in the United States by opening new offices or expanding its service area without further Board approval. (See section 225.23(b)). The Board, however, is retaining the authority to require an application where, for example, a bank holding company is not in sound financial condition and expansion may not be consistent with sound banking practice.

Because prior Board approvals under section 4(c)(8) were limited to the geographic area stated in the application, and potential opponents may have withheld protest because they were not affected by the limited geographic scope of the application, bank holding companies will be required to file a one-time notice to expand a nonbanking activity beyond the geographic areas previously approved by the Board under the current Regulation Y. These notices may be processed under the 30-day notice procedure for *de novo* expansion.

(2) *Notice for De Novo Entry.* The Board is retaining the present procedure of the regulation that allows a bank holding company to file a simple notice with the Reserve Bank to engage in a permissible nonbanking activity. The applicant may engage in the activity 30 days after filing the notice unless a substantive adverse comment is received or the Reserve Bank finds that the proposal is inconsistent with the statutory criteria. The notice period has been reduced from the present 45 days to 30 days. (Section 225.23(a)(1)).

(3) *Notice procedure for small nonbanking acquisitions.* The proposed revision contained an expedited 15-day notice procedure for small acquisitions of going concerns engaged in permissible nonbanking activities. The commenters generally favored this proposal as substantially remedying unnecessary delays imposed by the section 4(c)(8) prior approval requirement that place bank holding companies at a competitive disadvantage with respect to their nonbank competitors. Some suggestions were made to broaden the criteria for use of this procedure and to provide notice in the **Federal Register** rather than in a newspaper. The Board has incorporated these suggestions in the final regulation and has also clarified that the expedited procedure may not be used, and a full application is required, where the applicant bank holding company is not in sound financial condition and does not meet the Board's Capital Adequacy Guidelines. (See section 225.23(f)).

(4) *Exempt nonbanking asset acquisitions.* Most commenters favored the Board's proposal to exempt from prior approval requirements under the BHC Act acquisitions of offices and other assets of consumer finance and mortgage companies. They stated that this would enhance competitive equality between bank holding companies and their nonbank consumer finance and mortgage company competitors. Several suggestions were made to modify the provision to broaden its applicability and to include the acquisition of the assets by an industrial banking office. The Board is adopting a number of these suggestions in the final regulation, but is making the procedure available only if the acquiring bank holding company meets the Board's Capital Adequacy Guidelines. (See § 225.22(c)(8)).

(5) *List of permissible nonbanking activities.* The Board proposed to add five new activities to the Regulation Y list of permissible nonbanking activities: issuing money orders, arranging commercial real estate equity financing, underwriting and dealing in government obligations and certain money market obligations, providing foreign exchange advisory and transaction services, and acting as a futures commission merchant. The Board has previously approved these activities by order in a number of cases. The commenters supported these activities, and the Board is adding them to the list of permissible activities in the final regulation. The Board had adopted the suggestions of the commenters to eliminate a number of the conditions

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from the regulation proposed with respect to the conduct of these activities. (See § 225.25(14) and(18)).

In addition, there was support for a substantial expansion of the Regulation Y list of nonbanking activities permissible for bank holding companies. Several bank holding companies suggested that the Board defer action on the revision until proposals for new activities were developed. However, most of these commenters also urged prompt implementation of the procedural improvements in the proposed revision. In view of the expected benefits from the procedural improvements, the Board does not believe that it should delay final adoption of the regulation.

The Board made four decisions with respect to adding new nonbanking activities suggested for addition to the Regulation Y list in response to the Board's proposal to revise Regulation Y. First, the Board will publish a separate **Federal Register** notice seeking comment on an amendment to Regulation Y that defines the scope of insurance activities that are permissible under the authority of Title VI of the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97–320, 96 Stat. 1469, 1536–38) ("Garn-St Germain Act"). Second, certain of the suggested activities, particularly certain securities and real estate activities, the operation of a thrift institution and certain activities of a financial nature, are the subject of or related to bills currently pending in Congress, particularly, the Administration's proposed Financial Institutions Deregulation Act (S. 2181), the proposed Financial Services Competitive Equity Act introduced by Senator Garn (S. 2134), and the proposed Depository Institutions Holding Company Act Amendments introduced by Senator Proxmire (S. 2134). The Board does not believe that it is appropriate to commence a regulatory proceeding that would overlap with Congressional consideration of whether these activities should be performed by bank holding companies and, accordingly, it is not publishing these activities for comment at this time. Third, the Board will publish a separate **Federal Register** notice seeking public comment on a number of activities that the Board has previously approved by order in individual cases or that are similar to approved activities. Fourth, the Board will consider in the near future publishing for comment an additional number of activities that were suggested by commenters, have not previously been considered by the Board, and are not the subject of pending Congressional consideration.

(6) *Expedited processing schedules for all applications.* The proposed revision contained regulatory deadlines for each step of the applications process, including pre-acceptance review, acceptance, publication of notice, and final action. These deadlines represent a substantial reduction in the current informal schedules for processing applications—from 45 to 30 days for delegated applications and from 90 to 60 days for Board action on applications. The deadline for pre-acceptance review by the Reserve Banks has also been shortened to a maximum period of 30 days.

The comments supported the expedited processing schedules and the Board is adopting them as proposed. Under current procedures, more than 90 percent of all applications are processed under delegated authority. Based on this experience, the Board expects that, under the new procedures, most cases will be acted on under delegated authority within 30 days from acceptance. In this regard, the Board's decision to publish notice of receipt of the application immediately upon its submission to the Reserve Bank (rather than after acceptance of the application) will allow for approval of many cases within a few days of the acceptance of the application. (See §§ 225.14 and 225.23).

(7) *Stock redemptions.* More than 600 of the comments addressed the proposed changes concerning the redemption by a bank holding company of its own securities. The comments uniformly opposed the Board's proposed amendment, stating that it would adversely affect the transferability of ownership of small one-bank holding companies. The Board has decided to retain the current stock redemption notice procedures, including the rule that no notice is required unless redemptions within a 12-month period amount to 10 percent or more of the company's net worth. The Board has modified the regulation to specify the standards under which the Board will review a proposed redemption transaction for which notice is given. These standards are those generally applied by the Board in applications filed under the BHC Act, including the Board's Capital Adequacy Guidelines and the Board's standards for small one-bank holding companies. However, stock redemptions should not be made that would substantially impair an institution's capital or prevent the attainment of the capital and debt projections submitted in connection with bank holding company formations. (See § 225.4(b).)

(8) *Servicing subsidiaries of bank holding companies.* The Board proposed to modify its existing interpretations of sections 4(a)(2) and 4(c)(1)(C) of the BHC Act, which permit a holding company to own a servicing subsidiary that acts as agent for the holding company and its bank or nonbank subsidiaries in providing their services to the public. Under the proposed amendment, servicing subsidiaries would have been limited to providing services for the internal operations of the holding company and its subsidiaries. This provision was designed to address situations in which bank holding companies had used the servicing exemption to purchase nonbank companies and, in effect, to engage as principal in providing nonbank services to the public without complying with section 4(c)(8) of the BHC Act.

A number of comments were received objecting to the proposal as contrary to the Board's longstanding interpretations on which many companies had relied. Accordingly, the Board is modifying the proposed provision to reaffirm its longstanding interpretation that, although a servicing subsidiary may not act as principal in providing nonbank services to the public, it may act as agent for its affiliates in furnishing services to the public. The Board will rely on its supervisory authority under the Act to address problems in this area. (See § 225.22(a).)

(9) *Definition of "voting securities."* A number of the comments objected to the proposed definition of "voting securities," stating that it would include preferred shares, partnership interests, and shares with contingent voting rights. The Board has previously determined that preferred shares do not constitute voting securities if the voting rights are limited, generally by state law, to those necessary to protect the investment and do not otherwise provide the holder with control. The Board is clarifying the proposed definition to reflect this position. (See § 225.2(1).)

(10) *Definition of "bank."* The Board proposed to include in the revision its existing interpretations of the terms "deposits that the depositor has a legal right to withdraw on demand" and "commercial loans," the two essential elements of the definition of "bank" for the purpose of establishing coverage under the BHC Act. (See *First Bancorporation (Beehive Thrift and Loan)*, 68 *Federal Reserve Bulletin* 253 (1982) and Board ruling of December 10, 1982, regarding the Dreyfus Corporation,

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A number of commenters opposed the definitions. The Independent Bankers Association supported the definition of bank, as interpreted by the Board, and the American Bankers Association supported the definition of "commercial loan."

After careful consideration of the comments and for the reasons set out in Supplementary Information Appendix A to this notice, which follows the text of the regulation, the Board has determined to adopt the "bank" definition with minor modifications, including the definitions of "demand deposit" and "commercial loan." The Board believes these interpretations are consistent with the terms and legislative history of the Act, and reflect the equivalency between demand deposits and NOW accounts and between commercial loans and commercial paper and the other instruments referred to in the definition. In the Board's judgment, any other interpretation of these important terms would produce a result that is plainly at variance with the purposes of the BHC Act and would preempt Congressional discretion to determine the proper delineation between banking and commerce in this country as well as the permissible limits for interstate banking.

(11) *Permissible activities for subsidiaries of banks.* The proposed revision included the current provision of section 225.4(e) of Regulation Y that generally permits a subsidiary state bank of a bank holding company to acquire or retain the shares of a nonbank subsidiary engaged in activities that the bank may perform directly, subject to all limitations applicable to the bank. A number of comments were received challenging the Board's authority to adopt this provision. The Board plans to consider the comments on this issue separately in connection with certain pending bank holding company applications that directly raise the issue of the appropriateness of this provision and the scope of the Board's authority to adopt it. The Board believes that implementation of the other provisions of the regulation, which reduce regulatory burden and have widespread support, should not be delayed pending resolution of this issue. Until the rulemaking on this provision is complete, the provisions of former § 225.4(e) of Regulation Y remain in effect and have been reprinted as § 225.22(d) of the final regulation.

Revision of current interpretations

It will be necessary to revise some of the Board's published interpretations to reflect the changes being made in the regulation; and, in that connection, the Board will try to accommodate the views of those who favor a commentary or other format that would make other Board positions readily available. In the interim, the Board will republish this **Federal Register** notice in the Federal Reserve Regulatory Service to provide a convenient source of guidance on the final regulation.

Regulatory Flexibility Act

The Board certifies that none of the proposed changes will have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). A number of commenters asserted that the amendments regarding bank holding company redemption of securities would have a disproportionate impact on a large number of small entities. However, as noted above, the Board is modifying its proposed amendments to the bank holding company stock redemption provisions. Thus, the Board believes that no further analysis under the Regulatory Flexibility Act is necessary with respect to these amendments to Regulation Y.

Some commenters objected that there was no analysis under the Regulatory Flexibility Act regarding the impact of the definition of "bank" on small entities. In this regard, the Board notes that the bank definition incorporated by the Board in the final regulation represents the Boards's existing interpretations of terms in the BHC Act and would be applicable even if the definitions were not included in Regulation Y. The BHC Act contains no exemption from the bank definition for small institutions, and indeed such an exemption was affirmatively rejected by Congress when it amended the statute in 1970. Thus, the Board believes it would be inconsistent with legislative intent and the prudential policies of the Act to attempt to exempt some identifiable class of small institutions. Unlike some other statutes that the Board administers, the BHC Act does not generally give the Board discretionary authority to make adjustments and exceptions in the statutory coverage for particular classes of institutions so as to relieve compliance burdens.

Since the Board concludes that the definition is required to carry out the purposes and to prevent evasions of the BHC Act and that an exemption for small entities is not consistent with the BHC Act, an analysis of the impact on small entities is unnecessary. Nonetheless, to the extent it has been argued that some institutions covered by the definition would not be considered "banks" if the Board adopted another interpretation, the Board has considered the impact of the regulation on this group of institutions.

The impact of the definition would be felt in two ways: (1) eligibility for ownership of the institution would be affected; and (2) the institution itself would be required to obtain FDIC insurance if it is owned by a company.

For the most part, the organizations that will be affected by the Board's commercial loan definition are the large commercial, industrial, insurance, and securities companies that have recently acquired so called "nonbank banks" based upon a narrow reading of the bank definition in the Act or that may wish to do so in the future. These companies would become bank holding companies and would have to terminate nonconforming activities or divest the bank (or terminate the bank's demand deposit and NOW accounts or commercial lending activity). To date, such organizations have been large and do not include a "substantial number of small entities" within the meaning of the Regulatory Flexibility Act. Most of the banks that have been acquired by such large organizations already have FDIC insurance.

With respect to the FDIC insurance requirement, it appears that the impact would be primarily on industrial banks and similar institutions. Of course, these institutions would be affected only if the are subsidiaries of other companies. Moreover, the Board notes that the impact of this definition on such institutions results not from the definition *per se*, but from recent changes in state laws or interpretations thereof that have authorized these institutions to offer NOW accounts or other checking accounts and to make commercial loans. Prior to 1980, industrial banks did not typically offer checking accounts or make commercial loans, and data provided by trade associations indicate that only a few states authorize industrial banks to offer NOW accounts. Indeed, the legislative history of the BHC Act is clear that when Congress acted to exempt such institutions from the Act in 1966, it did so on the basis of testimony from the industrial banking industry that industrial banks did not offer checking accounts or make commercial loans. (See Supplementary Information Appendix A to this notice). The effect of these changes in state laws, which have rendered industrial banks "banks" for purposes of the statute, may be avoided if the institution in question discontinues either the commercial lending or NOW

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account activities that were recently commenced.

The Board notes that there are approximately 1,200 industrial banks or industrial loan companies operating in about 21 States. However, only about 100 of these institutions accept NOW or other checking accounts. In addition, about half of the states that authorized industrial banks or industrial loan companies do not permit them to offer transaction accounts, limiting the institution to the issuance of thrift notes, investment certificates and similar instruments or passbook savings accounts. The Board also notes that in some states that industrial bank must obtain FDIC insurance in order to offer NOW accounts. The Board received specific comments concerning the impact of the proposal in the States of Hawaii, where NOW accounts are not authorized, and Rhode Island, where eleven industrial loan companies operate, of which approximately 5 accept NOW accounts. No specific comment was received regarding the impact in any other State, although there were a number or comments regarding the impact of the rule generally. In view of the limited number of institutions engaged in accepting NOW accounts, it does not appear that the regulation would leave a significant economic impact on a substantial number of small entities.

Companies that control such banks would have 180 days to register with the Board and the institutions owned by such companies would have two years to obtain Federal Deposit Insurance. This two year period would lessen the impact of the regulation of these institutions and provides an opportunity for Congress to consider amending section 3(e) of the BHC Act to provide for other types of insurance as an alternative to FDIC insurance.

Finally, as discussed in § 225.2(a) below, the Board is adopting a procedure to exempt from the nonbanking prohibitions of the BHC Act and certain other requirements of this regulation companies that acquired a "bank", as defined in this final regulation, on or before December 10, 1982, on the basis of a narrow interpretation of the term "demand deposit" or "commercial loan." This provision will significantly reduce the burden of this regulation on companies that qualify for this exemption.

For these reasons, the Board believes that no further analysis under the Regulatory Flexibility Act is necessary with respect to the "demand deposit" or "commercial loan" definitions in Regulation Y.

II. Subpart A—General Provisions

No significant comments were received regarding § 225.1 ("Authority, purpose, and scope"), § 225.3 ("Administration"), § 225.5 ("Registration, reports, and inspections"), and § 225.6 ("Penalties for violations"). In § 225.2(e) of the final regulation the Board has incorporated the definitions of the terms "foreign banking organization" and "qualifying foreign banking organization" from § 211.23 of its Regulation K (12 CFR 211.23). In addition, the definition of "United States" contained in § 225.2(a)(1)(iii) of the proposed regulation appears at § 225.2(k) of the final regulation. Finally, the Board has clarified in paragraph (a) of § 225.5, that a company that has obtained the Board's prior approval to become a bank holding company may complete the registration process by filing its first annual report with the Board.

The remaining paragraphs in this subpart, § 225.2 ("Definitions") and § 225.4 ("Corporate Practices") were the subject of numerous comments, as discussed below.

Section 225.2—Definitions

The following definitions received comments:

Section 225.2(a) "Bank". Section 2(c) of the BHC Act defines "bank" as "any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." In its proposed revision, the Board interpreted the demand deposit aspect of the "bank" definition as including NOW accounts and other transaction accounts and the commercial loan aspect as including the purchase of commercial paper, certificates of deposit and bankers acceptances, the sale of federal funds and similar transactions. For the reasons set out in detail in the Supplementary Information Appendix A, the Board is adopting, with some modifications, the definitions of these two aspects of the bank definition as proposed in the revision, and in addition, is incorporating in the "commercial loan" definition the purchase of retail installment loans.

As is explained in the Supplementary Information Appendix A, the Board has clarified the scope of the regulation it is adopting since it has determined that at present it is unnecessary to regard as demand deposits such accounts as money market deposit accounts, preauthorized transfer accounts, telephone transfer accounts, savings accounts that do not have checking capability, accounts accessible through ATM machines, bill-payer accounts, and credit balance accounts accessible by negotiable check or draft. Also as is explained in the Supplementary Information Appendix A, the Board does not at this time believe repurchase transactions involving government securities or non-interest bearing demand deposits should be regarded as within the meaning of the term "commercial loan."

The Board received and has considered requests for hearings to explore the extent of the Board's authority to adopt the bank definition, the appropriateness of such action in light of pending judicial and Congressional actions, and the consistency of the definition with the terms of the Act. The Board believes that the opportunity presented for comment on the definitions through the submission of written materials provided as adequate method for interested persons to express their views regarding the legal issues and other matters raised by the proposed revision and that hearings on these issues are neither required nor appropriate.

The Board also has considered requests that the Board republish notice of the proposal providing greater specificity regarding the proposed definitions and the reasons for the definitions. In publishing the revision for comment, the Board stated that it was proposing to incorporate its interpretations of the BHC Act's provisions into Regulation Y to prevent evasions of the Act and specifically referred to its decisions in *First Bancorporation* and *The Dreyfus Corporation*, which contain detailed discussions of the basis for the Board's interpretations of the demand deposit and commercial loan aspects of the bank definition. Accordingly, the Board believes that adequate notice of the proposal has been given and has decided not to republish for comment the definitions of demand deposit or commercial loan.

The Board received several comments urging the Board to delay inclusion of the demand deposit and commercial loan definitions in Regulation Y in view of pending litigation regarding the Board's *First Bancorporation* decision and Congressional consideration of the types of institutions that should be subject to the Act. The Board emphasizes, however, that its decision to incorporate these definitions into Regulation Y is intended to bring the regulation into conformity with previous orders of the Board interpreting the Act

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and to carry out the purposes and prevent evasion of the Act. Amendments will be made as necessary in the light of any legislative or judicial action.

The Board notes that, under section 5 of the BHC Act, any company that controls an institution that is a bank under the BHC Act must, within 180 days of becoming a bank holding company, register with the Board and, under section 4 of the Act, must within two years either conform its activities to those permissible under section 4 of the Act or divest its subsidiary bank or cause the bank to cease being a "bank" under the Act. In the future, any company that seeks to acquire a "bank" must, in compliance with section 3 of the Act, file an application and obtain the Board's prior approval for the acquisition.

The Board recognizes that some companies may have prior to December 10, 1982, acquired banks on the basis of a narrow interpretation of the terms "demand deposit" or "commercial loan" and without objection by the Board. Accordingly, the Board has adopted a provision in the final regulation (section 225.21(b)(4)) under which the Board will consider grandfather rights for acquisitions accomplished, or banking operations commenced, prior to December 10, 1982, the date the Board issued its commercial loan interpretation in connection with the *Dreyfus* proposal. The Board will consider modifying the effect of the regulation on the basis of petitions from such companies that demonstrate that application of the regulation without a transition period to permit compliance would be unfair or represent an unreasonable hardship and that exclusion from coverage as a bank holding company would be consistent with the purposes of the BHC Act and the Bank Holding Company Act Amendments of 1970. The Board will promptly act on such petitions upon receipt of all necessary information regarding the petition.

The basis for the Board's actions is further described in detail in Supplementary Information Appendix A to this statement. Supplementary Information Appendix A is not part of the regulation, and is not codified in CFR.

Section 225.2(c) "Company". One commenter objected to including limited partnerships in the definition of "company," arguing that the regulation exceeds the scope of section 2(b) of the BHC Act. The statute defines "company" as "any corporation, partnership, business trust, association, or similar organization." (12 U.S.C. 1841(b).) The legislative history of the BHC Act indicates that limited partnerships as well as general partnerships are covered as companies under the Act. (H.R. Rep. No. 91-387, 91st Cong., 1st Sess. 22 (1969).) Accordingly, the Board is adopting the definition of "company" as proposed.

Section 225.2(d) "Control" of bank or company. Among other things, the definition of "control" in section 225.2(d) of the proposed regulation specifies that the Board may determine that a company controls another company if it finds that the company has the "power to exercise a controlling influence." This definition is based on sections 2(a)(2)(C) and 2(d)(3) of the BHC Act.

Some commenters objected to this provision on the basis that section 2(a)(2)(C) of the BHC Act defines control as the *actual* exercise of a controlling influence, rather than the *power* to exercise a controlling influence. However, section 2(d) of the Act in defining subsidiary for the purposes of the BHC Act, defines control to include the power to exercise a controlling influence. The proposed revision reconciles these two sections of the BHC Act. The Board notes that, because section 2(d) establishes the test for when a bank or company is a subsidiary of a bank holding company, the test in that section would be applicable when a bank holding company seeks to acquire a bank or other company. Thus, the proposed definition of control does not impose a more stringent standard on companies that are bank holding companies.

In addition, as indicated in its previous decisions regarding this matter, the Board believes that, to a large extent, this debate is one of semantics and not substance. (See, *e.g., Patagonia Corporation,* 63 *Federal Reserve Bulletin* 288 (1977).) The critical question is whether the Board may determine in advance that, as a result of a particular transaction, a company would be able to exercise a controlling influence over a bank or other company. It is the Board's belief that it may make such determinations in advance, and that it need not wait until a transaction is consummated in a manner that would frustrate the Act's purposes. Such advance determinations would also enable companies to avoid expending substantial resources on transactions that may ultimately be determined to be unlawful under the controlling influence provisions.

Based on the foregoing discussion, the definition of control is being adopted as proposed. The Board is also adopting the suggestion of a number of commenters to include in the regulation the presumptions of non-control in sections 2(a) (3) and (4) of the BHC Act. These presumptions have been included in section 225.31 of Subpart D of the final regulation.

Section 225.2(f) "Management official". The proposed definition of "management official," which is relevant to control and divestiture determinations under Subpart D, included advisory and honorary directors, as well as all officers. The Board's proposed definition was derived from its interpretation concerning the presumption of continued control under section 2(g)(3) of the BHC Act in divestiture situations. (12 CFR 225.139.)

Some comments suggested that the definition of management official specified in Regulation L (12 CFR Part 212) should be adopted in Regulation Y. The Board does not believe that the Regulation L definition of management official should be used here because it is derived from the Depository Institutions Management Interlocks Act (12 U.S.C. 3201), which has different purposes from the control provisions of the BHC Act.

A number of commenters objected to the proposal on the grounds that advisory and honorary directors do not have voting rights, and that not all officers have policy-making functions. Section 2(g)(3) of the BHC Act relating to divestitures and the presumptions of control in Regulation Y covers all officers and directors, regardless of whether they exercise policy-making functions. The Board's interpretation of section 2(g)(3) explicitly covers honorary and advisory directors. The Board does not believe this coverage should be limited because the divestiture and control provisions of the BHC Act are designed to prevent a control situation from developing or continuing and, in any event, are presumptions that may be rebutted upon a showing that control does not, in fact, exist.

One comment also objected to including employees with policy-making functions in the definition because the presumptions of control for use in control determinations do not now specifically include such employees. The Board does not believe this represents a substantive change in the current provisions because the Board regards an employee of a company with policy-making functions as an officer of the company even if the employee is not designated as an officer. (12 CFR 225.139(a)(2).)

Based on the foregoing, the Board is adopting the definition of management official as proposed.

Section 225.2(1) "Voting securities". The Board proposed to define "voting

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securities" as common and preferred stock, partnership interests, and other similar interests, if the holders are entitled (under statute, charter, or in any manner) to vote for or select directors, trustees, or partners, or to vote on significant corporate matters. A number of commenters objected to the inclusion of preferred stock and limited partnership interests in the definition of voting securities.

With respect to limited partnership interests, commenters stressed that limited partners do not have voting rights comparable to those of common stock, and that the business of a limited partnership is managed by the general partner and not by the limited partners who may only be passive investors. Commenters also pointed out that in order to preserve their limited liability status, limited partners may not actively participate in the business affairs of the partnership.

In 1970, the BHC Act was amended to include partnerships within the definition of the term "company." Accordingly, when the BHC Act refers to shares of a company throughout section 4, the term includes partnership interests. The Board has previously recognized that the term shares as used in section 2(g)(3) of the Act includes general as well as limited partnership interests. (12 CFR 225.139 (c)(3) (1983).)

Many commenters also objected to including in the definition nonvoting preferred stock that has limited or contingent voting rights, pointing out that such preferred stock does not have the right to vote regularly for election of directors or on other corporate matters. The commenters did not believe that nonvoting preferred stock should be defined as a voting security under the BHC Act merely because it often has limited voting rights. For example, under some state corporate statutes, preferred stock often has the right to vote as a class on dissolution, mergers, the payment of dividends, or the issuance of additional preferred stock. Similarly, to qualify under New York Stock Exchange rules, preferred stock as a class must have the right to elect two directors if six quarterly dividends are not paid.

The Board continues to believe that the term "voting shares" in the BHC Act includes equity securities, partnership interests, or similar interests that entitle the holder to vote for or select directors, trustees, or partners or to vote on or direct the management of company affairs. However, the Board has modified the proposed definition to meet some of the concerns of the commenters. Under the modified definition, preferred stock, limited partnership interests and similar interests will not be considered voting securities if they have limited voting rights that: (i) Are of the type customarily provided by statute solely with regard to matters that adversely and significantly affect the rights or preference of the stock or other interest; (ii) do not select or vote for the election of directors, general partners, or trustees; and (iii) do not otherwise constitute control. For example, preferred stock would not be viewed as a voting security if it may vote on a merger that would adversely affect its rights or preference or that involves the issuance of additional amounts or classes of senior securities, or the alteration of charter or by-laws that would adversely affect the preferred stock. On the other hand, preferred stock that may vote on any merger regardless of whether its preferred status would be affected, could be viewed as a voting security. Similarly, arrangements under which the limited partner may select the general partner or control the investments or policies of the partnership could constitute the partnership interest as a voting security.

With respect to nonvoting preferred stock that has the right to elect directors upon failure to pay preferred dividends, the **Federal Register** notice accompanying the proposed revision stated that such nonvoting stock would be considered a voting security only at the time the right to vote arises. Moreover, in a number of cases where the holders have committed that they will not exercise the right, or will only do so after obtaining the Board's prior approval, the Board has indicated that such action is appropriate to ensure compliance with the BHC Act. The Board, however, emphasizes that this position applies only in this particular circumstance. The Board has consistently held that a company may not purchase voting common stock on the basis that it will not exercise the voting rights associated with these securities or where the voting rights are extinguished while the company holds the securities. (*See, e.g.*, Policy Statement on Nonvoting Equity Investments by Bank Holding Companies, 12 CFR 225.143(d)(6)(iii); Board letter dated, August 30, 1974, Federal Reserve Regulatory Service ("FRRS") 4–550.)

Finally, investments in nonvoting preferred stock and limited partnership interests that are not voting securities under the terms of the regulation may raise issues under the Board's Policy Statement on Nonvoting Equity Investments by Bank Holding Companies (12 CFR 225.143). The Board has taken the position that such investments generally should not exceed 25 percent of the equity of the company issuing the securities. (12 CFR 225.143(d) (4) and (5); *Security Bancorp., Inc.*, 66 *Fed. Res. Bull.* 977 (1980); *United Midwest Bankshares, Inc.*, 68 *Fed. Res. Bull.* 774 (1982).) The foregoing rules are not intended to prevent bank holding companies from making venture capital investments that are consistent with these rules. As a result of the numerous inquiries on this subject, the Board is preparing an interpretation of these rules as they apply to venture capital investments.

Section 225.4—Corporate Practices

There were no substantive comments from the public on paragraph (a) ("Bank holding company policy and operations"), paragraph (d) ("Tie-in arrangements"), or paragraph (e) ("Acting as transfer agent, municipal securities dealer, or clearing agent"). The only comments on paragraph (c) ("Deposit insurance") were based on objections to the scope of the definition of "bank," which is discussed in § 225.2(a). The comments on paragraph (b) ("Purchase or redemption by a bank holding company of its own securities") are discussed below.

Section 225.4(b) Purchase or redemption by a bank holding company of its own securities. The proposed revision prohibited purchases and redemptions by a bank holding company of its own securities unless, after giving effect to the transaction, the holding company and subsidiary banks meet the minimum primary capital-to-total-assets ratios (based on size) contained in the Board's Capital Adequacy Guidelines. In addition, a bank holding company with banking assets of $150 million or less must have a consolidated debt-to-equity ratio of less than 30 percent after the redemption. There would be an exception to the prohibition for *de minimis* redemptions totalling less than one percent of the holding company's net worth. Also, a bank holding company could seek the Board's prior approval for a proposed redemption on the basis of unusual circumstances.

The current regulation requires a bank holding company to give 45 days' notice to the Board of a proposed redemption if the purchase price would exceed 10 percent of the holding company's net worth, or would exceed that amount when aggregated with all redemptions made in the previous twelve-month period. Under this procedure, the Board may institute cease and desist proceedings to present the redemption if the Board finds it would be unsafe or unsound.

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More than 600 comments objected to the removal of the exemption for purchases totalling 10 percent or less of net worth in a twelve-month period on the grounds that it would discourage local ownership of small banks and would interfere with the use of bank holding companies as estate planning vehicles. They stated that a small bank holding company often provides a market for its securities where no other market exists, and that under the proposed redemption provisions, bank holding companies would effectively be prevented from performing this function, resulting in the sale of the stock of small banks to larger banking organizations or other persons outside the local community.

Based on the comments, the Board has determined to modify the proposal in the following manner. First, the 10 percent exemption contained in the current regulation will be retained, and no notice will be required for redemptions involving less than 10 percent of net worth in any twelve-month period. This modification will significantly reduce the burdens associated with the proposed revision because it would exempt a large number of transactions.

Bank holding companies are cautioned, however, against the use of this exemption for repeated redemptions that do not require notice but undermine the capital position of the banking organization. Such situations will be closely examined by the Board to ensure that they do not constitute an unsafe or unsound practice. Also, the exemption should not be used by companies that do not meet the Board's capital guidelines for redemptions that would significantly reduce their capital, and by a small one-bank holding company to increase it debt-to-equity ratios significantly from the projections relied on by the Board in approving its application to become a bank holding company.

Two other modifications will also reduce the burden associated with these provisions. The final regulation reflects the modification of both the standards used in judging a proposed redemption transaction and the procedure for objecting to such transactions. Under the current regulation, a bank holding company is notified if it is determined that a proposed redemption is unsafe or unsound, or would violate any applicable law, rule, regulation, order, or any written agreement with the Board. The Board may then commence a cease-and-desist proceeding to prevent the transaction. The Board is modifying this provision to provide that, prior to the end of the notice period, the Board will advise the bank holding company that the proposed purchase or redemption has been approved or disapproved.

The standards for disapproval will be the same as those set forth in the current regulation; however, the final regulation provides that the safety and soundness of a proposed redemption transaction will be judged under the Board's Capital Adequacy Guidelines. The Board's Capital Adequacy Guidelines are contained in Appendix A to the final regulation. With respect to bank holding companies with banking assets of $150 million or less, if debt is incurred in connection with a proposed redemption, the amount and repayment of such indebtedness generally will be governed by the Board's standards for small one-bank holding company formations. (Policy Statement for Formation of Small One-Bank Holding Companies, FRRS 4-855 and FRRS 4-856.) This policy statement is contained in Appendix B to the final regulation.

The Board is authorized by the Financial Institutions Supervisory Act to issue rules prescribing practices that are unsafe or unsound, (12 U.S.C. 1818(b), (n)), and the courts have confirmed this authority. (*Independent Banker Association v. Heimann*, 613 F. 2d 1164 (D.C. Cir. 1979).) The Board has similar authority under section 5(b) of the BHC Act to issue rules to carry out the purposes of the Act, one of which is to assure that bank holding companies maintain adequate financial resources. Finally, section 908 of the recently enacted International Lending Supervision Act of 1983 (Title IX of Pub. L. 98-181), authorizes the appropriate federal banking agency to establish minimum levels of capital for banking institutions and to require institutions to achieve and maintain such minimum levels. The Board is also authorized under that provision to consider the impact of a holding company's proposals on its subsidiary bank's progress in achieving its minimum capital level and, under section 910(a)(2) of that statute, to apply the provisions of the statute to bank holding companies in order to promote uniform application of the statute and to prevent evasions thereof.

The information to be provided in connection with prior notice to the Board of a proposed redemption is being consolidated from eight to three items. In addition, the period for reviewing the notice is being reduced from 45 to 30 days, unless the notice is referred to the Board for decision, in which case the review period will be 60 days, in order to conform to the processing requirements for applications under the BHC Act.

III. Subpart B—Acquisition of Bank Securities or Assets

Section 225.11—Transactions Requiring Board Approval

This section of the proposed regulation, which is based on section 3(d) of the BHC Act, sets out the following transactions for which prior Board approval is required: (a) formation of a bank holding company; (b) acquisition of a subsidiary bank; (c) acquisition by a bank holding company of control of more than 5 percent of the voting securitites of a bank or a bank holding company; (d) acquisition of bank assets; (e) merger or consolidation of bank holding companies; and (f) any other transaction that the Board determines in a particular case requires prior approval under the BHC Act. The majority of the comments on this section addressed paragraphs (c), (d) and (f), as discussed below.

Generally, the acquisition by a bank or bank holding company of its own voting securities or those of its parent bank holding company would not require the Board's prior approval under this section of the regulation, unless there is an evasion of the BHC Act or other adverse effects. Such an acquisition may, however, require notice under section 225.4(b).

In the Federal Register notice accompanying the proposed revision, the Board stated that a redemption of securities by a bank or bank holding company that increases the proportional interest of a holder of such securities will be regarded as an "acquisition" of bank securities and will require the holder to file an application for prior Board approval under paragraph (a) or (c) of this section. For example, an application would be required under this section if the redemption results in the holder becoming a bank holding company because its proportional interest has increased to 25 percent or more of any class of voting securities of a bank or bank holding company.

Some commenters objected that there might not be sufficient time to obtain the Board's approval in advance when a redemption increases a shareholder's percentage ownership beyond a regulatory threshold. They suggested that the regulation specifically permit the filing of retention applications within a reasonable period after the redemption has occurred. The Board is not amending the regulation as suggested, because section 3 of the BHC Act specifies that the Board's approval

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is required prior to acquisitions of bank and bank holding company stock under that section. However, the Board has in similar situations accepted applications to retain shares acquired by a company for which it was impossible to obtain approval in advance. In the redemption situation, where the holder does not cause the redemption and does not have sufficient prior notice of it to file an application, the Board would consider 90 days after the redemption as an appropriate period within which to file an application (or to divest the necessary number of shares to bring it into compliance with the Act).

Section 225.11(c) Acquisition of control of bank or bank holding company securities. Under this provision, a bank holding company must apply for the Board's prior approval to acquire voting securities of a bank or bank holding company if, after the acquisition, the bank holding company would hold more than 5 percent of any class of voting securities of the bank or holding company.

Several commenters objected to applying this prior approval requirement to acquisitions of the voting securities of a bank holding company. The commenters argue that if a bank holding company does not acquire 25 percent or more of the voting shares of the other bank holding company, it cannot be presumed to indirectly control any of the bank shares held by the other bank holding company because the acquiring holding company would not control the acquired holding company under the BHC Act.

It is the Board's view that the same rationale that prompted Congress to require an application when a bank holding seeks to acquire more than 5 percent of a bank's shares, whether or not the interest acquired provides the holder with control, supports a similar rule when a bank holding company seeks to acquire more than 5 percent of the voting shares of another bank holding company. The Board has consistently required an application in such circumstances. Accordingly, the Board is adopting the proposed provision requiring an application for the acquisition by a bank holding company of voting securities of another bank holding company that would result in it holding more than 5 percent of the voting securities of the other bank holding company.

Commenters also objected to the requirement of prior approval where a bank holding company acquires more than 5 percent of any class of voting securities. They point out that section 3(a)(3) of the BHC Act only requires prior approval for the acquisition of more than 5 percent of the outstanding voting securities. Thus, they suggest that all voting securities should be aggregated to determine whether the five percent limitation has been met. The Board does not agree with this interpretation.

The requirement for an application in such a circumstance is intended to reconcile section 3(a)(3) with the control provisions of section 2(a)(2)(A) of the BHC Act. The 1970 Amendments to the BHC Act added the concept of a class of voting securities to the definition of control in section 2(a) of the BHC Act. The Board believes that, while corresponding changes were not made in all other sections of the BHC Act, such changes were intended and are necessary. Any other interpretation would allow a bank holding company to acquire 25 percent or more of a class of voting securities, and thereby to acquire control of a bank as defined in section 2(a)(2)(A) of the BHC Act without filing an application under section 3 of the BHC Act, whereas under section 3(a)(1) of the BHC Act a company that is not a bank holding company would have to file an application for the same acquisition. Such a result would produce an anamolous situation, imposing less stringent controls on bank holding company acquisitions of additional banks than on bank holding company formations under section 3(a)(1) of the BHC Act.

In addition, the Board believes that, because under corporate law various classes of stock may be given different voting rights, control of shares of a particular class of voting securities may provide a holder with disproportionate influence in the affairs of the target company or bank, and may present the concerns that the prior approval requirement of section 3(a)(3) of the BHC Act was meant to address, even though the amount of shares acquired may be less than 5 percent of all classes of voting securities of the target company or bank. The Board also believes that its clarification of the definition of "voting securities" to exclude preferred stock with only limited voting rights addresses in major part the concerns of the commenters about imposing the prior approval requirement on the acquisition by a bank holding company of more than 5 percent of a class of voting securities of a bank or bank holding company, because no application would be required if the preferred or other shares are not "voting securities."

Accordingly, the Board is adopting in the final regulation the proposed provision requiring an application for the acquisition of more than 5 percent of any class of voting securities of a bank or bank holding company.

Section 225.11(d) Acquisition of bank assets. This provision requires the Board's prior approval for an acquisition by a bank holding company or a nonbank subsidiary of all or substantially all the assets of a bank. Although several commenters requested the Board to quantify the percentage of assets that would require an application, in view of the absence of any questions arising concerning the interpretation of this provision in the almost 30 years it has been in place, the Board is adopting the provision as proposed.

Section 225.11(f) Other acquisitions. Under this provision, the Board proposed a procedure for determining when other acquisitions of securities of a bank or bank holding company require the Board's prior approval under section 3 of the BHC Act, after notice to the acquiring company. This proposal was based on the Board's responsibility for administration of the BHC Act, and its purpose was to avoid unnecessary filings with other agencies under the Bank Control Act and differing and conflicting interpretations of the BHC Act. Several commenters objected that adoption of the provision would exceed the Board's authority because there is no comparable provision in section 3 of the BHC Act. In view of the Board's action in adopting the definition of "bank," which specifies by regulation those institutions the acquisition of which require prior approval under the BHC Act, the Board does not believe that adoption of this provision is necessary to ensure compliance with and prevent evasions of the Act. Thus, the Board is not adopting this provision in the final regulation.

Section 225.12—Transactions Not Requiring Board Approval

This section specifies transactions for which prior Board approval is not required under section 3(a) of the BHC Act. No substantive comments were received concerning paragraph (c) ("Acquisition of securities by a bank holding company with majority control"); and paragraph (e) ("Holding securities in escrow"). Paragraphs (a), (b) and (d) are discussed below.

Section 225.12(a) Acquisition of securities in fiduciary capacity. This paragraph provides that Board approval is not required for a company (including a bank) to acquire voting securities of a bank or bank holding company in good faith in a fiduciary capacity, unless (1) the company has sole discretionary authority to vote the securities and will retain that authority for more than two

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years, or (2) the acquisition is for the benefit of the company, its shareholders, employees, or subsidiaries.

Under section 3(a) of the BHC Act, a company must apply to retain voting securities of a bank or bank holding company acquired in a fiduciary capacity with sole discretionary voting authority within 90 days of receiving such shares. The proposes regulation specified that no application is required unless the company proposed to retain the shares with sole discretionary voting authority beyond the two-year grace period provided in section 3(a) of the BHC Act. The Board is reaffirming the position reflected in the proposed regulation.

There was a request for an extension of the two-year grace period to file an application when the acquiring bank or company decides belatedly that it wishes to retain the shares in a fiduciary capacity. The BHC Act specifies a maximum grace period of two years, and the Board believes that if a company has any doubts about its plans regarding retention of fiduciary shares, it should file an application in time for Board action before the expiration of the grace period.

One commenter objected to excluding from the fiduciary exemption voting securities held in a fiduciary capacity for the employees of a company's subsidiaries. However, authority for this exclusion is clearly set forth in section 3(a)(A)(i) of the BHC Act, which excludes from the fiduciary exemption in that section, shares acquired as provided in section 2(g)(2) of the Act. Section 2(g)(2) provides that shares held by trustees for the benefit of the employees of a company are controlled by the company. Section 2(g)(1) of the BHC Act provides that shares owned or controlled by a subsidiary of a bank holding company are controlled by the bank holding company.

While the exception contained in section 3 of the BHC Act for the acquisition of bank or bank holding company securities or assets in a fiduciary capacity is limited to such acquisitions made by a bank, the regulation extends the exception for fiduciary acquisition of bank and bank holding company securities to those made by a nonbank company. This interpretation recognizes the fact that there are nonbank companies, including nonbank subsidiaries of bank holding companies, that are engaged in fiduciary activities and would receive securities or assets in a fiduciary capacity.

The fiduciary exemption in the BHC Act and the regulation does not exempt the acquisition of bank or bank holding company shares or assets by a bank as fiduciary for a trust that is a "company" as defined in § 225.2(c) of Subpart A. Thus, an application must be filed by such a trust if it proposes to make an acquisition of bank or bank holding company securities or assets covered under § 225.11 of the proposed regulation. In this situation, however, an application would not also be required from the fiduciary or its parent, if the fiduciary meets the requirements for the exemption described in § 225.12(a) of the proposed regulation.

The BHC Act also does not provide an exemption where the fiduciary receives shares from a selling company that is deemed to continue to control the shares after the diverstiture under section 2(g)(3) of the BHC Act.

Based on the foregoing, the Board is adopting the provision as proposed.

Section 225.12(b) Acquisition of securities in satisfaction of debts previously contracted. This paragraph exempts from prior approval under the BHC Act the acquisition by a bank or other company of voting securities of a bank or bank holding company in the regular course of securing or collecting a debt previously contracted in good faith so long as the company divests the securities within two years of acquisition.

Several commenters sought clarification about when the holding period begins to run. While the Board is adopting this provision as proposed, it believes clarification is appropriate. For example, in the Board's view, the pledge of more than 5 percent of the voting securities of a bank as collateral for a loan does not represent an acquisition that would start the holding period if the lender does not acquire voting rights to the pledged securities. On the other hand, if the lender acquires ownership or control of pledged voting securities as a result of a default on the loan, the transaction would be an acquisition under this paragraph and the two-year holding period would commence, regardless of whether the lender votes the securities.

While the statutory exception is limited to acquisitions made by banks, the final regulation extends the exception to any company that acquires bank securities in good faith in satisfaction of a debt previously contracted.

Section 225.12(d) Transactions subject to Bank Merger Act. This paragraph generally exempts from prior approval under the BHC Act a merger involving a subsidiary bank of a bank holding company if the merger is subject to approval under the Bank Merger Act. This exemption was proposed to implement section 3(a)(4) of the BHC Act, which does not require Board approval for the acquisition of bank assets by a bank. However, as one commenter noted, the Board would continue to retain jurisdiction over a transaction subject to the Bank Merger Act if the transaction would have a significantly adverse financial or other impact on the parent bank holding company. The Board has not found it necessary to exercise its authority in such cases, but the regulation has been clarified to reserve the Board's authority to do so when appropriate to effect the purposes of the Act. The Board has also clarified that a merger or consolidation of bank holding companies, which requires the Board's prior approval under section 3(a)(5) of the BHC Act, is not exempted from that requirement by this paragraph.

Section 225.13—Factors Considered in Deciding Applications Under Subpart B

Section 225.13(a) Prohibited anticompetitive transactions. Paragraph (a) of this section incorporates the antitrust standards in section 3(c) of the BHC Act, and paragraph (c) contains the prohibition against interstate bank acquisitions of section 3(d) of the Act. There were no significant comments regarding either of these provisions, and they are being adopted substantially as proposed with technical changes to conform to the language of the BHC Act. The comments on paragraph (b) ("Other factors considered") are discussed below.

Section 225.13(b) Other factors considered. This paragraph, which is based on section 3(c) of the BHC Act, outlines the factors considered by the Board in acting on all applications for acquisitions of banks and bank holding companies under this subpart. The factors include financial and managerial resources and the convenience and needs of the communities to be served. In view of objections raised by the commenters to including competitive considerations under the convenience and needs standard, the Board is deleting the reference in that provision to "existing and potential competition and the concentration of banking resources."

Several commenters objected to consideration of the financial and managerial resources of the subsidiaries of an applicant in connection with an application under section 3 to acquire an additional bank. They urge the Board to consider only the financial and managerial resources of the applicant and the bank to be acquired. Under section 3(c) of the BHC Act, the Board is directed to consider the financial and

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managerial resources of "the banks concerned." In a proposed acquisition by a bank holding company to acquire an additional bank, the Board believes that each of its existing subsidiaries is necessarily affected by the proposal, particularly since the bank holding company would be diverting financial and managerial resources from existing subsidiaries to the proposed new subsidiary.

Section 225.14—Procedures for Applications, Notices, and Hearings

This section sets forth the procedures for applications, notices, and hearings with respect to applications for the Board's prior approval of acquisitions of bank securities and assets. In an effort to expedite the processing of applications, the proposed regulation established time constraints for: (i) Accepting an application for processing or notifying the applicant that the application is incomplete and seeking additional information; (ii) publishing notice of the application in the **Federal Register**; and (iii) acting on the application. Similar provisions appear in section 225.23 with respect to applications for nonbanking activities under section 4(c)(8) of the BHC Act.

The procedural changes reflected in this section were favored by most commenters. Some commenters suggested that these procedural rules not be included in the regulation or that they be included elsewhere, such as the Board's Rules of Procedure (12 CFR Part 262). The Board believes that it is appropriate to include the procedural rules in Regulation Y, rather than the Rules of Procedure, because they relate specifically to applications under the BHC Act. Thus, incorporation of the procedural rules in Regulation Y will provide a more convenient source of guidance to those referring to the application provisions of the regulation. Accordingly, the Board is adopting the procedural rules as proposed with some modifications discussed below.

There were no significant comments on paragraph (a) ("Filing application"), paragraph (e) ("Hearings"), and paragraph (g) ("Exceptions to notice and hearing requirements"), and these provisions are being adopted as proposed. A new paragraph (e) has been added reflecting the statutory requirement that the Board notify the United States Attorney General of approval of an application under section 3 of the BHC Act. Accordingly, paragraphs (e), (f), (g) and (h) of section 225.14 of the proposed revision are renumbered as paragraphs (f), (g), (h) and (i) in the final regulation. The comments on the other paragraphs are discussed below.

Section 225.14(b) Notice. The majority of commenters favored the proposed prompt publication of the notice. Several commenters expressed concern that the provision in the proposed revision that calls for publication of notice in the **Federal Register** upon receipt of the application, rather than upon acceptance, would result in **Federal Register** publication of an application that ultimately may not be processed.

The object of the early notice provision was to allow an adequate **Federal Register** comment period (25 to 30 days), while at the same time enabling Reserve Banks to meet the 30-day processing schedule for delegated applications. Based on its experience with newspaper notices, which are published in advance of acceptance of the application, the Board does not believe that publication of **Federal Register** notice prior to acceptance of the application will result in any significant difficulties. Accordingly, the Board is adopting the notice provision as proposed in the revision.

Section 225.14(c) Accepting application for processing. Under the proposed revision, the Reserve Banks are allowed 10 calendar days from the date an application is filed to review the application and either to accept it, or if the application is found to be incomplete, to seek additional information. A number of commenters objected to beginning the time schedule for substantive review of an application from the date that the application is accepted by the Reserve Bank rather than from the date the application is filed, arguing that this delay will create uncertainty about the deadline for action on an application. Some commenters maintained that an application should be accepted immediately if it is responsive to each item on the application form, and that if additional information is needed, it can be obtained later.

In the Board's experience, many applications require additional information, and the time within which this information is furnished depends on the applicant. The time period for the pre-acceptance review process has been substantially shortened. Moreover, under the new application processing procedures, a Reserve Bank may only seek additional information once, and must review such information within 5 business days. If the application is not complete at that point, the application will be returned as incomplete. Establishing an earlier date for the processing schedule for an application would not reduce the processing time but would, instead, create uncertainty in processing deadlines, since the deadlines would often have to be extended in order to request additional information. Therefore the pre-acceptance review period is being retained in the final regulation. However, a modification is being made, at the suggestion of Reserve Banks, to state the time period for acceptance in business days, rather than calendar days, to ensure uniformity in the review process.

There were also requests for the Board to define the circumstances under which an application may be considered incomplete by the Reserve Bank. Because of the diversity of proposals made in applications to the Board under the BHC Act, the Board believes the better approach is to continue a case-by-case review of the information submitted in response to application forms, and to establish and adhere to very short time frames for the review of applications and supplemental material prior to acceptance.

Section 225.14(d) Action on applications. There was general approval of the proposed reduction in the processing time for applications to 60 days for those acted on by the Board and 30 days for those approved by the Reserve Banks. One commenter suggested that the Board processing period should be reduced to 45 days and that a special expedited schedule should be provided for tender offers. Another commenter questioned whether 60 days would allow sufficient time to develop the issues on an application for Board consideration.

The Board believes that the reduction of processing time by 33 percent represents the maximum reduction consistent with the Board's responsibility under the BHC Act to evaluate each application under the statutory factors, without resorting to frequent extensions of the processing periods. Also, the Board notes that the proposed timeframe for Board action is consistent with recent legislation, such as the Bank Control Act and the Bank Export Services Act (12 U.S.C. 1843(c)(14)). Of course, if a particular application can be processed more quickly than the period provided, it will be. A few applications that present protested or significant issues will take more than 60 days to process, but under the new procedures, the Board is required to advise the applicant in such cases of the reason for delay. The decision to extend the 60 day period for

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Board action on an application will be made by an appropriate Board member.

Under the proposed revision, the Reserve Bank could, after giving notice to the applicant, extend the 30-day period for acting on an application for an additional 15 days, for a total processing period of 45 days. Several Reserve Banks expressed concern that this limited extension period may not provide sufficient time to obtain necessary information from the applicant, another regulator, or a protestant. Some recommended authorizing them to extend the processing period for an indefinite time pending receipt of needed information. As noted above, one of the purposes of incorporating processing periods into the regulation is to provide more certainty concerning the date of final action on an application. An indefinite extension may interfere with this objective. However, the Board also agrees that the 15-day extension may not be sufficient where the Reserve Bank is awaiting receipt of information necessary to its decision. Accordingly, the extension provision is being clarified to indicate that where the Reserve Bank is waiting for requested information, the 15-day period does not begin to run until the date the information is received by the Reserve Bank.

Section 225.14(g) Approval through failure to act. This provision incorporates judicial constructions of the 91-day rule in the BHC Act, which provides that an application shall be deemed approved if the Board fails to act within 91 days after the date that the record on the application is complete. A number of commenters favored the inclusion in Regulation Y of a provision explaining the 91-day rule, since it would clarify a confusing subject. The Board is adopting this provision as proposed with minor modifications, as discussed below.

The 91-day rule is the legal maximum for the Board to make its decision on an application. More than 90 percent of all applications filed with the Board currently are approved in less than 46 days. Under the procedures set forth in the regulation, it is expected that most applications will be acted upon within 30 days of acceptance.

In conformity with established rules for computing time periods, such as the Federal Rules of Civil Procedure, the first day of the 91-day period is the day following completion of the record. Under this method of computations, the date the record is completed is day zero and the Board must act within 91 days thereafter. The regulation also specifies that Board act includes issuance of an order stating that the Board has approved or denied the application, reflecting the votes of the Board members, and indicating that a statement of the reasons for the action will follow.

The regulation specifies that the record on an application will not be considered complete before: (1) The date the Board receives an application accepted for processing by a Reserve Bank; (2) the last day of the formal comment period specified in any notice required under the regulation; (3) the date of the receipt of the last relevant, noncumulative information needed for the Board's decision on the application from a source outside the Federal Reserve System; or (4) the completion of any hearing required on the application.

Information from a source outside the Federal Reserve System includes any information submitted by the applicant in response to a request by the Board during the processing period as well as information from a government agency. If the Board has requested information that the Board believes is necessary for its decision, the record is not complete until the Board receives that information.[1] Similarly, the Board has previously stated that if it is awaiting the results of an examination of any bank involved in the application, or if issues raised by the application are the subject of pending litigation, legislation or rulemaking, the Board may appropriately suspend decision on an application. In such cases the record on the application is not deemed to be complete until the results of the examination are received or the collateral proceeding has been terminated. The purpose of the 91-day rule is, in the Board's view, to guard against unjustified delay resulting from inefficiency in the processing of applications, and is not to prevent the Board from withholding decision on an application when compelling reasons lead the Board to conclude that the public interest would be served by doing so. S-letter No. 2299, dated December 1, 1975, *reprinted in* [1978–1979 Transfer Binder] *Fed. Banking L. Rep.* (CCH), paragraph 96, 708.

Some commenters asserted that the 91-day period should start with the acceptance of the application by the Reserve Banks rather than the close of the comment period. However, this view of the statute is inconsistent with the legislative history, judicial precedent, and the Board's established construction of the 91-day rule. Thus, the Board is not accepting this suggestion. The notes, however, that the requirement for publication of notice in the **Federal Register** upon submission of the application (rather than acceptance) means that in many cases the 91-day period will in fact commence upon or shortly after acceptance of the application.

One commenter suggested that the Board notify an applicant when it receives information that would restart the 91-day period. The Board's procedures already provide that an applicant is to receive copies of materials from outside parties. Moreover, an applicant or other interested person may ask Board staff for advice on the calculation of the 91-day period in a particular application. Board staff will inform the applicant or other party of the last date provided in any notice for comment on the application and the last date that any relevant information concerning the application has been received from outside the Federal Reserve System.

There were objections to the provision that allows the Board to issue a statement of reasons for its action after the 91st day, if it issues an order by the 91st day. These commenters contend that parties adversely affected by an action of the Board would be deprived of the full 30 days to pursue judicial review of a Board action under the BHC Act. However, judicial decisions of similar statutory review provisions indicate that the period for judicial review does not commence until the statement of reasons in issued. *Airline Pilots Association* v. *C.A.B.*, 509 F. 2d 964 (D.C. Cir. 1975).)

There were also suggestions that the Board incorporate in the regulation the rules governing protests and the treatment of late comments. The Board's policy regarding comments and protests are set forth in the Board's Rules of Procedure (12 CFR Part 262). Since comments and protests are received on applications other than those under the BHC Act, the Board believes that its protest rules should remain in the Rules of Procedure, which apply to all types of applications the Board considers.

Section 225.14(i) Waiting period. Under section 11(b) of the BHC Act, a transaction that has been approved under section 3 of the Act, either as a result of Board approval or the 91-day rule, may not be consummated until 30 days after approval of the application. Emergency and failing bank acquisitions are generally exempt from the 30-day waiting period. The purpose of the

[1] See *Tri-State Bancorporation, Inc.* v. *Board of Governors*, 524 F.2d 562 (7th Cir. 1975); *North Lawndale Economic Development Corp.* v. *Board of Governors*, 553 F.2d 23 (7th Cir. 1977); *Central Wisconsin Bankshares, Inc.* v. *Board of Governors*, 583 F.2d 294 (7th Cir. 1978); *Republic of Texas Corp.* v. *Board of Governors*, 649 F.2d 1026 (5th Cir. 1981).

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waiting period is to afford the United States Department of Justice an opportunity to review the proposal and determine whether it conforms to the antitrust laws.

The Board requested comment on the desirability of an amendment to Regulation Y that would allow this waiting period to be reduced with the concurrence of the Department of Justice where the proposal does not present any anticompetitive effects. For example, one-bank holding company formations generally do not present anticompetitive effects and are not the type of proposals for which the 30-day waiting period was designed. This proposal was favored by a large number of commenters. The Department of Justice endorsed the Board's suggestion in principle, but took the position that an amendment to the BHC Act would be necessary to implement the proposal. Accordingly, the Board will recommend such a proposal to the Congress.

IV. Subpart C—Nonbanking Activities and Acquisitions By Bank Holding Companies

Section 4 of the BHC Act, which embodies one of the primary purposes of the BHC Act, the separation of banking and commerce, limits the nonbanking activities in which a bank holding company and its subsidiaries may engage and prohibits the acquisition of voting shares of nonbanking entities unless the acquisition is specifically exempted. This subpart of the regulation implements section 4 and applies to any bank holding company as defined in Subpart A (including certain foreign banking organizations).

The subpart sets forth the limitations on nonbanking activities and describes the major exemptions contained in the BHC Act. It does not include the statutory exemption in section 4(a)(2) of the BHC Act (relating to retention of real estate holdings acquired prior to 1970), and the limited exemption in section 4(c)(10) (for a bank that is a bank holding company) because of their limited applicability. Also not included are (i) the provisions of section 4(c)(12) of the BHC Act which pertain to the expansion of nonbanking activities that were required to be divested by 1980; and (ii) the statutory exemptions in sections 4(c) (9), (13) and (14) of the BHC Act, which generally pertain to international banking and export trading company activities and which are implemented in various provisions of Regulation K ("International Bank Operations," 12 CFR Part 211).

Section 225.21—Prohibited Nonbanking Activities and Acquisitions; Exempt Bank Holding Companies

There were no substantive comments concerning paragraph (b) ("Exempt bank holding companies"). As noted above, the Board has added a new paragraph (b)(4) to his section, which provides a procedure to exempt certain companies that acquired a so-called "nonbank bank" prior to December 10, 1982, on the basis of a narrow interpretation of the term "demand deposit" or "commercial loan" in the definition of "bank" in section 2(c) of the BHC Act. The comments on paragraph (a) are discussed below:

Section 225.21(a) Prohibited nonbanking activities and acquisitions. This paragraph contains the prohibitions of section 4(a) of the BHC Act that a bank holding company may not (i) acquire or retain the voting securities or assets of a company that is not a bank unless the company qualifies for one of the exemptions to the Act or (ii) engage in any activity other than those of banking or managing or controlling banks or activities otherwise deemed permissible under the BHC Act. The statutory exemptions to this prohibition, including the authorization for activities determined by the Board to be closely related to banking, are set forth in §§ 225.22 and 225.25 of Regulation Y, respectively.

This paragraph also sets forth the principal exception to the nonbanking prohibitions of section 4 of the BHC Act, under which a bank holding company may, with the prior approval of the Board, engage in, or acquire or control voting securities or assets of a company engaged in, activities that the Board has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Section 4(c)(8) of the BHC Act imposes a "two-step" test for determining the permissibility of nonbanking activities for bank holding companies, that is, whether the activity is closely related to banking and a "proper incident" to banking; and whether the benefits of a particular bank holding company engaging in a specific nonbanking activity outweigh the possible adverse effects. (*Board of Governors* v. *Investment Co. Institute,* 450 U.S. 46 (1981); *Nat'l Courier Ass'n.* v. *Board of Governors,* 516 F.2d 1229 (D.C. Cir. 1975).) The factors considered by the Board under the net public benefits test are set out in § 225.24 of the final regulation.

The Federal Register notice accompanying the proposed revision stated that the Board has found the guidelines set forth by the court in *National Courier* to be useful in determining whether an activity is closely related to banking. Several commenters asked the Board to expand the criteria beyond the *National Courier* tests, arguing that those guidelines do not allow sufficient flexibility and limit holding companies essentially to activities that have been traditional for banks. They urge the Board to look to other factors in evaluating activities under section 4(c)(8), including the changing competitive environment, particularly the expanded services offered by unregulated financial organizations.

The Board notes that the *National Courier* criteria are not considered exclusive, and the Federal Register notice accompanying the proposed revision stated that the Board has wide discretion under section 4(c)(8) of the BHC Act in making its closely related to banking determinations. The notice referred to judicial decisions stating that the Board may consider other factors in determining whether activities are closely related to banking. (*Alabama Ass'n of Ins. Agents* v. *Board of Governors,* 533 F.2d 224, 241 (5th Cir. 1976), *cert. denied,* 435 U.S. 904 (1978); *Board of Governors* v. *Investment Co. Institute,* 450 U.S. 46, 55 (1981).) In acting on a request to engage in a new nonbanking activity, the Board will consider, in addition to the *National Courier* criteria, any other factor that an applicant may advance to demonstrate a reasonable or close connection or relationship of the activity to banking or managing and controlling banks. Moreover, the Board agrees that the banking environment is changing and has indicated that it will reconsider any activity previously denied if it is demonstrated that circumstances have changed.

One commenter objected that section 4(a)(1) of the BHC Act does not require Board approval for acquisitions of assets. The Board has indicated, in its discussion of § 225.22 below, the circumstances under which an aquisition of assets will not be subject to the prior approval requirement of this section of the regulation. The Board believes that prior approval is required for the acquisition of assets to prevent a company from engaging in an impermissible nonbanking activity represented by the acquired assets in violation of section 4(a) of the BHC Act. Moreover, the Board views the acquisition of all or substantially all of the assets of a company as being equivalent to the acquisition of voting

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securities, a transaction that would be prohibited without prior approval under section 4(c)(8) of the BHC Act.

The Federal Register notice accompanying the proposed revision stated that the prohibition against engaging in a nonbanking activity also applies to a bank holding company or subsidiary becoming a partner in a partnership (or acquiring voting securities in a partnership) that is engaged in nonbanking activities. (See *Central Colorado Co. & C.C.B., Inc.*, 66 *Federal Reserve Bulletin* 665 (1980).) Similarly, the prohibition applies to acquiring an interest in a joint venture (either in corporate or partnership form) where the joint venture is engaged in a nonbanking activity.

Several commenters objected to the statement that section 4(a) of the BHC Act prohibits a bank holding company from becoming a partner in a firm engaged in impermissible nonbanking activities, arguing that a limited partnership interest is not a voting security, that only the acquisition of voting securities is prohibited under section 4(a), and that a finding of control of the partnership is necessary for a nonbanking partnership interest to be prohibited under section 4(a).

The Board believes that these objections are addressed in its clarification of the definition of "voting securities," (see section 225.2(1)), which would not include preferred stock or similar interests with certain limited voting rights. However, the Board notes that a bank holding company may be presumed to be engaged in the business of a partnership, or may have established a control relationship over the partnership, because of (i) the size of its equity investment in the partnership (ii) its selection, or ability to select or to vote for the selection, of the general partner: (iii) limitations imposed on the management discretion of the general partner over the affairs or assets of the partnership; or (iv) the particular facts and circumstances of a case. In addition, the Board believes that a bank holding company that is a general partner in a partnership should be regarded as engaging in the activities of the partnership.

Commenters questioned the meaning of paragraph (a)(1) of this section regarding "banking" activities of bank holding companies. One commenter suggested that nonbanking activities (such as making loans) may also be "banking" functions and could be performed under section 4(c)(8) of the BHC Act or § 225.23 of the regulation without prior Board approval. Another commenter suggested that paragraph (a)(1) empowers bank holding companies to engage in banking.

The Board has previously limited the exception now contained in paragraph (a)(1) by interpreting it to mean that a bank, which is or becomes a bank holding company, may continue to function as a bank (FRRS 4–510). Thus, paragraph (a)(1) does not authorize a bank holding company to become a bank, nor does it authorize a bank holding company that is not a bank to perform any bank functions.

One commenter asked whether paragraph (a) of this section prohibits the holding of shares of a namesaver company. It does not because a namesaver company is not engaged in any activity and is merely a corporate shell.

Based on the foregiong, the Board is adopting section 225.21(a) substantially as proposed with some editorial amendments.

Section 225.22—Exempt Nonbanking Activities and Acquisitions

A bank holding company may engage in an activity or acquire shares of a nonbanking company without prior Board approval, if the activity or acquisition falls within one of the exemptions set forth in this section. The exemptions are derived from those set forth in section 4(c) of the BHC Act, and from interpretations issued by the Board.

There were no substantive comments concerning paragraph (b) ("Safe deposit business"), paragraph (c)(2) ("Securities or assets required to be divested by subsidiary"), paragraph (c)(3) ("Fiduciary investments"), paragraph (e) ("Activities and securities of new bank holding companies"), and paragraph (g) ("Securities or activities exempt under Regulation K"), and these paragraphs are being adopted as proposed. Comments were received on the following paragraphs:

Section 225.22(a) Servicing activities. This section of the proposed regulation interpreted sections 4(a)(2) and 4(c)(1)(C) of the BHC Act, which allow a bank holding company to furnish services to and perform services for its subsidiaries. The provision also reflected sections 4(c)(1) (A) and (D) of the BHC Act, which allow a bank holding company to form or acquire a company to hold and operate properties for the use of the bank holding company and its subsidiary banks, and to liquidate assets acquired from the bank holding company and its subsidiary banks, respectively. The proposed servicing provision limited a bank holding company to providing services only for the internal operations of the bank holding company and its subsidiaries, and enumerates the services that could be provided under this exemption, such as insurance, accounting, advertising and data processing. Under the proposal, a servicing subsidiary could not act as agent for the holding company or its subsidiaries in providing services to the public. The proposed limitation was intended to prevent the use of servicing subsidiaries to circumvent the requirements of section 4(c)(8) of the BHC Act by acquiring going concerns or providing services for customers as principal.

The Board received numerous comments on this provision, which objected to the proposed limitation as reversing the Board's longstanding position regarding section 4(c)(1)(C) subsidiaries, and not accurately reflecting the language and legislative history of the servicing exemptions in sections 4(a)(2) and 4(c)(1)(C) of the BHC Act. In light of these concerns, the Board is modifying the proposed provision and is reaffirming and clarifying its longstanding position that servicing subsidiaries may not deal with the public as principal, but may deal with outside parties provided they are acting only as agent for the holding company or its subsidiaries. (12 CFR 225.104, 225.109, 225.118, 225.122, 225.123, 224.141.) The Board believes its supervisory authority is sufficient to prevent abuse of the servicing exemption and that the proposed modification is not necessary. In this regard, bank holding companies that seek to acquire going concerns to furnish services under this exemption should consult with the appropriate Reserve Bank to ensure that the acquisition is exempt under this paragraph.

Several commenters objected to the requirement that the holding company own all the shares of the servicing subsidiary, as is the case under the Board's operations subsidiary ruling (12 CFR 225.141). The Board agrees that section 4(c)(1)(C) of the BHC Act, which authorizes a bank holding company to form or acquire a company to furnish services to its subsidiary banks, does not require the ownership of all the shares of a servicing subsidiary. However, section 4(a)(2) of the BHC Act, which permits a bank holding company to provide services for both its bank and nonbank subsidiaries, does not specifically authorize a bank holding company to establish or acquire shares of a company to perform such services. The Board has interpreted section 4(a)(2) to allow a bank holding company to establish a subsidiary to provide

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services to the holding company's bank and nonbank subsidiaries under section 4(a)(2) of the BHC Act if the servicing subsidiary is wholly-owned (12 CFR 225.141). This requirement is based in part on the Board's interpretation under section 9 of the Federal Reserve Act (12 U.S.C. 335) that a state member bank may establish and hold shares of operations subsidiaries to perform activities that the member bank could perform directly or through a department or division of the bank (12 CFR 250.141).

In response to comments, the Board is deleting the requirement in the regulation that a servicing subsidiary must be wholly-owned. However, in accordance with 12 CFR 225.141, the ownership requirement continues to apply to a subsidiary that provides services to nonbank subsidiaries of the bank holding company. The Board will continue to review whether a similar requirement should be imposed on servicing subsidiaries established under section 4(c)(1)(C) to provide services exclusively to bank subsidiaries of the holding company, and will amend the regulation and its interpretation accordingly.

In connection with the question of the ownership requirement for servicing subsidiaries, the Board notes that a servicing subsidiary may not engage in impermissible nonbanking activities in addition to its servicing functions. For example, a holding company may not acquire on the basis of the servicing exemption a 10 per cent interest in a data processing company that, in addition to serving the internal needs of the holding company and acting as agent for the banking subsidiaries, offers data processing services to others. Thus, the regulation specifies that a servicing subsidiary may engage solely in permissible servicing functions.

The Board also notes that there is an exemption from the lending restrictions of section 23A of the Federal Reserve Act (12 U.S.C. 371c) for loans by a member bank to affiliates organized under section 4(c)(1) of the BHC Act. Thus, a servicing subsidiary exempt under § 225.22(a) of this regulation that provides services exclusively to the holding company or its subsidiary banks is not subject to the lending restrictions of section 23A. However, a servicing subsidiary exempt under this provision of the regulation that provides services in whole or part to or for the nonbanking subsidiaries of the bank holding company is subject to the lending restrictions of section 23A of the Federal Reserve Act.

A number of commenters stated that the list of activities servicing subsidiaries are authorized to perform for the internal operations of the bank holding company should not be exhaustive. Although the list was preceded by the word "include," and was clearly meant to be illustrative, the provision has been modified to make this clearer. At the suggestion of some commenters, the Board is also expanding the list of servicing activities to include activities identified in the legislative history of section 4(c)(1)(C), such as auditing, appraising, advertising and public relations. The Board is also incorporating in the list data processing and courier services for the internal operations of the bank holding company, which are permissible servicing activities contained in § 225.23 (b)(7)(i) and (b)(10)(i) of the proposed revision. The commenters favored this change, which clarifies that there is no prior approval requirement to engage in these servicing activities. The Board emphasizes that, these activities may be provided only for the internal operations of the holding company, unless the activities are authorized for the nonbanking subsidiaries of a bank holding company under section 4(c)(8) or for its banking subsidiaries under appropriate banking laws.

The only activity on the proposed list of permissible servicing activities that drew significant comment was insurance. Some commenters contended that the only authority for bank holding company insurance activities is section 4(c)(8) of the BHC Act, and objected to allowing bank holding companies under the servicing exemption to act as agent or to underwrite insurance on their own risks (*e.g.,* blanket bond insurance or employee group insurance plans).

The Board believes that sections 4(a)(2) and 4(c)(1)(C) provide general authority for bank holding companies to engage in activities necessary for their internal operations. While the legislative history indicates that the Congress did not intend servicing subsidiaries to be used as a means of supplanting section 4(c)(8), that section is relevant only when a bank holding company provides services to the public. The prohibition on insurance activities now contained in section 4(c)(8) as a result of the Garn-St Germain Act has no bearing on the internal operations of a bank holding company.

The purchase of group health insurance for a company's employees or property and casualty insurance for a company's buildings and equipment is a normal internal operating activity for most businesses, including bank holding companies. If the most economical or efficient way for a bank holding company to secure such insurance is to act as agent or underwriter, the Board believes that this is authorized under the servicing exemption. Accordingly, the Board is retaining this activity on the list of permissible servicing activities.

Section 225.22(c) Nonbanking acquisitions not requiring prior Board approval. This paragraph sets forth a number of exemptions to the prohibition of section 4 of the BHC Act against the acquisition of the voting securities or assets of a company engaged in nonbanking activities. In some situations, more than one exemption may apply to a particular acquisition. A bank holding company is entitled to rely on any applicable exemption. Thus, a bank holding company that acquires voting securities in satisfaction of a debt previously contracted is entitled to retain up to five percent of these securities under section 225.22(c)(5) of this regulation, notwithstanding the requirement of section 225.22(c)(1) of this regulation to divest DPC property within 2 years.

Section 225.22(c)(1) DPC acquisitions. The proposed regulation exempted from the prior approval requirement of section 4(c)(8) of the BHC Act a holding company's acquisition of securities and real or personal property in satisfaction of debts previously contracted ("DPC property"), so long as the company disposes of such property within two years of acquisition. The Board may extend the two-year period upon request for three additional one-year periods, for a total holding period of five years. Also, with regard to real property the Board may grant an additional five-year holding period, for a total of 10 years. The proposed regulation was based on the Board's published interpretation that while acquisitions of assets "dpc" may be regarded as necessary and incidental to the business of lending, prudent banking practice and the BHC Act require that such assets be liquidated and not held for an extended period of time (12 CFR 225.140).

Some commenters objected that this provision should apply only to voting shares, and that the BHC Act does not prohibit the ownership or control of assets. The Board's longstanding position has been that the nonbanking prohibitions of the BHC Act cover certain assets held by a bank holding company, such as real estate. (Liberty National Corporation, 38 FR 31054 (1973).) Moreover, in exempting certain real estate from the nonbanking prohibitions of section 4(a) of the BHC Act, section 4(a)(2) of the BHC Act expressly recognizes that real estate, or interests in real estate, held by bank

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holding companies is covered by the nonbanking prohibition of the Act. The applicability of the nonbanking prohibitions of the BHC Act to the ownership of particular property depends upon whether that ownership constitutes engaging in an activity, which is a question resolved on the basis of the facts and circumstances of the particular case. The Board believes it is necessary to retain the reference to property in this paragraph in order to allow holding companies an appropriate period of time to comply with section 4 of the Act and effect a divestiture where the holding of DPC property would constitute engaging in an impermissible activity.

One commenter requested that the Board also allow extensions beyond 5 years for the holding of personal property, as well as for real estate. The Board's interpretation provides a maximum 5-year holding period for property other than real estate. The Board does, however, believe that where personal property has value and marketability characteristics similar to real estate, an additional extension for up to five years may be appropriate. The Board is adopting the proposed paragraph with this modification.

Another commenter suggested specifying that the divestiture period commences only when the bank holding company acquires title to and possession of the property. The Board believes that such questions depend on the facts and circumstances of a particular case, and companies with such questions should consult the appropriate Reserve Bank.

Section 225.22(c)(4) Securities eligible for investment by a national bank. This exemptive provision, which is derived from section 4(c)(5) of the BHC Act, permits a bank holding company to own securities of the kinds and amounts that are explicitly eligible by federal statute for investment by a national bank. The Board proposed to limit this exemption by excluding investments in companies authorized under the Bank Services Corporation Act ("BSCA") (12 U.S.C. 1861 *et seq.*). Under the BSCA, banks may invest in bank service corporations, which may, with the prior approval of the Board, engage in nonbanking activities on the Regulation Y list of activities permissible for bank holding companies. Under the proposed provision, a bank holding company would have to obtain the Board's prior approval under section 4(c)(8) of the BHC Act to invest in a bank service corporation just as a bank must now obtain prior approval to invest in such a corporation. If investments authorized under the BSCA were not excluded from the section 4(c)(5) exemption, bank holding companies would be permitted to make such investments and engage in nonbanking activities without complying with either the section 4(c)(8) or BSCA prior approval requirements. In order to ensure that the exemption in section 4(c)(5) does not supplant the requirements of section 4(c)(8) and the BSCA, the limitation as proposed is necessary and is being adopted.

A question was raised as to the status of bank service corporations owned by bank holding companies under the provisions of the BSCA prior to the amendments made by the Garn-St Germain Act. An earlier Board interpretation (12 CFR 225.115) stated that section 4(c)(5) could be used as authority for a bank holding company to own such a corporation. The types of activities authorized in the earlier Bank Service Corporation Act are now contained in section 3 of the amended BSCA, which is codified at 12 U.S.C. 1863. The Board has determined that bank holding companies may, on the basis of section 4(c)(5) of the BHC Act and without the Board's prior approval, invest in a bank service corporation whose activities are limited to those allowed under section 3 of the BSCA. However, the Board notes that in using this authority the other requirements of the BSCA with respect to notice, services, and prices would apply. Of course, a bank holding company may also apply under section 4(c)(8) of the BHC Act to invest in a bank service corporation engaged in activities under section 4 of the BSCA (12 U.S.C. 1864).

Section 225.22(c)(5) Securities or property representing 5 percent or less of a company. This paragraph implements section 4(c)(6) of the BHC Act, which allows a bank holding company to acquire and retain shares in a nonbanking company that do not exceed 5 percent of its outstanding voting shares. There were three objections to the Board's proposed interpretation of section 4(c)(6) as discussed below.

First, some commenters objected to limiting the exemption to ownership of 5 percent of any *class* of voting securities, whereas section 4(c)(6) of the BHC Act does not specifically impose such a limit. As discussed in § 225.11(c) of this notice regarding the acquisition of bank shares, the Board believes that the concept of a class of voting securities was intended to be incorporated in all the sections of the BHC Act dealing with acquisitions of voting securities. The Board has previously so construed this section.

Second, there was an objection to including property in the exemption on the ground that the nonbanking prohibitions of section 4 of the BHC Act do not extend to real estate or other assets, and thus there is no need for a 5 percent exemption for property. As explained with regard to DPC acquisitions (section 225.22(c)(1)), the Board believes the BHC Act encompasses interests in property in some circumstances. Moreover, the Board believes that section 4(c)(6) of the BHC Act reflects the concept found elsewhere in the Act that a 5 percent or less interest generally does not constitute engaging in an activity. Since this is a regulatory exemption to the general prohibition against acquiring nonbank shares or engaging in nonbank activities, it does not necessarily prohibit larger nonvoting interests that (i) are passive; (ii) do not involve engaging in an activity; and (iii) do not establish a control relationship. (*See* discussion of section 225.21(a).) If the ownership of property constitutes engaging in an activity, the holding company is limited to a 5 percent interest, as it would be if it were investing in voting securities of a company that is engaged in nonbanking activities.

Third, some commenters objected to including the requirement, derived from a current Board interpretation, that the investment be held as a "passive investment," arguing that such a requirement is not in section 4(c)(6) and creates uncertainty because it is subjective in nature. The Board agrees that there have been few problems in this area, and that the Board's interpretation (12 CFR 225.137) and the control provisions of the BHC Act are sufficient to address any problems that may arise. Accordingly, the Board is replacing this requirement in the final regulation, with a reference to its interpretation of section 4(c)(6) of the BHC Act.

Section 225.22(c)(6) Securities of investment company. The only substantive comments on this paragraph concerned the requirement that an exempt investment company may not hold more than 5 percent of any *class* of voting securities. The Board is retaining this requirement for the reasons discussed in sections 225.11(c) and 225.22(c)(5) of this notice.

Section 225.22(c)(7) Assets acquired in the ordinary course of business. This paragraph incorporates a Board interpretation (12 CFR 225.132) of the BHC Act as not requiring prior approval for certain acquisitions of assets in the ordinary course of business, as long as

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the acquisition is not of all or of substantially all of the assets of a going concern, or of a subsidiary, division, department or office of the company, and provided that the assets acquired relate to activities previously approved by the Board. The primary comments on this provision asked that the regulation quantify or clarify the meaning of "all or substantially all of the assets of a company."

The Board's interpretation provides flexibility to determine whether an acquisition of assets constitutes an exempt acquisition in the ordinary course of business or whether it constitutes the acquisition of all or substantially all the assets of a company. A primary consideration in determining if an application is required would be whether there is a purchase of a substantial portion of the assets in the particular line of nonbanking activity in which the seller is engaged. There are other equally important considerations outlined in the Board's interpretation, including the size of the proposed acquisition in terms of the acquiror's assets, whether the acquisition of assets is for resale and the resale would not be a normal business activity of the acquiror, and whether the purpose of the acquisition is to hire employees or gain expertise. The Board believes that establishing an arbitrary number to define the phrase "substantially all the assets" is not appropriate. In addition, the following paragraph of Regulation Y, § 225.22(c)(8), which exempts from prior approval requirements certain asset acquisitions by consumer finance or mortgage companies, addresses in substantial part the concerns expressed by the commenters.

Finally, the Board believes its interpretation provides the Reserve Banks with sufficient flexibility to review, on a prompt basis, asset acquisition proposals with due regard for the purposes of the Act and the competitive situation of bank holding companies with respect to nonbank competitors in this area. Accordingly, the Board is modifying the proposed language of this regulatory provision in favor of the more flexible procedures of the Board's interpretation.

Section 225.22(c)(8) Asset acquisitions by a consumer finance or mortgage company. Under this paragraph, an application for prior approval is not required under section 4(c)(8) of the BHC Act for acquisitions of all or substantially all of the assets of an office that relate solely to consumer and residential mortgage finance activities and that do not involve the acquisition of voting securities. The comments generally favored this provision, but suggested a number of changes. The Board is adopting the provision as proposed with some modifications as discussed below.

Several commenters suggested expanding this exemption to include all nonbanking activities on the Regulation Y list of those permissible for bank holding companies. This provision was designed for those industries where asset acquisitions are a normal part of the business operations, and where bank holding companies have indicated they are at a particular competitive disadvantage because of the section 4(c)(8) prior approval requirement. Based on the Board's experience, it appears that, with the exception of industrial banking, which the Board is adding to this provision, there are no other permissible activities where asset acquisitions are a normal part of business operations. The Board will consider including other nonbanking activities in this provision if it is demonstrated to be appropriate.

A number of commenters stated that exempting acquisitions only where the assets acquired relate "solely" to making, acquiring, or servicing consumer or residential mortgage loans limits the usefulness of the exemption because in many cases a company will also have nonconforming assets such as commercial loans among the qualifying assets. To address this issue, the Board is modifying the provision to require that substantially all of the assets (rather than all of the assets) relate to qualifying loans. Thus, a nonconforming asset acquired pursuant to this provision may be held until it is repaid in accordance with its terms. This modification does not authorize a bank holding company to expand the activity represented by the nonconforming assets and thereby engage in a nonbanking activity for which the company does not have approval under section 4(c)(8).

Some commenters stated that the amount of assets that may be purchased under the exemption should be increased. The limitations in the proposed revision (10 percent of the acquiring company's assets or $10 million, whichever is less) were based in part on a 1971 provision regarding asset acquisitions. The Board agrees with the commenters that these limits should be increased to 25 percent of the acquiring bank holding company's assets or $25 million, whichever is less. The Board believes that this increase is appropriate in view of provision (v) of this paragraph, under which the Board may notify a bank holding company that it may not acquire assets under this section, if, for example, it is experiencing financial problems or has expanded too rapidly. In addition, the regulation is being clarified to indicate that the percentage and dollar limits are annual limits on aggregate purchases from all companies, rather than limits on purchases from any single company during the year.

The proposed exemption limits the assets acquired to no more than 50 percent of the assets of the seller. Some commenters recommended the elimination of this condition, arguing that the proportion of the seller's assets that are acquired should not concern the Board. This provision was designed to ensure that the acquisition does not represent the acquisition or elimination of a competitor, and is being retained in the final regulation.

Some commenters noted that, in some cases, one or more offices of the selling company may be separately incorporated and thus, the acquisition of the office represents the acquisition of 100 percent of the assets of a company. To address this problem, the Board is modifying this condition to clarify that it refers to the consolidated assets of the ultimate selling company engaged in the line of the business being acquired, rather than the assets of a separately incorporated office.

It should also be noted that under a current Board interpretation, (12 CFR 225.140), a company that has obtained the Board's approval to engage in a nonbanking activity in a particular geographic area may form and acquire a shell corporation for the purpose of acquiring assets, the direct acquisition of which would be permissible under this paragraph. Similarly, a bank holding company may acquire assets under this provision and then form and acquire a subsidiary to hold the assets without prior approval if the bank holding company previously received the Board's approval to engage in the activity. If, however, the seller holds the assets to be acquired in a separate subsidiary corporation, and the bank holding company proposes to acquire the shares of the subsidiary corporation, an application for prior Board approval is required under section 4(c)(8) of the BHC Act. Several commenters suggested that the exemption be expanded to permit "asset acquisitions" effected by stock purchases. However, the Board does not believe acquisitions of voting shares are exempt from the prior approval requirements of section 4(c)(8) of the BHC Act. The Board has addressed the issue of small acquisitions by providing the expedited

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15-day notice procedures in § 225.23(f) of the proposed revision, which would be available in the case of an acquisition of the voting securities of a going concern.

Several commenters objected to the provision reserving the right to revoke, upon notice, a bank holding company's authority to make acquisitions under this provision and to require applications for such acquisitions, on the ground that the regulation does not set forth standards for the Board's use of this revocation authority. As discussed below (in § 225.23(a)(1)), the Board intends to exercise this authority only where, for example, the holding company is not in sound financial condition. In this regard, the Board believes that this exemption should only be available where the bank holding company meets the Board's Capital Adequacy Guidelines, and is so modifying the final regulation.

Section 225.22(d) Acquisition of securities by subsidiary banks. This paragraph restates § 225.4(e) of the current regulation, which was adopted in 1971, and provides an exemption (set out in paragraph (d)(2) of the revision) from the prohibitions of section 4 of the BHC Act for a state-chartered bank that is a subsidiary of a bank holding company to make the same kinds of investments explicitly eligible for national banks. In addition, the paragraph authorizes the state bank to acquire or retain shares of a company that engages solely in activities in which the parent bank may engage directly, at the same locations and subject to the same limitations as if the bank were engaged in the activity directly. Paragraph (d)(1) of the proposed revision provides that national bank subsidiaries of holding companies may acquire or retain subsidiaries in accordance with the rules of the Comptroller of the Currency.

The Board received numerous comments urging the Board not to adopt paragraph (d)(2) of this provision. These comments were based on conflicting theories, with some commenters contending the Board has no authority to exempt the nonbank subsidiaries of a bank from the nonbanking provisions of section 4 of the BHC Act, while others asserted that the Board has no authority to regulate the nonbanking activities or subsidiaries of a subsidiary bank of a bank holding company.

The provision regarding nonbank subsidiaries of state banks, which has not presented any substantive issues since its addition to the current regulation in 1971, has assumed major importance as a result of state legislation being enacted or considered that would authorize state-chartered banks to engage directly or through subsidiaries in nonbanking activities that are not permissible for bank holding companies under the Act. For example, the State of South Dakota has authorized banks chartered under its laws to engage in all facets of the insurance business. As noted, Title VI of the Garn-St Germain Act generally prohibits bank holding companies from engaging in insurance agency and underwriting activities under section 4(c)(8) of the BHC Act.

There are pending before the Board applications by a number of bank holding companies to acquire state banks in South Dakota that raise the issue of the scope of the nonbanking restrictions of the BHC Act relative to nonbank subsidiaries of state banks that are owned by bank holding companies. The Board has received requests for hearing on these applications and, as noted above, believes it appropriate to consider this provision of the proposed revision and the comments thereon in connection with its consideration of these applications and hearing requests. The Board does not wish to delay final action on Regulation Y and, accordingly, is postponing further consideration of paragraph (d) of this provision at this time. The provisions of § 225.4(e) of Regulation Y, which have been reprinted in this section, will continue in effect pending completion of the rulemaking on this provision.

Section 225.22(f) Grandfathered activities and securities. This paragraph reflects the Board's interpretation of sections 4(a)(2) and 4(c)(11) of the BHC Act, which provide grandfather privileges to a "company covered in 1970" (i.e., a company that become a bank holding company as a result of the 1970 Amendments to the BHC Act and would have been a bank holding company on June 30, 1968, if the amendments had been in effect then). Generally, such a company may hold interests and engage in activities that it held or engaged in continuously since June 30, 1968, and may expand such activities *de novo*, including the formation of new subsidiaries to engage in such activities.

One comment asserted lack of authority to permit unlimited *de novo* expansion of grandfathered activities, including the formation of new subsidiaries. The provision is being adopted as proposed because the legislative history of the BHC Act clearly indicates that it was the intent of Congress that the Board limit grandfathered activities only when it determines, after notice and opportunity for a hearing, that it is necessary to prevent undue concentration of resources or other specified adverse effects.

Section 225.23—Procedures for Applications, Notices, and Hearings

This section sets out the procedures for the filing of notices and applications, the acceptance of notices and applications, and action with regard to notices and applications to engage in nonbanking activities. In the final regulation, the Board is eliminating the provision of proposed § 225.23(a), ("Nonbanking activities requiring Board approval") because that section was redundant of the provisions of § 225.21(a) ("Prohibited nonbanking activities and acquisitions"). The Board is also moving the list of permissible nonbanking activities from § 225.23(b) of the proposed regulation to § 225.25 of the final regulation.

The comments regarding the following paragraphs, which parallel provisions of § 225.14 of Subpart B relating to acquisition of banks, have been discussed in connection with that section: paragraph (c) ("Accepting application for processing"), paragraph (d)(1) ("**Federal Register** notice—listed activities"), paragraph (e) ("Action on applications"), and paragraph (h) ("Approval through failure to act; 91-day rule"). No significant substantive comments were received regarding paragraph (i) ("Emergency thrift institution acquisitions"). The remaining paragraphs in this section are discussed below.

Section 225.25(a) Application or notice required for nonbanking activities. This paragraph sets out the circumstances and procedures under which a bank holding company may apply for the Board's prior approval to engage in, or acquire or control the voting securities or assets of a company engaged in, nonbanking activities that the Board determines are so closely related to banking or managing or controlling banks as to be a proper incident thereto. An application is generally required to acquire a company engaged in activities that the Board has previously added to the list of permissible nonbanking activities for bank holding companies (section 225.23(a)(2)), or to engage *de novo*, or to acquire a company engaged, in activities that the Board has not added to the list of permissible activities (section 225.23(a)(3)). In the latter case, the application must contain evidence demonstrating that the activity is so closely related to banking as to be a proper incident thereto.

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The Department of Justice recommended that the Board use "notice" procedures for initial entry by a particular company into an activity previously determined to be closely related to banking. Thus, instead of a full application, a notice would be required that would be considered approved if the Board failed to disapprove it within a fixed period of time.

The Department's recommendation is essentially contained in the present § 225.4(b)(1) of the Board's Regulation Y. Under this provision, a bank holding company is permitted to engage *de novo* in a nonbanking activity that is on the Board's list of permissible activities in Regulation Y, 45 days after filing a notice with the appropriate Reserve Bank unless within that period the company is advised that it may not consummate the proposal because of the receipt of adverse comments of a substantive nature or because the proposal is not appropriate under the Board's Rules Regarding Delegation of Authority. The Board proposed to omit this provision in the revision because it did not appear to have any practical effect in view of the Board's current and proposed operating procedures. However, based on the Department's comments, the Board is retaining the notice procedure in such cases, and is also reducing the notice period from 45 to 30 days. The Board is authorizing the Reserve Banks to extend for 15 days this 30-day notice period (§ 225.23(a)(1)).

Section 225.23(b) Notice to expand or alter nonbanking activities. In this paragraph, the Board proposed to modify the requirement of the current regulation that a bank holding company obtain the Board's prior approval each time it opens a new office of a nonbanking activity or expands the service area for that activity on a *de novo* basis.

The Board proposed two alternative approaches with respect to such *de novo* expansion. Under the first approach, a bank holding company would be allowed to open offices *de novo* without the Board's prior approval within any state or states where it had previously received approval to engage in the specified nonbanking activity. Alternatively, the Board proposed to eliminate all application requirements for *de novo* expansion once the bank holding company received initial Board approval to engage in the activity. Under the latter approach, a bank holding company that wished to engage in consumer finance activities, for example, would be required to file a one-time application to engage in the activity. Once the bank holding company received Board approval for that activity, no further applications to the Board under section 4 of the Act would be required to expand that activity *de novo* through the opening of new offices, the expansion of the service area of the activity, or the incorporation of new subsidiaries to engage in the activity. Under both approaches, the Board reserved the right, upon notice, to require applications for *de novo* expansion under certain circumstances as discussed below. Expansion through the acquisition of a going concern engaged in a nonbanking activity would continue to require an application, although the Board also has proposed expedited notice procedures for certain small acquisitions (§ 225.23(f)).

This paragraph of the proposed revision received a large number of comments, almost all of which urged the Board to adopt the alternative eliminating all applications for *de novo* expansion. In view of the comments and the Board's experience with applications involving *de novo* expansion, the Board is adopting the alternative to eliminate any requirement for an application for *de novo* expansion by a bank holding company in an activity in which it has previously received Board approval to engage. In the Board's view, this approach will substantially reduce regulatory burden.

The Board imposed the office-by-office approval requirement in 1971 to monitor the significant expansion authorized by the 1970 Amendments to the BHC Act, both with respect to the new types of nonbanking activities permitted for bank holding companies and the interstate scope of such activities. In the more than 5,000 applications involving *de novo* expansion decided since 1971, not one application has been denied on the merits. Based on its experience, the Board believes the requirement for an application for *de novo* expansion is no longer warranted except, perhaps, in certain cases where the holding company is experiencing financial problems. The Board will continue to monitor *de novo* expansion in connection with its ongoing supervision of each bank holding company.

Some comments objected that adoption of this alternative is inconsistent with the requirements of section 4(c)(8) of the BHC Act, contending that the Board is required to consider the public benefits and adverse effects associated with each *de novo* office. Section 4 of the BHC Act requires that the Board's prior approval be obtained by a bank holding company to engage in, or acquire shares of a company engaged in, nonbanking activities that the Board has determined to be closely related to banking. The courts have interpreted this provision as a two-step test: first, that the Board determine, after notice and opportunity for hearing, that a nonbanking activity is closely related to banking and a proper incident thereto; and second, that the Board determine whether performance of a particular nonbanking activity by a particular bank holding company will result in net public benefits.

The Board believes that the alternative being adopted is consistent with the requirements of section 4(c)(8). The provision allowing geographic *de novo* expansion of nonbanking activities applies only to activities listed in Regulation Y that the Board has already determined are closely related to banking and a proper incident thereto. Second, this provision does not eliminate the requirement of section 4(c)(8) of the BHC Act, as interpreted by the courts, that a bank holding company apply to the Board to engage in a particular nonbanking activity. However, once a bank holding company has obtained approval to engage in an activity determined to be closely related to banking, and the Board has found that the public benefits associated with the performance of that specific activity by the bank holding company outweigh any reasonably likely adverse effects, the Board does not believe that separate approval for individual offices is specifically required under section 4(c)(8) of the BHC Act. In this regard, section 4(c)(8) specifically provides that in regulations issued under that section, the Board may distinguish between nonbanking activities commenced *de novo* and those commenced by the acquisition of a going concern. The United States Department of Justice, in its comment on the proposed revision, also noted that prior approval is not required under section 4(c)(8) for individual new offices.

The proposed regulation requires that a holding company must exercise its authority to engage in an activity within two years. If it fails to consummate the proposal within this time period, a new application would be required. Several commenters suggested allowing periods longer than two years. The Board believes that a proposal should be consummated within a relatively short period of time in order to preserve the factual situation on which the approval was based. The Board is eliminating the two-year period from the regulation in favor of a case-by-case determination by the appropriate Reserve Bank of the

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time within which a proposal should be consummated. Under current practice, this period is normally 90 days. Because the Board has eliminated the requirement for *de novo* expansion in most cases, this should not impose an undue burden on applicants.

The modification of the regulation to allow *de novo* expansion without further applications is prospective only. Consequently, holding companies that have received approval to engage in a particular activity within a limited geographic area (e.g., a particular state or local market) may not expand *de novo* outside of that geographic area without filing an additional notice, which will be processed on an expedited basis under the *de novo* notice procedure in this regulation. Once the additional notice to expand throughout the country is approved, no further notice or application would be required for new offices. A holding company that previously received approval to solicit business on a nationwide basis from any office engaged in the relevant activity could open additional offices nationwide without a further notice, on the basis of the geographic area authorized previously. This requirement is contained in § 225.23(b)(1) of the final regulation.

Under the amended provision, the Board may notify a company that it must file an application for prior approval of *de novo* expansion. Some commenters requested the Board to establish guidelines indicating when it might withdraw the authority of a company to rely on this provision of the regulation to expand *de novo*. As discussed in connection with a similar provision in § 225.22(c)(8) concerning asset acquisitions, the Board expects that its authority under this provision will be used sparingly, and that guidelines in the regulation would not be practicable or desirable. In general, the authority will be invoked when the Board believes that the holding company is not in sound financial condition or does not meet the Board's Capital Adequacy Guidelines; or where the Board wishes to monitor the expansion of a particular activity more closely.

The Board is also transferring § 225.25(f) of the proposed regulation regarding nonbanking activities conducted outside of the United States, to § 225.23(b)(2) of the final regulation.

Section 225.23(b)(3)—Alteration of nonbanking activity. The proposed revision specified that "nonbanking activities shall not be altered in any significant respect from those considered by the Board in acting on the application, nor provided in any states other than those specified in the notice published with respect to such application." The Board is clarifying that an application or notice is required only where the alteration would represent a material, rather than significant, change from the activity as approved by the Board. This provision is also being modified to reflect the Board's decision not to require applications for *de novo* expansion on a state by state basis.

One commenter asked the Board to clarify that if a bank holding company or any nonbanking subsidiary has permission to engage in an activity, then the holding company may engage in that activity through any other nonbanking subsidiary. An outstanding Board interpretation of section 4(c)(8) of the BHC Act states that a holding company may shift authorized activities from one subsidiary to another without any additional approval (12 CFR 225.123), and the Board does not believe it is necessary to modify the regulation. The Board notes, however, that in some instances, the activities of different subsidiaries could not be combined where such combination would otherwise be inconsistent with the BHC Act or the Board's regulations.

Section 225.23(d)(2) Federal Register notice—unlisted activities. This paragraph sets forth the procedures for publication in the **Federal Register** of proposals by bank holding companies to engage in nonbanking activities that have not previously been found by the Board to be closely related to banking. Under the current regulation, the Board will publish notice of a new nonbanking activity only if the applicant demonstrates a reasonable basis for believing that the activity is closely related to banking. No time period is specified for publishing notice of a proposal to engage in a new nonbanking activity, and the decision whether to publish notice of an unlisted activity is currently made in every case by the Board at a formal Board meeting. As a result, processing of such proposals has at times been delayed.

The Board asked for comment on two alternative procedures, both of which were designed to expedite publication of notice of applications for new activities not on the Regulation Y list. Under the procedure in the proposed regulation, the Board would publish notice in the **Federal Register** of every such application, within 10 business days, unless there is no basis to believe that the activity is closely related to banking. Alternatively, the Board suggested in the **Federal Register** notice accompanying the proposed revision that it retain discretion to extend the 10-day period for an additional 30 days to allow the Board to decide whether to publish notice of the application. If the Board decides not to publish notice of the proposal, the Board will notify the applicant of the reasons for its decision. Under either procedure, the Board expects that a prompt decision will be made whether to publish notice of an application for a new activity.

Most of the commenters favored the procedure for automatic publication of notice of applications to engage in new activities. The Board, however, believes that it should retain the discretion to review applications for proposed new activities in order to determine whether there is a reasonable basis for believing that the activity is closely related to banking. The proposed alternate procedure addresses the concern of the commenters for more expeditious publication of new nonbanking activities by requiring a Board decision on publication within a maximum of 40 days as well as the concerns regarding the desirability of publishing an activity for comment whether or not there is any prospect for its adoption under the standards of section 4(c)(8) of the BHC Act.

Some commenters questioned whether an application is necessary in order for the Board to consider adding a new activity to the list of new activities in the regulation. Under the Administrative Procedure Act, any party may petition for amendment of a regulation at any time (5 U.S.C 552(b)), although the time frames specified in this section for processing applications to engage in new activities would not apply to a petition for rulemaking.

Section 225.23(f) Expedited procedure for small acquisitions. In response to requests that the Board reinstitute the simplified procedures contained in the current regulation (which were suspended in 1971) and to establish a procedure for expedited consideration of small acquisitions that raise no significant issues, the Board proposed in this paragraph to adopt an expedited 15-day notice procedure for small acquisitions involving permissible nonbanking activities.

Under this paragraph of the proposed revision, a bank holding company may acquire voting securities or assets of a company engaged in nonbanking activities on the Regulation Y list by filing with the Reserve Bank a brief description of the proposed transaction and a notice of the proposed acquisition that appeared in a newspaper of general circulation in the area(s) to be served as a result of the acquisition. As proposed, the procedure would apply only to an

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acquisition where the book value of the assets acquired or the gross consideration paid for the securities or assets is $10 million or less, and the bank holding company had previously received approval to engage in the activity in the relevant State. Within five business days after the close of the comment period, the Reserve Bank would notify the bank holding company that the proposed acquisition has been approved pursuant to delegated authority, or that the application has been referred to the Board because the application is not eligible for action under delegated authority.

While this proposal was supported by bank holding companies as well as the Department of Justice, a number of commenters suggested modifications to the provision. Some commenters objected to publishing notice of a proposal in a newspaper of general circulation, since in 1978 the Board eliminated that method of giving notice under section 4(c)(8) of the BHC Act in favor of **Federal Register** notice. However, one commenter recognized that the use of newspaper notice might be the only way for the Board to adopt an expedited application procedure and at the same time satisfy the notice requirement of the BHC Act, because publication of a notice in the **Federal Register** is more time-consuming and may not be feasible on the proposed expedited basis.

To address the concerns of the commenters, the Board is amending the provision to provide for notice in the **Federal Register** as an alternative to newspaper notice. Thus, an applicant may choose the type of notice most suitable to its needs and objectives. The Board notes that publication of notice in the **Federal Register** will extend the application process under the expedited procedure by about 15 additional days.

There were a variety of suggestions for raising the maximum limit on acquistitions that may be made under the expedited procedures. On the other hand, some commenters suggested that a percentage limitation also be applied because an absolute dollar limitation may represent a significant investment for many bank holding companies.

The Board is responding to these suggestions by raising the maximum amount from $10 million to $15 million, the amount suggested by most commenters. The Board does not believe that a percentage limitation is necessary, because in the case of an application filed under the expedited procedure that raises financial or other issues, the Reserve Bank is authorized to require a full application and to refer the application to the Board for decision. In this regard, the Board is also specifying in the regulation that this procedure may not be used unless the bank holding company meets the Board's Capital Adequacy Guidelines.

Finally, in view of the fact that the Board is not adopting the proposal to require bank holding companies to file applications for new offices of previously-approved nonbanking activities on a state by state basis, there is no reason to require, as a condition of eligibility for the expedited notice procedures, that the company have received prior authority from the Board to engage in the particular activity in the area served by the company to be acquired. Accordingly, the final regulation is being modified to require only that the acquiring company previously must have received Board approval to engage in the particular activity. While some commenters favored use of expedited procedures for a bank holding company's entry into a new nonbanking activity by acquisition of a going concern, the Board does not believe that the 15-day notice period would allow sufficient time to consider the financial, managerial and other factors specified in the BHC Act.

Section 225.23(g) Hearing. This paragraph indicates that the Board may order a hearing or other proceeding in connection with an application. Several commenters suggested that in order to avoid delay, requests for hearing should be presented to the Board for decision as soon as they are received, rather than when the staff completes its analysis of the application. In view of the shortened processing schedules that are being adopted by the Board, the suggested procedure would not save much time in most cases and in fact might unduly lengthen the application process. Accordingly, the Board believes that it is more efficient under the new processing schedules to evaluate the merits of the protest and hearing request in the context of the evaluation of the application. The Board will, however, take the opportunity in applications raising major issues in which a hearing is required to order the hearing at the earliest possible time.

Some commenters objected that the proposed revision did not include detailed procedures for handling protests. They argued that such procedures are necessary to avoid substantial delays in deciding protested cases. The Board's procedures for handling protested applications are already set forth in its Rules of Procedure (12 CFR Part 262), and there appears to be no reason to transfer them to Regulation Y, since the protest procedures also apply to other types of applications. The Board notes that adoption in 1980 of revised protest procedures have been useful in reducing delays in processing protested applications. In addition, the Board is continuing to study improvements that may be made in processing protested applications.

Section 225.24—Factors Considered in Acting on Nonbanking Applications

This section describes the factors the Board considers in deciding applications under section 4(c)(8) of the BHC Act to engage in nonbanking activities. The Board has consolidated the three paragraphs of this section in the proposed regulation into one paragraph in the final regulation.

This section incorporates the statutory test in section 4(c)(8) of the BHC Act, which requires the Board, in its consideration of an application, to weigh the public benefits against the possible adverse effects that are likely to result from a bank holding company's proposal to engage in a specific nonbanking activity. This paragraph also reflects the general finding of the Board that performance of an activity by a bank holding company on a *de novo* basis is likely to yield public benefits, which is based on section 4(c)(8) of the BHC Act, allowing the Board to differentiate between nonbanking activities commenced *de novo* and those commenced through the acquisition of a going concern.

The comments supported the presumption in the regulation that *de novo* entry will result in benefits to the public through increased competition. The provision is being adopted as proposed.

This section also reflects the Board's practice in acting on applications under section 4(c)(8) of the BHC Act to consider the financial and managerial resources of the bank holding company, its subsidiaries, and the company to be acquired, and the effect of the transaction on their resources. For example, a proposal that may detract from the financial condition of the applicant bank holding company would be weighed as an adverse factor in the Board's overall evaluation of the application under section 4(c)(8).

Some commenters urged deleting these criteria because section 4(c)(8) of the BHC Act does not explicitly list financial and managerial considerations among the factors the Board is required to consider. Section 4(c)(8) specifically mentions "unsound banking practices" under the adverse effects to be considered, and the list of adverse effects and public benefits in section

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4(c)(8) is illustrative rather than exhaustive. The Board regards consideration of financial and managerial factors in connection with applications for nonbanking activities as included within the required net public benefits analysis under section 4(c)(8) of the BHC Act.

Section 225.25—List of Permissible Nonbanking Activities

This section, which was proposed as § 225.23(b) of the revision, lists the nonbanking activities that the Board has determined by regulation to be closely related to banking under the BHC Act. Generally, an application involving a listed activity may be acted on by the Reserve Banks under delegated authority, whereas an application involving an unlisted activity is considered by the Board. In addition, an applicant may file a simple notice under a 30-day procedure to engage *de novo* in a listed activity, whereas a full application is required for an unlisted activity.

This section, as proposed, essentially restated the current list of permissible activities, but combined two of the activities (making and servicing loans), and expanded one activity to include issuing money orders. Four new activities were proposed to be added to the list, all of which the commenters favored.

The Board is adopting a list of 18 activities, including five proposed new activities that the Board, on the basis of the record in this proceeding, has determined to be closely related to banking within the meaning of section 4(c)(8) of the BHC Act. The final regulation also includes securities brokerage (§ 225.25(b)(15)), which the Board recently adopted in a separate rulemaking proceeding (48 FR 37003 (1983)). There were no significant comments regarding activity (6) community development, and activity (13) real estate appraising. Activities receiving substantive comments or requests for clarification are discussed below.

(1) Making and servicing loans. In considering applications to engage in this activity, the Board requires a bank holding company to specify the type of loans it is proposing to make or the type of finance company to be acquired (e.g., consumer finance, factor, etc.). Some commenters suggested that approval be granted to bank holding companies for all types of lending without specification. The Board believes that, because of the section 4(c)(8) requirement of notice of competitors and opportuniy for hearing, the specification of the type of lending activities should be retained.

Commenters questioned whether, in combining the activities of making loans with servicing loans, the Board intended to confer servicing authority on companies that currently have lending authority. The Board did not intend to confer such authority, and companies that wish to acquire loan servicing authority must apply for it specifically. However, as a practical matter, the Board notes that generally companies that have obtained approval for various lending activities have also applied for and received authority for servicing such loans.

(2) Industrial banking. A banking holding company may acquire or retain an industrial bank under this section only if the industrial bank is not a "bank" within the meaning of section 225.2(a) of this regulation. Otherwise, the application would have to be filed under section 3 of the Act and Subpart B of this regulation relating to the acquisition of "banks." The acquisition of an industrial bank or loan company under section 3 of the BHC Act may also raise issues under the interstate prohibition of § 225.13(c), as well as the deposit insurance requirement of § 225.4(c) of the final regulation.

The only comments on this section were incidential to comments on the definition of "bank" in § 225.2(a) of the regulation. Commenters noted that, under that definition, many industrial banks would be regarded as banks.

In acting on applications to acquire industrial banks under section 4(c)(8) of the BHC Act and § 255.4(a)(2) of the current regulation, the Board has required that such institutions not engage both in taking NOW accounts and making commercial loans, as those terms have been defined by the Board. In light of the Board's definition of bank in this regulation, a bank holding company may acquire or retain an industrial bank under this section only where the bank either does not accept demand deposit or NOW accounts or does not make commercial loans, as defined in this regulation.

(3) Trust company functions. The Board has clarified that a trust company that functions as a bank may not be acquired under this subpart, but rather under section 3 of the BHC Act and subpart B of this regulation.

(4) Investment or financial advice. In the final regulation, the Board is including the footnote in the current regulation that distinguishes investment advice from management consulting. The substance of this footnote was included in the notice accompanying the proposed revision.

(5) Leasing personal or real property. The **Federal Register** notice accompanying the proposed revision inadvertently failed to discuss the addition of the following limitation to permissible leasing activities not contained in the current regulation: "provided, that in the aggregate the amount derived from estimated residual value under subparagraph C and any unconditional guarantee shall not exceed 60 percent of the acquisition cost of the property."

Although this limitation reflects staff advice that has consistently been given in response to inquiries regarding the conditions of permissible leasing activities, the Board is not adopting the limitation in the final regulation. The Board agrees with the objections of commenters that the limitation is more restrictive than the current provision, and will have serious adverse effects in terms of the ability of holding companies to compete on an equitable basis with their nonbank competitors.

(7) Data processing. The proposed revision reflected the amendments to this activity that the Board adopted in 1982. Several commenters urged deletion of the requirement that the data to be processed must be limited to "banking, economic or financial data." However, as noted, the Board has recently completed an extensive formal rulemaking proceeding with respect to the type of data processing permissible for bank holding companies. This rulemaking resulted in a substantial broadening of the scope of this activity consistent with the requirements of section 4(c)(8) of the BHC Act. That rule is currently being challenged in the U.S. Court of Appeals for the District of Columbia, and the Board believes that it would not be appropriate to commence another rulemaking proceeding until that matter is resolved.

As discussed above with respect to § 225.22(a), the provision by a bank holding company of data processing services for the internal operations of the holding company system is considered an exempt servicing activity and has been deleted from this paragraph.

(8) Insurance sales. The proposed revision reflected the enactment of Title VI of the Garn-St Germain Act without delineating the changes it effected in the scope of permissible bank holding company insurance activities, pending review and resolution of the issues raised by the changes.

A number of comments, particularly from holding companies with insurance

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activities grandfathered or otherwise exempt under the Garn-St Germain Act, expressed the view that the regulation should be explicit in defining the scope of permissible activities and in recognizing grandfather rights. Since the proposed revision, the Board has considered a number of issues raised with regard to the proper scope and interpretation of Title VI of the Garn-St Germain Act. Based on that review, the Board will publish for comment in the near future in a separate **Federal Register** notice an amendment to this section to define the scope of permissible insurance activities under Title IV of the Garn-St Germain Act.

(9) Underwriting credit life, accident and health insurance. Commenters suggested deleting the footnote and related interpretation that require a bank holding company to provide and maintain the public benefits of engaging in this activity by, for example, reducing rates or increasing policy benefits. On November 25, 1983, the Board sought public comment on a proposal to delete this requirement. (48 FR 53125 (1983)).

(10) Courier services. As discussed above with respect to § 225.22(a), the provision by a bank holding company of courier services for the internal operations of the holding company system is regarded as an exempt servicing activity and has been deleted from this paragraph.

The **Federal Register** notice accompanying the proposed revision indicated that applications to provide courier services would not be acted on by the Reserve Banks under delegated authority, but would be forwarded to the Board for action. In response to comments, the Board is deleting this restriction.

(11) Management consulting to depository institutions. There were requests to expand this activity to permit bank holding companies to offer general managment consulting. For the reasons set out in its decision in *First Commerce Corp.*, 58 *Federal Reserve Bulletin* 674 (1972), the Board is not seeking public comment on whether to add this activity to the Regulation Y list of permissible activities.

(12) Money orders, savings bonds, and travelers checks. The Board received no objections to its proposal to include in this activity the issuance of money orders with a face value of no more than $1,000. Several commenters suggested that the $1,000 dollar limitation on the issuance and sale of money orders be raised to at least $5,000, or, alternatively, be eliminated. In a notice dated November 23, 1983 (48 FR 52977) (1983)), the Board sought public comments on a proposal to raise the dollar limit for the sale or issuance of money orders to $10,000.

(14) Arranging commercial real estate equity financing. The commenters generally favored the Board's proposal to add this activity to the list of nonbanking activities permissible for bank holding companies, but objected to inclusion in the regulation of conditions on performance of the activity, which they contend were voluntarily undertaken by the applicants in particular cases, are not necessary to determine that the activity is closely related to banking, and should be imposed on a case-by-case basis.

The Board has reviewed the conditions and believes that they are necessary for the conduct of equity financing by bank holding companies under the standards in section 4(c)(8) of the BHC Act. The Board believes that imposing conditions on a case-by-case basis as suggested would defeat the major purpose of placing equity financing on the Regulation Y list, because it would prevent approval by the Reserve Banks under delegated authority within a shorter time period. The Board notes that the Office of the Comptroller of the Currency has recently authorized a subsidiary of a national bank to provide equity financing services subject to all the conditions imposed by the Board, with the exception of the retirement that an affiliate of the equity financing subsidiary may not finance the investor's purchase of the property. The Board imposed this requirement to prevent unsafe and unsound banking practices and conflicts of interest, as required under section 4(c)(8) of the BHC Act. The Board is, however, evaluating the possibility of an alternative to this requirement that would address the Board's concerns with these adverse effects and will consider the modification of this restriction if a satisfactory alternative is developed.

For the reasons set out in *BankAmerica Corporation*, 68 *Federal Reserve Bulletin* 647 (1982), the Board concludes that the activity of arranging commercial real estate equity financing, subject to the conditions and limitations proposed, is closely related to banking, and the Board is hereby adding that activity to its Regulation Y list of nonbanking activities permissible for bank holding companies.

(16) Underwriting and dealing in government obligations and money market instruments. The commenters favored adding this proposed new nonbanking activity to the Regulation Y list. For the reasons set out in *Citicorp* (*Citicorp Government Securities, Inc.*), 68 *Federal Reserve Bulletin* 249 (1982), the Board concludes that the activity of underwriting and dealing in government securities and money market instruments is closely related to banking and is hereby adding that activity to its Regulation Y list of nonbanking activities permissible for bank holding companies. The applicant is subject to the same limitations that would be applicable if the activity were performed by the applicant's subsidiary member bank or by its subsidiary nonmember banks as if they were member banks.

(17) Foreign exchange advisory and transactional services. The commenters generally favored the Board's proposal to add foreign exchange services to the list of permissible activities for bank holding companies, but objected to inclusion in the regulation of conditions for engaging in the activity. The Board has reviewed the conditions and believes that they are necessary for the conduct of this activity in accordance with the standards of section 4(c)(8) of the BHC Act. For the reasons set out in its decision in *Hongkong and Shanghai Banking Corporation*, 69 *Federal Reserve Bulletin* 221 (1983), the Board concludes that the activity of foreign exchange advisory and transactional services, subject to the conditions and limitations proposed, is closely related to banking, and the Board is hereby adding that activity to its Regulation Y list of permissible activities. In response to comments, the Board is also specifying that arranging for the execution of foreign exchange transactions is included within the activity because the Board found this facet of foreign exchange transactional services to be closely related to banking in its *Hongkong and Shanghai Banking Corporation* decision.

(18) Futures commission merchant. The commenters generally favored adding this activity to the list of permissible activities, but objected to including conditions in the regulation, which they contend are not necessary for conduct of the activity and should be imposed on a case-by-case basis. The Board has reviewed each of these conditions, most of which are designed to ensure safety and soundness and avoid conflicts of interest, and continues to believe that the conditions appearing in paragraphs (i), (ii), (iii), (iv), (vi) and (vii) of the activity as proposed are necessary for the conduct of the activity in accordance with the standards of section 4(c)(8) of the BHC Act.

The activities of a futures commission merchant are highly specialized, and require well defined parameters to ensure that their conduct is consistent

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with the BHC Act. For example, one of the more important conditions is that relating to capitalization. The Board regards this as a critical factor in its analysis, and has required substantial capitalization in each application to engage in this activity. By retaining the conditions in the regulation, the Board believes it will facilitate the prompt processing of applications by specifying the threshold criteria that must be met.

However, the conditions appearing in paragraphs (v), (viii) and (ix) of the activity as proposed have been deleted because the substance of those requirements can be monitored and evaluated in other ways. In addition, conditions (i) and (ii) have been shortened and combined. The Board is also modifying the condition regarding capitalization to require fully adequate capital rather than capital in substantial excess of that required by the CFTC.

For the reasons set forth in its decision in *J.P. Morgan & Co., Inc.*, 68 *Federal Reserve Bulletin* 514 (1982), the Board concludes that the activity of acting as a futures commission merchant is closely related to banking, and is hereby adding that activity to its Regulation Y list of permissible activities. In addition, the Board is including in this activity the execution and clearance of options on futures contracts for bullion, U.S. Government securities and money market instruments, which the Board authorized by order after proposing the revision of Regulation Y for comment. (*J.P. Morgan & Co. Inc.*, 69 *Federal Reserve Bulletin* 733 (1983); *Security Pacific Corp.*, 69 *Federal Reserve Bulletin* —— (1983)). In so doing, the Board found that an option on a futures contract is functionally and operationally similar to a futures contract on the same commodity, and in view of this close relationship, the Board believes that its initial proposal to place the execution and clearance of futures contracts on the list of permissible activities is sufficiently broad to encompass the execution and clearance of options on these contracts.

V. Subpart D—Control and Divestiture Proceedings

This subpart consists of two sections: the first covers control proceedings (§ 225.2 of the current regulation); the second covers divestiture proceedings and is based on a published Board interpretation (12 CFR 225.139). There were no substantive comments regarding § 225.32 ("Divestiture proceedings").

Section 225.31—Control Proceedings

Under sections 2(a)(2)(C) and 2(d)(3) of the BHC Act, the Board may determine, after notice and opportunity for hearing, that a company exercises or has the power to exercise a controlling influence over the management or policies of a bank or other company, even though the company may not otherwise have control over 25 percent of the voting securities or the power to elect a majority of the directors of the other company. Sections 225.2 (b) and (c) of the current regulation describe circumstances and procedures under which control determinations may be made. While these provisions were reorganized and simplified in the proposed revision, the basic approach of the current provisions has not been altered. Where facts and circumstances are present or information is received to indicate that a company exercises a controlling influence over the management or policies of a bank or another company, the Reserve Bank will review the relationship to determine if it would be appropriate for the Board to issue a preliminary determination of control.

It is anticipated that most situations involving possible control relationships will be handled informally. However, where discussion does not resolve the issue, the Board may institute a formal proceeding by issuing a preliminary determination of control under the procedures described in this section. In those situations where a preliminary determination of control is issued, the company will be given notice of the facts and the circumstances on which the determination is based and provided an opportunity to contest the determination.

There were objections to paragraph (c) of this section in which the Board reserves the discretion to order a hearing when the company contests a preliminary determination of control. The commenters assert that under section 2(a)(2)(C) of the BHC Act, a company has the right to a hearing in a controlling influence proceeding. The Board agrees that a company is entitled to a hearing with respect to controlling influence determinations under section 2(a)(2)(C), but not with respect to control of shares under section 2(a)(2)(A) of the BHC Act. The regulation is being clarified accordingly.

With respect to the rebuttable presumptions of control in paragraph (d) of this section, there were several comments contending that substantive changes had been made in the proposed revision, notwithstanding the statement in the **Federal Register** notice that no changes had been proposed. Since the Board did not intend to make substantive changes, the paragraphs in question are being modified in the final regulation to follow the language of the current regulation more closely. In this regard, one commenter claimed that the current presumptions do not apply to an employee with policy-making factors. However, the Board believes that such an individual would qualify as an officer under the current regulation and that this clarification effects no substantive change (compare § 225.2(f) in the revision and existing § 225.2(b)(1)).

Finally, the Board is adopting the suggestion of commenters to include in this section of the final regulation the presumption in section 2(a) of the BHC Act that a company that controls less than 5 percent of any class of voting securities of another company or bank does not control it.

VI. Subpart E—Change in Bank Control

This subpart reorganizes § 225.7 of the current regulation relating to notices filed with the Board under the Bank Control Act involving State member banks and bank holding companies. (See also the Board's Policy Statement on Change in Bank Control Act of 1978, FRRS 4–801). In general, a description of the specific provisions of this subpart is contained in the **Federal Register** notice accompanying the proposed revision. The only change proposed was the addition of paragraph (d) in § 225.43 of the proposed revision to clarify the lack of standing of third parties who submit information during the investigation of a Bank Control Act notice. No substantive comments were received regarding the proposed provisions of this subpart, and the Board is adopting the subpart as proposed with some editorial changes.

It was suggested that the Board add a provision to define "acting in concert," although the commenters did not offer a specific proposal in this regard. The Board does not believe that it has enough regulatory experience with respect to this issue to propose a regulatory definition at this time, although the **Federal Register** notice accompanying the proposed revision contained some guidance concerning the term. It was stated in that notice that the Board regards two or more persons (which may also include a corporation or other entity) as acting in concert when they have joined together formally or informally for the purpose of acquiring voting securities of a bank or bank holding company. For example, a group of persons who have identified themselves as a group for purpose of the Federal securities laws may constitute persons "acting in concert" for purposes of this section.

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List of Subjects in 12 CFR Part 225

Banks, Bankings, Federal Reserve Systems, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in this notice, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); Title IX of the International Lending Supervision Act of 1983 (Pub. L. 98-181, Title IX); the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*); and section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13)), the Board is amending 12 CFR Part 225 by: (1) Removing §§ 225.1 through 225.7 and § 225.51, except § 225.4(e), which is redesignated § 225.22(d) as set forth below (§§ 225.101 through 225.143 remain in effect); and (2) adding the following Subparts A through E and the Appendices to Subparts A through E to Part 225:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

Subpart A—General Provisions

Sec.
225.1 Authority, purpose, and scope.
225.2 Definitions.
225.3 Administration.
225.4 Corporate practices.
225.5 Registration, reports, and inspections.
225.6 Penalties for violations.

Subpart B—Acquisition of Bank Securities or Assets

225.11 Transactions requiring Board approval.
225.12 Transactions not requiring Board approval.
225.13 Factors considered in acting on bank applications.
225.14 Procedures for applications, notices, and hearings.

Subpart C—Nonbanking Activities and Acquisitions by Bank Holding Companies

225.21 Prohibited nonbanking activities and acquisitions; exempt bank holding companies.
225.22 Exempt nonbanking activities and acquisitions.
225.23 Procedures for applications, notices, and hearings.
225.24 Factors considered in acting on nonbanking applications.
225.25 List of permissible nonbanking activities.

Subpart D—Control and Divestiture Proceedings

225.31 Control proceedings.
225.32 Divestiture proceedings.

Subpart E—Change in Bank Control

225.41 Transactions requiring prior notice.
225.42 Transactions not requiring prior notice.
225.43 Procedures for filing, processing and acting on notices.

Appendices to Subparts A through E

Appendix A—Capital Adequacy Guidelines
Appendix B—Policy Statement for Formation of Small One-Bank Holding Companies

* * * * *

Authority: 12 U.S.C. 1844(b), 3106, 3108, 1817(j)(13), 1818(b); and Pub L. 98-181, Title IX.

Subpart A—General Provisions

§ 225.1 Authority, purpose, and scope.

(a) *Authority.* This Part (Regulation Y) is issued by the Board of Governors of the Federal Reserve System ("Board") under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) ("BHC Act"); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13)) ("Bank Control Act"); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)); and the International Lending Supervision Act of 1983 (Pub. L. 98-181, Title IX). The BHC codified at 12 U.S.C. 1841, *et seq.*

(b) *Purpose.* The principal purposes of this Part are to regulate the acquisition of control of banks by companies and individuals, to define and regulate the nonbanking activities in which bank holding companies and foreign banking organizations with United States operations may engage, and to set forth the procedures for securing approval for such transactions and activities.

(c) *Scope.* (1) Subpart A contains general provisions and definitions of terms used in this regulation.

(2) Subpart B governs acquisitions of bank or bank holding company securities and assets by bank holding companies or by any company that will become a bank holding company as a result of the acquisition.

(3) Subpart C defines and regulates the nonbanking activities in which bank holding companies and foreign banking organizations may engage directly or through a subsidiary. In addition, certain nonbanking activities conducted by foreign banking organizations and certain foreign activities conducted by bank holding companies are governed by the Board's Regulation K (12 CFR Part 211, International Banking Operations).

(4) Subpart D specifies situations in which a company is presumed to control voting securities or to have the power to exercise a controlling influence over the management or policies of a bank or other company, sets forth the procedures for making a control determination, and provides rules governing the effectiveness of divestitures by bank holding companies.

(5) Subpart E governs changes in bank control resulting from the acquisition by individuals or companies (other than bank holding companies) of voting securities of a bank holding company or state member bank of the Federal Reserve System.

(6) Appendix A to the regulation contains the Board's Capital Adequacy Guidelines for bank holding companies and for state member banks.

(7) Appendix B to the regulation contains the Board's Policy Statement for Formation of Small One-Bank Holding Companies.

§ 225.2 Definitions.

Except as modified in this section or unless the context otherwise requires, the terms used in this regulation have the same meanings as set forth in the relevant statutes.

(a)(1) "Bank" means any institution organized under the laws of the United States that: (i) accepts deposits that the depositor has a legal right to withdraw on demand and (ii) engages in the business of making commercial loans. For the purposes of this definition:

(A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments; the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

(2) "Bank" includes any state-chartered bank or national banking association that (i) is owned exclusively (except to the extent directors' qualifying shares are required by law) by other depository institutions, or by a bank holding company owned exclusively by other depository institutions; and (ii) is organized to engage exclusively in providing services for other depository institutions and their officers, directors, and employees.

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(3) "Bank" does not include:

(i) Any institution that does not do business in the United States except as an incident to its activities outside the United States;

(ii) Any institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or any institution chartered by the Federal Home Loan Bank Board; or

(iii) "Agreement" or "Edge" corporations operating under sections 25 or 25(a) of the Federal Reserve Act (12 U.S.C. 601–604(a), 611–631).

(b)(1) "Bank holding company" means any company (including a bank) that has direct or indirect control of a bank, other than control that results from the ownership or control of:

(i) Voting securities held in good faith in a fiduciary capacity (other than as provided in paragraphs (d)(2)(ii) and (iii) of this section) without sole discretionary voting authority, or as otherwise exempted under section 2(a)(5)(A) of the BHC Act;

(ii) Voting securities acquired and held only for a reasonable period of time in connection with the underwriting of securities, as provided in section 2(a)(5)(B) of the BHC Act;

(iii) Voting rights to voting securities acquired for the sole purpose and in the course of participating in a proxy solicitation, as provided in section 2(a)(5)(C) of the BHC Act;

(iv) Voting securities acquired in satisfaction of debts previously contracted in good faith, as provided in section 2(a)(5)(D) of the BHC Act, if the securities are divested within two years of acquisition (or such later period as the Board may permit by order); or

(v) Voting securities of certain institutions owned by a thrift institution or a trust company, as provided in sections 2(a)(5)(E) and (F) of the BHC Act.

(2) Except for the purposes of section 225.4(b) of this subpart and Subpart E of this regulation or as otherwise provided in this regulation, the term "bank holding company" includes a foreign banking organization. For the purposes of Subpart B, the term "bank holding company" includes a foreign banking organization only if it owns or controls a bank in the United States.

(c)(1) "Company" includes any bank, corporation, general or limited partnership, association or similar organization, business trust, or any other trust unless by its terms it must terminate either within 25 years, or within 21 years and 10 months after the death of individuals living on the effective date of the trust.

(2) "Company" does not include any organization, the majority of the voting securities of which are owned by the United States or any state.

(d)(1) "Control" of a bank or other company means (except for the purposes of Subpart E):

(i) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting securities of the bank or other company, directly or indirectly or acting through one or more other persons;

(ii) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the bank or other company;

(iii) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the bank or other company, as determined by the Board after notice and opportunity for hearing in accordance with § 225.31 of Subpart D of this regulation; or

(iv) Conditioning in any manner the transfer of 25 percent or more of the outstanding shares of any class of voting securities of a bank or other company upon the transfer of 25 percent or more of the outstanding shares of any class of voting securities of another bank or other company.

(2) A bank or other company is deemed to control voting securities or assets owned, controlled, or held, directly or indirectly:

(i) By any subsidiary of the bank or other company;

(ii) In a fiduciary capacity (including by pension and profit-sharing trusts) for the benefit of the shareholders, members, or employees (or individuals serving in similar capacities) of the bank or other company or of any of its subsidiaries; or

(iii) In a fiduciary capacity for the benefit of the bank or other company or any of its subsidiaries.

(e) "Foreign banking organization" and "qualifying foreign banking organization" shall have the same meanings as provided in § 211.23 of the Board's Regulation K (12 CFR 211.23).

(f) "Management official" means any officer, director (including honorary or advisory directors), partner, or trustee of a bank or other company, or any employee of the bank or other company with policy-making functions.

(g) "Outstanding shares" means any voting securities, but does not include securities owned by the United States or by a company wholly-owned by the United States.

(h) "Person" includes an individual, bank, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

(i) "Principal shareholder" means a person that owns or controls, directly or indirectly, 25 percent or more of any class of voting securities of a bank or other company.

(j) "Subsidiary" means a bank or other company that is controlled by another company, and refers to a direct or indirect subsidiary of a bank holding company. An indirect subsidiary is a bank or other company that is controlled by a subsidiary of the bank holding company.

(k) "United States" means the United States and includes any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

(l) (1) "Voting securities" means shares of common or preferred stock, general or limited partnership shares or interests, or similar interests if the shares or interest, by statue, charter, or in any manner, entitle the holder: (i) to vote for or to select directors, trustees, or partners (or persons exercising similar functions of the issuing company); or (ii) to vote on or to direct the conduct of the operations or other significant policies of the issuing company.

(2) Preferred shares, limited partnership shares or interests, or similar interests are not "voting securities" if: (i) any voting rights associated with the shares or interest are limited solely to the type customarily provided by statute with regard to matters that would significantly and adversely affect the rights or preference of the security or other interest, such as the issuance of additional amounts or classes of senior securities, the modification of the terms of the security or interest, the dissolution of the issuing company, or the payment of dividends by the issuing company when preferred dividends are in arrears; (ii) the shares or interest represent an essentially passive investment or financing device and do not otherwise provide the holder with control over the issuing company; and (iii) the shares or interest do not entitle the holder, by statute, charter, or in any manner, to select or to vote for the selection of directors, trustees, or partners (or persons exercising similar functions) of the issuing company.

§ 225.3 Administration.

(a) *Delegation of authority.* Designated Board members and officers and the Federal Reserve Banks are authorized by the Board to exercise

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various functions prescribed in this regulation and in the Board's Rules Regarding Delegation of Authority (12 CFR Part 265) and the Board's Rules of Procedure (12 CFR Part 262).

(b) *Appropriate Federal Reserve Bank.* In administering this regulation, the appropriate Federal Reserve Bank is as follows:

(1) For a bank holding company (or a company applying to become a bank holding company): the Reserve Bank of the Federal Reserve district in which the company's banking operations are principally conducted, as measured by total domestic deposits in its subsidiary banks on the date it became (or will become) a bank holding company;

(2) For a foreign banking organization that has no subsidiary bank and is not subject to paragraph (b)(1) of this section: the Reserve Bank of the Federal Reserve district in which the total assets of the organization's United States branches, agencies, and commercial lending companies are the largest as of the later of January 1, 1980, or the date it becomes a foreign banking organization;

(3) For an individual or company submitting a notice under Subpart E of this regulation: the Reserve Bank of the Federal Reserve district in which the banking operations of the bank holding company or State member bank to be acquired are principally conducted, as measured by total domestic deposits on the date the notice is filed.

§ 225.4 Corporate practices.

(a) *Bank holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and mangerial strength to its subsidiary banks and shall not contuct its operations in an unsafe or unsound manner.

(2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Superisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*), the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

(b) *Purchase or redemption by a bank holding company of its own securities.*—(1) *Filing notice.* A bank holding company shall give the Board prior written notice before purchasing or redeeming its equity securities, if the gross consideration for the purchase or redemption, when aggregated with the net consideration paid by the company for all such purchases or redemptions during the preceding 12 months, is equal to 10 percent or more of the company's consolidated net worth. For the purposes of this section, "net consideration" is the gross consideration paid by the company for all of its equity securities purchased or redeemed during the period minus the gross consideration received for all of its equity securities sold during the period other than as part of a new issue.

(2) *Content of notice.* Any notice under this section shall be filed with the appropriate Reserve Bank and shall contain the following information:

(i) The purpose of the transaction, a description of the securities to be purchased or redeemed, the total number of each class outstanding, the gross consideration to be paid, and the terms of any debt incurred in connection with the transaction;

(ii) A description of all equity securities redeemed within the preceding 12 months, the net consideration paid, and the terms of any debt incurred in connection with those transactions; and

(iii) A current and *pro forma* consolidated balance sheet if the bank holding company has total assets of over $150 million, or a current and *pro forma* parent company only balance sheet if the bank holding company has total assets of $150 million or less.

(3) *Acting on notice.* Within 30 calendar days of receipt of a notice under this section, the appropriate Reserve Bank shall either approve the transaction proposed in the notice or refer the notice to the Board for decision. If the notice is referred to the Board for decision, the Board shall act on the notice within 60 calendar days after the Reserve Bank receives the notice.

(4) *Factors considered in acting on notice.* The Board may disapprove a proposed purchase or redemption if it finds that the proposal would constitute an unsafe or unsound practice, or would violate any law, regulation, Board order, directive, or any condition imposed by, or written agreement with, the Board. In determining whether a proposal constitutes an unsafe or unsound practice, the Board will consider whether the bank holding company's financial condition, after giving effect to the proposed purchase or redemption, meets the financial standards applied by the Board under section 3 of the BHC Act, including the Board's Capital Adequacy Guidelines (Appendix A to Subparts A through E) and the Board's Policy Statement for Formation of Small One-Bank Holding Companies (Appendix B to Subparts A through E).

(5) *Disapproval and hearing.* The Board shall notify the bank holding company in writing of the reasons for a decision to disapprove any proposed purchase or redemption. Within 10 calendar days of receipt of a notice of disapproval by the Board, the bank holding company may submit a written request for a hearing. The Board will order a hearing within 10 calendar days of receipt of that request if it finds that material facts are in dispute or if it otherwise appears appropriate. Any hearing conducted under this paragraph shall be held in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR Part 263). At the conclusion of the hearing, the Board shall by order approve or disapprove the proposed purchase or redemption on the basis of the record of the hearing.

(c) *Deposit insurance.* Every bank that is a bank holding company or a subsidiary of a bank holding company shall obtain Federal Deposit Insurance and shall remain an "insured bank" as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)).

(d) *Tie-in arrangements.* A bank holding company and any nonbanking subsidiary conducting an activity authorized under section 225.23 of this regulation may not in any manner extend credit, lease or sell property of any kind, provide any service, or fix or vary the consideration for any of these transactions subject to any condition or requirement that, if imposed by a bank, would constitute an unlawful tie-in arrangement under section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)).

(e) *Acting as transfer agent, municipal securities dealer, or clearing agent.* A bank holding company or any nonbanking subsidiary that is a "bank," as defined in section 3(a)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(6)), and that is a transfer agent of securities, a municipal securities dealer, a clearing agency, or a participant in a clearing agency (as those terms are defined in section 3(a) of the Securities Exchange Act, (12 U.S.C. 78c(a)), shall be subject to sections 208.8(f)-(j) of the Board's Regulation H (12 CFR 208.8(f)-(j)) as if it were a state member bank.

§ 225.5 Registration, reports, and inspections.

(a) *Registration of bank holding companies.* Each company shall register within 180 days after becoming a bank

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holding company by furnishing information in the manner and form prescribed by the Board. A company that receives the Board's prior approval under subpart B of this regulation to become a bank holding company may complete this registration requirement through submission of its first annual report to the Board as required by paragraph (b) of this section.

(b) *Reports of bank holding companies.* Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.

(c) *Examinations and inspections.* The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operations and activities. The Board will rely as far as possible on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of a bank holding company or of the branch or agency of the foreign bank.

§ 225.6 Penalties for violations.

(a) *Criminal and civil penalties.* Section 8 of the BHC Act provides criminal penalties for willful violation, and civil penalties for violation, by any company or individual of the BHC Act or any regulation or order issued under it, or for making a false entry in any book, report, or statement of a bank holding company. Civil money penalty assessments for violations of the BHC Act shall be made in accordance with subpart B of the Board's Rules of Practice for Hearings (12 CFR 263, Subpart B). For any willful violation of the Bank Control Act or any regulation or order issued under it, the Board may assess a civil penalty as provided in 12 U.S.C. 1817(j)(15).

(b) *Cease and desist proceedings.* For any violation of the BHC Act, the Bank Control Act, this regulation, or any order or notice issued thereunder, the Board may institute a cease and desist proceeding in accordance with the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*).

Subpart B—Acquisition of Bank Securities or Assets

§ 225.11 Transactions requiring Board approval.

The following transactions require an application for the Board's prior approval under section 3 of the BHC Act unless otherwise exempted under § 225.12 of this subpart:

(a) *Formation of bank holding company.* Any action that causes a bank or other company to become a bank holding company.

(b) *Acquisition of subsidiary bank.* Any action that causes a bank to become a subsidiary of a bank holding company.

(c) *Acquisition of control of bank or bank holding company securities.* The acquisition by a bank holding company of direct or indirect ownership or control of any voting securities of a bank or bank holding company, if the acquisition results in the company's control of more than 5 percent of the outstanding shares of any class of voting securities of the bank or bank holding company. An acquisition includes the purchase of additional securities through the exercise of preemptive rights, but does not include securities received in a stock dividend or stock split that does not alter the bank holding company's proportional share of any class of voting securities.

(d) *Acquisition of bank assets.* The acquisition by a bank holding company or by a subsidiary thereof (other than a bank) of all or substantially all of the assets of a bank.

(e) *Merger of bank holding companies.* The merger or consolidation of bank holding companies, including a merger through the purchase of assets and assumption of liabilities.

§ 225.12 Transactions not requiring Board approval.

The following transactions do not require the Board's approval under § 225.11 of this subpart:

(a) *Acquisition of securities in fiduciary capacity.* The acquisition by a bank or other company (other than a trust that is a company) of control of voting securities of a bank or bank holding company in good faith in a fiduciary capacity, unless:

(1) The acquiring bank or other company has sole discretionary authority to vote the securities and retains the authority for more than two years; or

(2) The acquisition is for the benefit of the acquiring bank or other company, or its shareholders, employees, or subsidiaries.

(b) *Acquisition of securities in satisfaction of debts previously contracted.* The acquisition by a bank or other company of control of voting securities of a bank or bank holding company in the regular course of securing or collecting a debt previously contracted in good faith, if the acquiring bank or other company divests the securities within two years of acquisition. The Board or Reserve Bank may grant requests for up to three one-year extensions.

(c) *Acquisition of securities by a bank holding company with majority control.* The acquisition by a bank holding company of additional voting securities of a bank or bank holding company if more than 50 percent of the outstanding voting securities of the bank or bank holding company is lawfully controlled by the acquiring bank holding company prior to the acquisition.

(d) *Transactions subject to Bank Merger Act.* The merger or consolidation of a subsidiary bank of a bank holding company with another bank, or the purchase of assets by such a subsidiary bank, or a similar transaction involving subsidiary banks of a bank holding company, if the transaction requires the prior approval of a Federal supervisory agency under the Bank Merger Act (12 U.S.C. 1828(c)). This exception does not include: (1) the merger of a nonsubsidiary bank and a nonoperating subsidiary bank formed by a company for the purpose of acquiring the nonsubsidiary bank; and (2) any transaction requiring the Board's prior approval under section 225.11(e) of this subpart. The Board may require an application under this subpart if it determines that the merger or consolidation would have a significant adverse impact on the financial condition of the bank holding company or otherwise requires approval under section 3 of the BHC Act.

(e) *Holding securities in escrow.* The holding of any voting securities of a bank or bank holding company in an escrow arrangement for the benefit of an applicant pending the Board's action on an application for approval of the proposed acquisition, if title to the securities and the voting rights remain with the seller and payment for the securities has not been made to the seller.

§ 225.13 Factors considered in acting on bank applications.

(a) *Prohibited anticompetitive transactions.* As specified in sections 3(c) (1) and (2) of the BHC Act, the Board may not approve any application under this subpart if:

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(1) The transaction would result in a monopoly or would further any combination or conspiracy to monopolize, or to attempt to monopolize, the business of banking in any part of the United States; or

(2) The effect of the transaction may be substantially to lessen competition in any section of the country, tend to create a monopoly, or in any other manner be in restraint of trade, unless the Board finds that the transaction's anticompetitive effects are clearly outweighed by its probable effect in meeting the convenience and needs of the community.

(b) *Other factors.* In deciding applications under this subpart, the Board also considers the following factors with respect to the applicant, its subsidiaries, any banks related to the applicant through common ownership or management, and the bank or banks to be acquired:

(1) *Financial condition.* Their financial condition and future prospects, including whether current and projected capital positions and levels of indebtedness conform to standards and policies established by the Board.

(2) *Management.* The competence and character of the principals of the applicant and banks or bank holding companies concerned; their record of compliance with laws and regulations; and applicant's record of fulfilling any commitments to, and any conditions imposed by, the Board in connection with prior applications.

(3) *Convenience and needs of the community.* The convenience and needs of the communities to be served, including the record of performance under the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*) and regulations issued thereunder, including the Board's Regulation BB (12 CFR Part 228).

(c)(1) *Interstate transactions.* The Board may not approve any application under this subpart that would permit:

(i) The formation of a bank holding company that controls more than 5 percent of the outstanding shares of any class of voting securities of two or more banks located in different states; or

(ii) The acquisition by a bank holding company or by any of its subsidiaries of any voting securities of, any interest in, or substantially all of the assets of, an additional bank located in a state other than the state in which the operations of the banking subsidiaries of the bank holding company were principally conducted (as measured by total deposits) on July 1, 1966, or on the date on which the company became a bank holding company, whichever date is later.

(2) *Exceptions.* The prohibitions of this paragraph do not apply if:

(i) The Bank is located in a state that by statute expressly authorizes the acquisition of securities of, an interest in, or substantially all of the assets of, a bank within the state by an out-of-state bank holding company; or

(ii) The acquisition involves a closed or failing bank with assets of at least $500,000,000, and has been authorized under section 13(f) of the Federal Deposit Insurance Act (12 U.S.C. 1823(f)).

§ 225.14 Procedures for applications, notices, and hearings.

(a) *Filing application.* An application for the Board's prior approval under this subpart shall be filed with the appropriate Reserve Bank on the designated form and shall comply with § 262.3 of the Rules of Procedure (12 CFR 262.3), which requires the applicant to publish newspaper notice of the application.

(b) *Notice.*—(1) *Notice to primary banning supervisor.* Upon receipt of an application under this subpart, the Reserve Bank shall promptly furnish notice and a copy of the application to the primary banking supervisor of the bank to be acquired. The primary supervisor shall have 30 calendar days from the date of the letter giving notice in which to submit its views and recommendations to the Board.

(2) *Federal Register notice.* Upon receipt by the Reserve Bank of an application under this section, notice of the application shall be promptly sent to the **Federal Register** for publication. The **Federal Register** notice shall invite comment on the application for a period of no more than 30 days.

(c) *Accepting application for processing.* Within 10 business days after the Reserve Bank receives an application under this section, the Reserve Bank shall accept it for processing, request additional information to complete the application, or return the application if it is substantially incomplete. If additional information is requested, the Reserve Bank shall, within 5 business days of receipt of the requested information, either accept the application for processing or return it to the applicant if it is still incomplete. Upon accepting an application, the Reserve Bank shall immediately send copies to the Board.

(d) *Action on applications.*—(1) *Action under delegated authority.* The Reserve Bank shall approve an application under this section within 30 calendar days after it has accepted the application, unless the Reserve Bank, upon notice to the applicant, refers the application to the Board for decision because action under delegated authority is not appropriate. Upon written notice to the applicant, the Reserve Bank may extend the 30-day period for 15 days. If the extension of time is to request necessary additional information, the 15-day period does not commence until after the Reserve Bank receives the requested information.

(2) *Board action.* The Board shall act on an application under this subpart that is referred to it for decision within 60 calendar days after the Reserve Bank has accepted the application, unless the Board notifies the applicant that the 60-day period is being extended for a specified period and states the reasons for the extension. In no event may the extension exceed the 91-day period provided in paragraph (g) of this section. The Board may request additional information that it believes is necessary for its decision.

(e) *Notice to Attorney General.* The Board or Reserve Bank shall immediately notify the Attorney General of approval of any application under this section.

(f) *Hearings.* As provided in section 3(b) of the Act, the Board shall order a hearing if it receives from the primary supervisor of the bank to be acquired, within the 30-day period specified in paragraph (b)(1) of this section, a written recommendation of disapproval of an application. The Board may order a formal or informal hearing or other proceeding on the application, as provided in section 262.3(i)(2) of the Board's Rules of Procedure. Any request for hearing (other than from the primary supervisor) shall comply with section 262.3(e) of the Rules of Procedure (12 CFR 262.3(e)).

(g) *Approval through failure to act.*—(1) *Ninety-one day rule.* An application under this subpart shall be deemed approved if the Board fails to act on the application within 91 calendar days after the date of submission to the Board of the complete record on the application. For this purpose, the Board acts when it issues an order stating that the Board has approved or denied the application, reflecting the votes of the members of the Board, and indicating that a statement of the reasons for the decision will follow promptly.

(2) *Complete record.* For the purpose of computing the commencement of the 91-day period, the record is complete on the latest of:

(i) The date of receipt by the Board of an application that has been accepted by the Reserve Bank;

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(ii) The last day provided in any notice for receipt of comments and hearing requests on the application;

(iii) The date of receipt by the Board of the last relevant material regarding the application that is needed for the Board's decision, if the material is received from a source outside of the Federal Reserve System; or

(iv) The date of completion of any hearing or other proceeding.

(h) *Exceptions to notice and hearing requirements.*—(1) *Probable bank failure.* If the Board finds it must act immediately on an application in order to prevent the probable failure of a bank or bank holding company, the Board may modify or dispense with the notice and hearing requirements provided in this section.

(2) *Emergency.* If the Board finds that, although immediate action on an application is not necessary, an emergency exists requiring expeditious action, the Board shall provide the primary supervisor ten days to submit its recommendation. The Board may act on such an application without a hearing and may modify or dispense with the other notice and hearing requirements provided in this section.

(i) *Waiting period.* A transaction approved under this subpart shall not be consummated until thirty days after the date of approval of the application, unless the Board has determined under paragraph (h) of this section that: (1) the application involves a probable bank failure, in which case the transaction may be consummated immediately upon approval; or (2) an emergency exists requiring expeditious action, in which case the transaction may be consummated on or after the fifth calendar day following approval.

Subpart C—Nonbanking Activities and Acquisitions by Bank Holding Companies

§ 225.21 Prohibited nonbanking activities and acquisitions; exempt bank holding companies.

(a) *Prohibited nonbanking activities and acquisitions.* Except as provided in § 225.22 of this subpart, a bank holding company or a subsidiary may not engage in, or acquire or control, directly or indirectly, voting securities or assets of a company engaged in, any activity other than:

(1) Banking or managing or controlling banks and other subsidiaries authorized under the BHC Act; and

(2) An activity that the Board determines to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, including any incidental activities that are necessary to carry on such an activity, if the bank holding company has obtained the prior approval of the Board for that activity in accordance with and subject to the requirements of this regulation.

(b) *Exempt bank holding companies.* The following bank holding companies are exempt from the provisions of this subpart:

(1) *Family-owned companies.* Any company that is a "company covered in 1970," as defined in section 2(b) of the BHC Act, more than 85 percent of the voting securities of which was collectively owned on June 30, 1968, and continuously thereafter, by members of the same family (or their spouses) who are lineal descendants of common ancestors.

(2) *Labor, agricultural, and horticultural organizations.* Any company that was on January 4, 1977, both a bank holding company and a labor, agricultural, or horticultural organization exempt from taxation under section 501 of the Internal Revenue Code (26 U.S.C. 501(c)).

(3) *Companies granted hardship exemption.* Any bank holding company that has controlled only one bank since before July 1, 1968, and that has been granted an exemption by the Board under section 4(d) of the BHC Act, subject to any conditions inposed by the Board.

(4) *Companies granted exemption on other grounds.* Any company that acquired control of a bank before December 10, 1982, without the Board's prior approval under section 3 of the BHC Act, on the basis of a narrow interpretation of the term "demand deposit" or "commercial loan" if the Board has determined that: (i) coverage of the company as a bank holding company under this subpart would be unfair or represent an unreasonable hardship; and (ii) exclusion of the company from coverage under this regulation is consistent with the purposes of the BHC Act and section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)). The provisions of section 225.4 of subpart A of this regulation are not applicable to a company exempt under this paragraph.

§ 225.22 Exempt nonbanking activities and acquisitions.

(a) *Servicing activities.* A bank holding company may, without the Board's prior approval under this subpart, furnish services to or perform services for, or establish or acquire a company that engages solely in furnishing services to or performing services for:

(1) The bank holding company or its subsidiaries in connection with their activities as authorized by law, including services that are necessary to fulfill commitments entered into by the subsidiaries with third parties, if the bank holding company or servicing company complies with the Board's published interpretations and does not act as principal in dealing with third parties; and

(2) The internal operations of the bank holding company or its subsidiaries. Services for the internal operations of the bank holding company or its subsidiaries include, but are not limited to: (i) accounting, auditing, and appraising; (ii) advertising and public relations; (iii) data processing and data transmission services, data bases or facilities; (iv) personnel services; (v) courier services; (vi) holding or operating property used wholly or substantially by a subsidiary in its operations or for its future use; (vii) liquidating property acquired from a subsidiary; (viii) liquidating property acquired from any sources either prior to May 9, 1956, or the date on which the company became a bank holding company, whichever is later; and (ix) selling, purchasing, or underwriting insurance such as blanket bond insurance, group insurance for employees, and property and casualty insurance.

(b) *Safe deposit business.* A bank holding company or nonbank subsidiary may, without the Board's prior approval, conduct a safe deposit business, or acquire voting securities of a company that conducts such a business.

(c) *Nonbanking acquisitions not requiring prior Board approval.* The Board's prior approval is not required under this subpart for the following acquisitions:

(1) *DPC acquisitions.* (i) Voting securities or assets, acquired by foreclosure or otherwise, in the ordinary course of collecting a debt previously contracted ("DPC property") in good faith, if the DPC property is divested within two years of acquisition.

(ii) The Board may, upon request, extend this two-year period for up to three additional one-year periods. The Board may permit additional extensions for up to 5 years (for a total of 10 years), for real estate or other assets that are demonstrated by the bank holding company to have value and marketability characteristics similar to real estate.

(iii) Transfers of DPC property within the bank holding company system do not extend any period for divestiture of the property.

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(2) *Securities or assets required to be divested by subsidiary.* Voting securities or assets required to be divested by a subsidiary at the request of an examining federal or state authority (except by the Board under the BHC Act or this regulation), if the bank holding company divests the securities or assets within two years from the date acquired from the subsidiary.

(3) *Fiduciary investments.* Voting securities or assets acquired by a bank or other company (other than a trust that is a company) in good faith in a fiduciary capacity, if the voting securities or assets are:

(i) Held in the ordinary course of business; and

(ii) Not acquired for the benefit of the company or its shareholders, employees, or subsidiaries.

(4) *Securities eligible for investment by a national bank.* Voting securities of the kinds and amounts explicitly eligible by federal statute (other than section 4 of the Bank Service Corporation Act, 12 U.S.C. 1864) for investment by a national bank, and voting securities acquired prior to June 30, 1971, in reliance on section 4(c)(5) of the BHC Act and interpretations of the Comptroller of the Currency under section 5136 of the Revised Statutes (12 U.S.C. 24(7)).

(5) *Securities or property representing 5 percent or less of a company.* Voting securities of a company or property that, in the aggregate, represent 5 percent or less of the outstanding shares of any class of voting securities of a company or a 5 percent interest or less in the property, subject to the provisions of 12 CFR 225.137.

(6) *Securities of investment company.* Voting securities of an investment company that is solely engaged in investing in securities and that does not own or control more than 5 percent of the outstanding shares of any class of voting securities of any company.

(7) *Assets acquired in the ordinary course of business.* Assets of a company acquired in the ordinary course of business, subject to the provisions of 12 CFR 225.132, if the assets relate to activities in which the acquiring company has previously received Board approval under this regulation to engage in the geographic areas to be served.

(8) *Asset acquisitions by consumer finance or mortgage company or industrial bank.* Assets of an office(s) of a company, all or substantially all of which relate to making, acquiring, or servicing loans for personal, family, or household purposes, if:

(i) The acquiring company has previously received Board approval under this regulation to engage in consumer finance, residential mortgage banking, or industrial banking activities in the geographic areas to be served by the acquired office(s);

(ii) The assets acquired during any twelve-month period do not represent more than 25 percent of the assets (on a consolidated basis) of the acquiring consumer finance company, mortgage company or industrial bank, or more than $25 million, whichever amount is less;

(iii) The assets acquired do not represent more than 50 percent of the selling company's consolidated assets that are devoted to the consumer finance, residential mortgage banking, or industrial banking business;

(iv) The acquiring company notifies the Reserve Bank of the acquisition within 30 days after the acquisition; and

(v) The acquiring company, after giving effect to the transaction, meets the Board's Capital Adequacy Guidelines (Appendix A to Subparts A through E) and the Board has not previously notified the acquiring company that it may not acquire assets under the exemption in this paragraph.

(d) *Acquisition of securities by subsidiary banks.*—(1) *National bank.* A national bank or its subsidiary may, without the Board's approval under this subpart, acquire or retain securities on the basis of section 4(c)(5) of the BHC Act in accordance with the regulations of the Comptroller of the Currency.

(2) *State bank.* A state-chartered bank or its subsidiary may, insofar as federal law is concerned and without the Board's prior approval under this subpart: (i) acquire or retain securities, on the basis of section 4(c)(5) of the BHC Act, of the kinds and amounts explicitly eligible by federal statute for investment by a national bank; or (ii) acquire or retain all (but, except for directors' qualifying shares, not less than all) of the securities of a company that engages solely in activities in which the parent bank may engage, at locations at which the bank may engage in the activity, and subject to the same limitations as if the bank were engaging in the activity directly.

(e) *Activities and securities of new bank holding companies.* A company that becomes a bank holding company may, for a period of two years, engage in nonbanking activities and control voting securities or assets of a nonbank subsidiary, if the bank holding company engaged in such activities or controlled such voting securities or assets on the date it became a bank holding company. The Board may grant requests for up to three one-year extensions of the two-year period.

(f) *Grandfathered activities and securities.* Unless the Board orders divestiture or termination under section 4(a)(2) of the BHC Act, a "company covered in 1970," as defined in section 2(b) of the BHC Act, may:

(1) Retain voting securities or assets and engage in activities that it has lawfully held or engaged in continuously since June 30, 1968; and

(2) Acquire voting securities of any newly-formed company to engage in such activities.

(g) *Securities or activities exempt under Regulation K.* A bank holding company may acquire voting securities or assets and engage in activities as authorized in Regulation K (12 CFR Part 211).

§ 225.23 Procedures for applications, notices, and hearings.

(a) *Application or notice required for nonbanking activities.* An application or notice for the Board's prior approval under § 225.21(a) of this subpart for the following transactions shall be filed by a bank holding company with the appropriate Reserve Bank on the designated form in accordance with the Board's Rules of Procedure (12 CFR 262.2):

(1) *Engaging de novo in listed nonbanking activities.* A notice is required to commence or to engage *de novo,* either directly or through a subsidiary, in a nonbanking activity listed in § 225.25 of this subpart. The applicant may commence the activity 30 days after receipt by the Reserve Bank of the notice unless the Reserve Bank within the 30-day period:

(i) Returns the notice because it is incomplete or requires an application under paragraph (a) (2) or (3) of this section;

(ii) Notifies the company that it may consummate the transaction at an earlier date;

(iii) Extends the 30-day period for an additional 15 days; or

(iv) Refers the notice to the Board for decision because substantive adverse comment is received or it otherwise appears appropriate.

If the 30-day period is extended by the Reserve Bank to request necessary additional information, the 15-day period does not commence until after the Reserve Bank receives the requested information. The Reserve Bank shall promptly send a copy of any notice received under this paragraph to the Board.

(2) *Acquiring a company engaged in listed nonbanking activities.* An application is required to acquire or control voting securities or assets of a company engaged in a permissible

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nonbanking activity listed in § 225.25 of this subpart.

(3) *Engaging in or acquiring a company to engage in unlisted nonbanking activities.* An application is required to commence or to engage *de novo*, or to acquire or control voting securities or assets of a company engaged in, any activity not listed in § 225.25 of this subpart. The application shall contain evidence that the proposed activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

(b) *Notice to expand or alter nonbanking activities.*—(1) *De novo expansion.* A notice under paragraph (a)(1) of this section is required to open a new office or to form a subsidiary to engage in, or to relocate an existing office engaged in, a nonbanking activitiy that the Board has previously approved for the bank holding company under this regulation, only if:

(i) The Board's prior approval was limited geographically;

(ii) The activity is to be conducted in a country outside of the United States and the bank holding company has not previously received prior Board approval under this regulation to engage in the activity in that country; or

(iii) The Board or appropriate Reserve Bank has notified the company that a notice under paragraph (a)(1) of this section is required.

The Board may require an application under paragraph (a)(2) or (a)(3) of this section instead of a notice.

(2) *Activities outside United States.* With respect to activities to be engaged in outside the United States that require approval under this subpart, the procedures of this section apply only to activities to be engaged in directly by a bank holding company that is not a qualifying foreign banking organization or by a nonbank subsidiary of a bank holding company approved under this subpart. Regulation K (12 CFR Part 211) governs other international operations of bank holding companies.

(3) *Alteration of nonbanking activity.* A notice under paragraph (a)(1) of this section is required to alter a nonbanking activity in any material respect from that considered by the Board in acting on the application or notice to engage in the activity. The Board may require an application under paragraph (a) (2) or (3) of this section instead of a notice.

(c) *Accepting application for processing.* Withing 10 business days after the Reserve Bank receives an application under this section, the Reserve Bank shall accept it for processing, request additional information to complete the application, or return the application to the applicant if it is substantially incomplete. If additional information is requested, the Reserve Bank shall, within 5 business days of receipt of the requested information, either accept the application for processing or return the application to the applicant if it is still incomplete. Upon accepting an application, the Reserve Bank shall immediately send copies to the Board.

(d) *Federal Register notice.*—(1) *Listed activities.* Upon receipt by the Reserve Bank of an application or notice involving an activity listed in § 225.25 of this subpart, notice of the application or proposal shall be promptly sent to the **Federal Register** for publication. The **Federal Register** notice shall invite comment for a period of not more than 30 days.

(2) *Unlisted activities.* In the case of an application under this section involving an activity not listed in § 225.25 of this subpart, the Board shall, within 10 business days of acceptance by the Reserve Bank, send notice of the application to the **Federal Register** for publication, unless the Board determines that the applicant has not demonstrated that the activity is so closely related to banking or to managing or controlling banks as to be a proper incident thereto. The Board may extend the 10-day period for an additional 30 calendar days upon notice to the applicant. In the event notice of an application is not published for comment, the Board shall inform the applicant of the reasons for the decision. The **Federal Register** notice shall invite comment on the proposal for a reasonable period of time, generally for 30 days.

(e) *Action on applications.*—(1) *Action under delegated authority.* The Reserve Bank shall approve an application under paragraph (a)(2) of this section within 30 calendar days after it has accepted the application, unless the Reserve Bank, upon notice to the applicant, refers the application to the Board for decision because action under delegated authority is not appropriate. Upon written notice to the applicant, the Reserve Bank may extend the 30-day period for 15 days. If the extension of time is to request necessary additional information, the 15-day period does not commence until the Reserve Bank receives the requested information.

(2) *Board action.* The Board shall act on an application or notice under this secton that is referred to it for decision within 60 calendar days after the Reserve Bank has accepted the application or received the notice, unless the Board notifies the applicant that the 60-day period is being extended for a specified period and explains the reasons for the extension. In no event may the extension exceed the 91-day period specified in paragraph (h) of this section. The Board may request additional information that it believes is necessary for its decision.

(f) *Expedited procedure for small acquisitions.*—(1) *Filing notice.* As an alternative to the application procedure of paragraph (a)(2) of this section, a bank holding company may apply to acquire voting securities or assets of a company engaged in an activity listed in § 225.25 of this subpart by: (i) providing the appropriate Reserve Bank with a description of the transaction; and either (ii) submitting a copy of a newspaper notice in the form prescribed by the Board; or (iii) requesting the Board to publish notice of the application in the **Federal Register**. The newspaper notice shall be published in a newspaper of general circulation in the areas to be served as a result of the acquisition and shall provide an opportunity for interested persons to comment on the application for a period of at least 10 calendar days. If the applicant elects **Federal Register** notice, the notice shall provide an opportunity for interested persons to comment for a period of at least 15 calendar days.

(2) *Criteria for use of expedited procedure.* The procedure in this paragraph is available only if:

(i) Neither the book value of the assets to be acquired nor the gross consideration to be paid for the securities or assets exceeds $15 million;

(ii) The bank holding company has previously received Board approval to engage in the activity involved in the acquisition; and

(iii) The bank holding company meets the Board's Capital Adequacy Guidelines (Appendix A to Subparts A through E).

(3) *Action on application.* Within 5 business days after the close of the comment period specified in the **Federal Register** notice or within 15 calendar days after receipt by the Reserve Bank of the newspaper notice, the Reserve Bank shall either approve the application or refer it to the Board for decision if action under delegated authority is not appropriate. The Board shall act on an application under this paragraph that is referred to it for decision in accordance with paragraph (e)(2) of this section. The Reserve Bank, upon written notice to the applicant, may extend the time period for approval under this paragraph for a reasonable period of time not to exceed 30 days. The Reserve Bank or the Board may require an application under paragraph (a)(2) of this section.

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(g) *Hearing.* Any request for a hearing on an application or notice under this section shall comply with the provisions of § 262.3(e) of the Board's Rules of Procedure (12 CFR 262.3(e)). The Board may order a formal or informal hearing or other proceeding on an application, as provided in § 262.3(i)(2) of the Rules of Procedure (12 CFR 262.3(i)(2)). The Board shall order a hearing only if there are disputed issues of material fact that cannot be resolved in some other manner.

(h) *Approval through failure to act; 91-day rule.* An application or notice under this subpart shall be deemed approved if the Board fails to act on the application or notice within 91 calendar days after the date of submission to the Board of the complete record on the application or notice. The procedures for computation of the 91-day rule as set forth in § 225.14(g) of Subpart B of this regulation apply to applications and notices under this subpart.

(i) *Emergency thrift institution acquisitions.* In the case of an application to acquire a thrift institution, the Board may modify or dispense with the notice and hearing requirements of this section if the Board finds that an emergency exists that requires the Board to act immediately and the primary Federal regulator of the institution concurs.

§ 225.24 Factors considered in acting on nonbanking applications.

In evaluating an application or notice under section 225.23 of this subpart, the Board shall consider whether the performance by the applicant of the activity can reasonably be expected to produce benefits to the public (such as greater convenience, increased competition, the gains in efficiency) that outweigh possible adverse effects (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices). This consideration includes an evaluation of the financial and managerial resources of the applicant, including its subsidiaries, and any company to be acquired, and the effect of the proposed transaction on those resources. Unless the record demonstrates otherwise, the commencement or expansion of a nonbanking activity *de novo* is presumed to result in benefits to the public through increased competition.

§ 225.25 List of permissible nonbanking activities.

(a) *Closely related nonbanking activities.* The activities listed below are so closely related to banking or managing or controlling banks as to be a proper incident thereto and may be engaged in by a bank holding company or a subsidiary thereof in accordance with and subject to the requirements of this regulation.

(b)(1) *Making and servicing loans.* Making, acquiring, or servicing loans or other extensions of credit (including issuing letters of credit and accepting drafts) for the company's account or for the account of others, such as would be made, for example, by the following types of companies: (i) consumer finance; (ii) credit card; (iii) mortgage; (iv) commercial finance; and (v) factoring.

(2) *Industrial banking.* Operating an industrial bank, Morris Plan bank, or industrial loan company, as authorized under state law, so long as the institution is not a bank.

(3) *Trust company functions.* Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law, so long as the institution is not a bank and does not make loans or investments or accept deposits other than:

(i) Deposits that are generated from trust funds not currently invested and that are properly secured to the extent required by law;

(ii) Deposits representing funds received for a special use in the capacity of managing agent or custodian for an owner of, or investor in, real property, securities, or other personal property; or for such owner or investor as agent or custodian of funds held for investment or as escrow agent; or for an issuer of, or broker or dealer in securities, in a capacity such as a paying agent, dividend disbursing agent, or securities clearing agent; provided such deposits are not employed by or for the account of the customer in the manner of a general purpose checking account or interest-bearing account; or

(iii) Making call loans to securities dealers or purchasing money market instruments such as certificates of deposit, commercial paper, government or municipal securities, and bankers acceptances. (Such authorized loans and investments, however, may not be used as a method of channeling funds to nonbanking affiliates of the trust company.)

(4) *Investment or financial advice.* Acting as investment or financial advisor to the extent of:

(i) Serving as the advisory company for a mortgage or a real estate investment trust;

(ii) Serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a–2(a)(20)), to an investment company registered under that act, including sponsoring, organizing, and managing a closed-end investment company;

(iii) Providing portfolio investment advice [1] to any other person;

(iv) Furnishing general economic information and advice, general economic statistical forecasting services and industry studies; [2] and

(v) Providing financial advice to state and local governments, such as with respect to the issuance of their securities.

(5) *Leasing personal or real property.* Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if:

(i) The lease is to serve as the functional equivalent of an extension of credit to the lessee of the property;

(ii) The property to be leased is acquired specifically for the leasing transaction under consideration or was acquired specifically for an earlier leasing transaction;

(iii) The lease is on a nonoperating basis;[3]

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[1] The term "portfolio investment" is intended to refer generally to the investment of funds in a "security" as defined in section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b) or in real property interests, except where the real property is to be used in the trade or business of the person being advised. In furnishing portfolio investment advice, bank holding companies and their subsidiaries shall observe the standards of care and conduct applicable to fiduciaries.

[2] This is to be contrasted with "management consulting," which the Board views as including, but not limited to, the provision of analysis or advice as to a firm's (A) purchasing operations, such as inventory control, sources of supply, and cost minimization subject to constraints; (B) production operations, such as quality control, work measurement, product methods, scheduling shifts, time and motion studies, and safety standards; (C) marketing operations, such as market testing, advertising programs, market development, packaging, and brand development; (D) planning operations, such as demand and cost projections, plant location, program planning, corporate acquisitions and mergers, and determination of long-term and short-term goals; (E) personnel operations, such as recruitment, training, incentive programs, employee compensation, and management-personnel relations; (F) internal operations, such as taxes, corporate organization, budgeting systems, budget control, data processing systems evaluation, and efficiency evaluation; or (G) research operations, such as product development, basic research, and product design and innovation. The Board has determined that "management consulting" is not an activity that is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

[3] For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly: (A) provide for the servicing, repair, or maintenance of the leased vehicle during the lease term; (B) purchase parts and accessories in bulk or for an individual vehicle

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(iv) At the inception of the initial lease the effect of the transaction (and, with respect to governmental entities only, reasonably anticipated future transactions[4]) will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease,[5] from:

(A) Rentals;

(B) Estimated tax benefits (investment tax credit, net economic gain from tax deferral from accelerated depreciation, and other tax benefits with a substantially similar effect);

(C) The estimated residual value of the property at the expiration of the initial term of the lease, which in no case shall exceed 20 percent of the acquisition cost of the property to the lessor; and

(D) In the case of a lease of personal property of not more than seven years in duration, such additional amount, which shall not exceed 60 percent of the acquisition cost of the property, as may be provided by an unconditional guarantee by a lessee, independent third party, or manufacturer, which has been determined by the lessor to have the financial resources to meet such obligation, that will assure the lessor of recovery of its investment and cost of financing;

(v) The maximum lease term during which the lessor must recover the lessor's full investment in the property, plus the estimated total cost of financing the property, shall be 40 years; and

(vi) At the expiration of the lease (including any renewals or extensions with the same lessee), all interest in the property shall be either liquidated or released on a nonoperating basis as soon as practicable but in no event later than two years from the expiration of the lease;[6] however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

(6) *Community development.* Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

(7) *Data processing.* Providing to others data processing and data transmission services, facilities (including data processing and data transmission hardware, software, documentation or operating personnel), data bases, or access to such services, facilities, or data bases by any technological means, if:

(i) The data to be processed or furnished are financial, banking, or economic, and the services are provided pursuant to a written agreement so describing and limiting the services;

(ii) The facilities are designed, marketed, and operated for the processing and transmission of financial, banking, or economic data; and

(iii) The hardware provided in connection therewith is offered only in conjunction with software designed and marketed for the processing and transmission of financial, banking, or economic data, and where the general purpose hardware does not constitute more than 30 percent of the cost of any packaged offering.

(8) *Insurance sales.* Except as prohibited in Title VI of the Garn-St Germain Depository Institutions Act of 1982 (12 U.S.C. 1843(c)(8)), acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:

(i) Any insurance that (A) is directly related to an extension of credit by a bank or bank-related firm of the kind described in this regulation, or (B) is directly related to the provision of other financial services by a bank or such a bank-related firm; and

(ii) Any insurance sold by a bank holding company or a nonbanking subsidiary in a community that has a population not exceeding 5,000 (as shown by the last preceding decennial census), if the principal place of banking business of the bank holding company is located in a community having a population not exceeding 5,000.

(9) *Underwriting Credit Life, Accident and Health Insurance.* Acting as underwriter for credit life insurance and credit accident and health insurance that is directly related to an extension of credit by the bank holding company system.[7]

(10) *Courier services.* Providing courier services for:

(i) Checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

(ii) Audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.[8]

(11) *Management consulting to depository institutions.* Providing management consulting advice [9] to nonaffiliated bank and nonbank depository institutions, including commercial banks, savings and loan associations, mutual savings banks, credit unions, industrial banks, Morris Plan banks, cooperative banks, and industrial loan companies, if:

(i) Neither the bank holding company nor any of its subsidiaries own or control, directly or indirectly, any equity securities in the client institution;

(ii) No management official, as defined in 12 CFR 212.2(h), of the bank holding company or any of its subsidiaries serves as a management official of the client institution, except

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after the lessee has taken delivery of the vehicle; (C) provide for the loan of an automobile during servicing of the leased vehicle; (D) purchase insurance for the lessee; or (E) provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

[4] The Board understands that some federal, state and local governmental entities may not enter into a lease for a period in excess of one year. Such an impediment does not prohibit a company authorized to conduct leasing activities under this paragraph from entering into a lease with such governmental entities if the company reasonably anticipates that the governmental entities will renew the lease annually until such time as the company is fully compensated for its investment in the leased property plus its costs of financing the property. Further, a company authorized to conduct personal property leasing activities under this paragraph may also engage in so-called "bridge" lease financing of personal property, but not real property, if the lease is short-term pending completion of long-term financing, by the same or another lender.

[5] The estimate by the lessor of the total cost of financing the property over the term of the lease should reflect, among other factors: the term of the lease, the modes of financing available to the lessor, the credit rating of the lessor and/or the lessee, if a factor in the financing, and prevailing rates in the money and capital markets.

[6] In the event of a default on a lease agreement prior to the expiration of the lease term, the lessor shall either release the property, subject to all the conditions of this paragraph, or liquidate the property as soon as practicable but in no event later than two years from the date of default on a lease agreement or such additional time as the Board may permit under section 225.22(c)(1) of this regulation, as if the property were DPC property.

[7] To assure that engaging in the underwriting of credit life and credit accident and health insurance can reasonably be expected to be in the public interest, the Board will only approve applications in which an applicant demonstrates that approval will benefit the consumer or result in other public benefits. Normally such a showing would be made by a projected reduction in rates or increase in policy benefits due to bank holding company performance of this service.

[8] See also the Board's interpretation on courier activities (12 CFR 225.129), which sets forth conditions for bank holding company entry into the activity.

[9] A bank holding company that has received the Board's prior approval to engage in offering management consulting advice to nonaffiliated commercial banks as of April 20, 1982, may offer such advice on a *de novo* basis to nonbank depository institutions pursuant to this paragraph without filing an application under section 225.23 of this subpart.

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where such interlocking relationships are permitted pursuant to an exemption granted under 12 CFR 212.4(b);

(iii) The advice is rendered on an explicit fee basis without regard to correspondent balances maintained by the client institution at any depository institution subsidiary of the bank holding company; and

(iv) Disclosure is made to each potential client institution of (A) the names of all depository institutions that are affiliates of the consulting company, and (B) the names of all existing client institutions located in the same county(ies), Metropolitan Statistical Area, or Primary Metropolitan Statistical Area as the client institution.[10]

(12) *Money orders, savings bonds, and travelers checks.* The issuance and sale at retail of money orders and similar consumer-type payment instruments having a face value of not more than $1,000; the sale of U.S. savings bonds; and the issuance and sale of travelers checks.

(13) *Real estate appraising.* Performing appraisals of real estate.

(14) *Arranging commercial real estate equity financing.* Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control and risk of such a real estate project to one or more investors, if:

(i) The financing arranged exceeds $1 million;

(ii) The bank holding company and its affiliates do not provide financing to the investors to acquire a real estate project for which the bank holding company arranges equity financing;

(iii) The bank holding company and its affiliates do not have an interest in or participate in managing, developing or syndicating a real estate project for which it arranges equity financing, and do not promote or sponsor the development or syndication of such property; and

(iv) The fee received for arranging equity financing for a real estate project is not based on profits to be derived from the project and is not larger than the fee that would be charged by an unaffiliated intermediary.

(15) *Securities Brokerage.* Providing securities brokerage services, related securities credit activities pursuant to the Board's Regulation T (12 CFR Part 220), and incidental activities such as offering custodial services, individual retirement accounts, and cash management services, if the securities brokerage services are restricted to buying and selling securities solely as agent for the account of customers and do not include securities underwriting or dealing or investment advice or research services.

(16) *Underwriting and dealing in government obligations and money market instruments.* Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including bankers' acceptances and certificates of deposit, under the same limitations as would be applicable if the activity were performed by the bank holding company's subsidiary member banks or its subsidiary nonmember banks as if they were member banks.

(17) *Foreign exchange advisory and transactional services.* Providing, by any means, general information and statistical forecasting with respect to foreign exchange markets; advisory services designed to assist customers in monitoring, evaluating and managing their foreign exchange exposures; and transactional services with respect to foreign exchange by arranging for "swaps" among customers with complementary foreign exchange exposures and for the execution of foreign exchange transactions; provided the activity is conducted through a separately incorporated subsidiary of the bank holding company that:

(i) Does not take positions in foreign exchange for its own account;

(ii) Observes the standards of care and conduct applicable to fiduciaries with respect to its foreign exchange advisory and transactional services; and

(iii) Does not itself execute foreign exchange transactions.

(18) *Futures commission merchant.* Acting as a futures commission merchant for nonaffiliated persons in the execution and clearance on major commodity exchanges of futures contracts and options on futures contracts for bullion, foreign exchange, government securities, certificates of deposit and other money market instruments that a bank may buy or sell in the cash market for its own account, if the activity is conducted through a separately incorporated subsidiary of the bank holding company that:

(i) Does not become a clearing member of any exchange or clearing association that requires the parent corporation of the clearing member to also become a member of that exchange or clearing association unless a waiver of the requirement is obtained;

(ii) Does not trade for its own account except for the purpose of hedging a cash position in the related government security, bullion, foreign currency, or money market instrument;

(iii) Time stamps orders of all customers to the nearest minute, executes all orders strictly in chronological sequence to the extent consistent with the customers' specifications, and executes all orders with reasonable promptness with due regard to market conditions;

(iv) Does not extend credit to customers for the purpose of meeting initial or maintenance margins required of customers except for posting margin on behalf of customers in advance of prompt reimbursement; and

(v) Has and maintains capitalization fully adequate to meet its own commitments and those of its customers, including affiliates.

Subpart D—Control and Divestiture Proceedings

§ 225.31 Control proceedings.

(a) *Preliminary determination of control.* (1) The Board may issue a preliminary determination of control under the procedures set forth in this section in any case in which:

(i) Any of the presumptions of control set forth in paragraph (d) of this section is present; or

(ii) It otherwise appears that a company has the power to exercise a controlling influence over the management or policies of a bank or other company.

(2) If the Board makes a preliminary determination of control under this section, the Board shall send notice to the controlling company containing a statement of the facts upon which the preliminary determination is based.

(b) *Response to preliminary determination of control.* Within 30 calendar days of issuance by the Board of a preliminary determination of control or such longer period permitted by the Board, the company against whom the determination has been made shall:

(1) Submit for the Board's approval a specific plan for the prompt termination of the control relationship;

(2) File an application under subpart B or C of this regulation to retain the control relationship; or

[10] In performing this activity, bank holding companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. See also the Board's interpretation of bank management consulting advice (12 CFR 225.131). This interpretation shall apply to the performance of management consulting services for commercial banks and any other type of depository institution.

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(3) Contest the preliminary determination by filing a response, setting forth the facts and circumstances in support of its position that no control exists, and, if desired, requesting a hearing or other proceeding.

(c) *Hearing and final determination.* (1) The Board shall order a formal hearing or other appropriate proceeding upon the request of a company that contests a preliminary determination that the company has the power to exercise a controlling influence over the management or policies of a bank or other company, if the Board finds that material facts are in dispute. The Board may also in its discretion order a formal hearing or other proceeding with respect to a preliminary determination that the company controls voting securities of the bank or other company under the presumptions in paragraph (d)(1) of this section.

(2) At a hearing or other proceeding, any applicable presumptions established by paragraph (d) of this section shall be considered in accordance with the Federal Rules of Evidence and the Board's Rules of Practice for Formal Hearings (12 CFR Part 263).

(3) After considering the submissions of the company and other evidence, including the record of any hearing or other proceeding, the Board shall issue a final order determining whether the company controls voting securities, or has the power to exercise a controlling influence over the management or policies, of the bank or other company. If a control relationship is found, the Board may direct the company to terminate the control relationship or to file an application for the Board's approval to retain the control relationship under subpart B or C of this regulation.

(d) *Rebuttable presumptions of control.* The following rebuttable presumptions shall be used in any proceeding under this section:

(1) *Control of voting securities.*—(i) *Securities convertible into voting securities.* A company that owns, controls, or holds securities that are immediately convertible, at the option of the holder or owner, into voting securities of a bank or other company, controls the voting securities.

(ii) *Option or restriction on voting securities.* A company that enters into an agreement or understanding under which the rights of a holder of voting securities of a bank or other company are restricted in any manner controls the securities. This presumption does not apply where the agreement or understanding:

(A) is a mutual agreement among shareholders granting to each other a right of first refusal with respect to their shares;

(B) Is incident to a *bona fide* loan transaction; or

(C) Relates to restrictions on transferability and continues only for the time necessary to obtain approval from the appropriate federal supervisory authority with respect to acquisition by the company of the securities.

(2) *Control over company.*—(i) *Management agreement.* A company that enters into any agreement or understanding with a bank or other company (other than an investment advisory agreement), such as a management contract, under which the first company or any of its subsidiaries directs or exercises significant influence over the general management or overall operations of the bank or other company controls the bank or other company.

(ii) *Shares controlled by company and associated individuals.* A company that, together with its management officials or principal shareholders (including members of the immediate families of either as defined in 12 CFR 206.2(k)), owns, controls, or holds with power to vote 25 percent or more of the outstanding shares of any class of voting securities of a bank or other company controls the bank or other company, if the first company owns, controls, or holds with power to vote more than 5 percent of the outstanding shares of any class of voting securities of the bank or other company.

(iii) *Common management officials.* A company that has one or more management officials in common with a bank or other company controls the bank or other company, if the first company owns, controls or holds with power to vote more than 5 percent of the outstanding shares of any class of voting securities of the bank or other company, and no other person controls as much as 5 percent of the outstanding shares of any class of voting securities of the bank or other company.

(iv) *Shares held as fiduciary.* The presumptions in paragraphs (d)(2) (ii) and (iii) of this section do not apply if the securities are held by the company in a fiduciary capacity without sole discretionary authority to exercise the voting rights.

(e) *Presumption of non-control.* (1) In any proceeding under this section, there is a presumption that any company that directly or indirectly owns, controls, or has power to vote less than 5 percent of the outstanding shares of any class of voting securities of a bank or other company does not have control over that bank or other company.

(2) In any proceeding under this section, or judicial proceeding under the BHC Act, other than a proceeding in which the Board has made a preliminary determination that a company has the power to exercise a controlling influence over the management or policies of the bank or other company, a company may not be held to have had control over the bank or other company at any given time, unless that company, at the time in question, directly or indirectly owned, controlled, or had power to vote 5 percent or more of the outstanding shares of any class of voting securities of the bank or other company, or had already been found to have control on the basis of the existence of a controlling influence relationship.

§ 225.32 Divestiture proceedings.

(a) *Ineffective divestitures.* (1) The divestiture of assets or voting securities by a bank holding company (or a company that would be a bank holding company but for the divestiture) is ineffective, and the divesting company shall be presumed to control the acquiring person or the divested assets or securities, if

(i) The acquiring person is indebted in any manner to the divesting company; or

(ii) The divesting company has any management official in common with the acquiring person.

(2) For the purposes of this section:

(i) "Indebtedness" does not include routine business or personal credit that is unrelated to the divestiture transaction and that is extended by the divesting company in the ordinary course of its lending business; and

(ii) "Divesting company" and "acquiring person" include their parent companies, subsidiaries, and, if the acquiring person is an individual, companies controlled by the individual.

(b) *Request for divestiture determination.* For any divestiture that is deemed ineffective under paragraph (a) of this section, the divesting company may request the Board to determine that the divestiture is in fact effective by submitting a letter that includes:

(1) A description of the divestiture transaction and the existing and prospective relationship between the divesting company and the acquiring person;

(2) Evidence and argument demonstrating that the divesting company is not capable of controlling the acquiring person or the divested assets or securities; and

(3) A request for a hearing, if desired.

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(c) *Hearing.* The Board shall order a formal hearing or other appropriate proceeding upon the request of a divesting company under paragraph (b) of this section, if the Board finds that material facts are in dispute. The Board may also order a formal hearing or other proceeding if, in the Board's judgment, such a proceeding would be appropriate.

(d) *Standards for making divestiture determination.* In acting on the request of a divesting company under paragraph (b) of this section, the Board shall consider the following factors, among others, in determining whether the divesting company is capable of controlling the acquiring person or the divested assets or securities:

(1) *Indebtedness of acquiring person to divesting company.* (i) The terms of the indebtedness, including the amount of the indebtedness in relation to the total purchase price;

(ii) The ability of the acquiring person to repay the indebtedness; and

(iii) The manner in which the divesting company would dispose of the divested assets in the event it reacquires the assets as a result of default on the indebtedness.

(2) *Management official interlocks.* The extent of the involvement of the interlocking management official in the operations of the divesting company and the acquiring person, and the management official's relationship to the assets or securities being divested.

(e) *Final determination.* After considering the submission of the divesting company and other evidence, including the record of any hearing or other proceeding, the Board shall issue an order determining whether the company controls or is capable of controlling the acquiring person or the divested assets or securities.

(f) *Review of other divestitures.* In any divestiture of assets or securities by a company that is not covered under paragraph (a) of his section, the Board may review the divestiture to assure that the divesting company is not capable of controlling the acquiring person or the divested assets or securities.

Subpart E—Change in Bank Control

§ 225.41 Transactions requiring prior notice.

(a) *Prior notice requirement.* (1) Any person acting directly or indirectly, or through or in concert with one or more persons, shall give the Board 60 days' written notice, as specified in § 225.43 of this subpart, before acquiring control of a state member bank or bank holding company, unless the acquisition is exempt under § 225.42 of this subpart.

(2) For the purposes of this subpart, "acquisition" includes a purchase, assignment, transfer, or pledge of voting securities, or an increase in percentage ownership of a bank or other company resulting from a redemption of voting securities.

(b) *Acquistions requiring prior notice.* The following transactions constitute, or are presumed to constitute, the acquisition of control under the Bank Control Act, requiring prior notice to the Board:

(1) the acquisition of any voting securities of a state member bank or bank holding company if, after the transaction, the acquiring person (or persons acting in concert) owns, controls, or holds with power to vote 25 percent or more of any class of voting securities of the institution; or

(2) the acquisition of any voting securities of a state member bank or bank holding company if, after the transaction, the acquiring person (or persons acting in concert) owns, controls, or holds with power to vote 10 percent or more (but less than 25 percent) of any class of voting securities of the institution, and if:

(i) the institution has registered securities under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*); or

(ii) no other person will own a greater percentage of that class of voting securities immediately after the transaction.

(c) *Rebuttal of presumption of control.* Prior notice to the Board is not required for any acquisition of voting securities under the presumption set forth in paragraph (b)(2) of this section, if the Board finds that the acquisition will not result in control. The Board will afford the person seeking to rebut the presumption an opportunity to present views in writing or, if appropriate, orally before its designated representatives at an informal conference.

(d) *Other transactions.* Transactions other than those set forth in paragraph (b)(2) resulting in a person's control of less than 25 percent of a class of voting securities of a state member bank or bank holding company do not result in control for purposes of the Bank Control Act.

§ 225.42 Transactions not requiring prior notice.

The following transactions do not require prior notice to the Board under this subpart:

(a) *Increase of previously authorized acquisitions.* The acquisition of additional shares of a class of voting securities of a state member bank or bank holding company by any person who has lawfully acquired and maintained control of 25 percent or more of that class of voting securities after filing the notice required under § 225.41(b)(1) of this subpart.

(b) *Acquisitions subject to approval under BHC Act or Bank Merger Act.* Any acquisition of voting securities subject to approval under section 3 of the BHC Act (§ 225.11 of subpart B), or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 U.S.C. 1828(c)).

(c) *Transactions exempt under BHC Act.* Any acquisition described in sections 2(a)(5) or 3(a) (A) or (B) of the BHC Act (12 U.S.C. 1841(a)(5), 1842(a) (A) and (B)) by a person described in those provisions.

(d) *Grandfathered control relationships.* (1) The acquisition of additional voting securities of a state member bank or bank holding company by a person who continuously since March 9, 1979 (or since that institution commenced business, if later) held power to vote 25 percent or more of any class of voting securities of that institution; or

(2) the acquisition of additional voting securities of a state member bank or bank holding company by a person who is presumed under § 225.41(b)(2) of this subpart to have controlled the institution continuously since March 9, 1979, if the aggregate amount of voting securities held does not exceed 25 percent of any class of voting securities of the institution.

(e) *Acquisitions in satisfaction of debts previously contracted or through inheritance or gift.* Any acquisition of voting securities, which would otherwise require a notice under this subpart, in satisfaction of a debt previously contracted in good faith, or through inheritance or a *bona fide* gift, if the acquiring person notifies the appropriate Reserve Bank within 30 calendar days after the acquisition and provides any relevant information requested by the Reserve Bank.

(f) *Proxy solicitation.* The acquisition of the power to vote securities of a state member bank or bank holding company through receipt of a revocable proxy in connection with a proxy solicitation for the purpose of conducting business at a regular or special meeting of the institution, if the proxy terminates within a reasonable period after the meeting.

(g) *Stock dividends.* The receipt of voting securities of a state member bank or bank holding company through a stock dividend or stock split if the proportional interest of the recipient in

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the institution remains substantially the same.

(h) *Acquisition of foreign banking organization.* The acquisition of voting securities of a qualifying foreign banking organization. (This exemption does not extend to the reports and information required under paragraphs 9, 10, and 12 of the Bank Control Act (12 U.S.C. 1817(j)(9), (10), and (12)).

§ 225.43 Procedures for filing, processing, and acting on notices.

(a) *Filing notice.* a notice required under this subpart shall be filed with the appropriate Reserve Bank and shall contain the information required by paragraph 6 of the Bank Control Act (12 U.S.C. 1817(j)(6)), or prescribed in the designated Board form. With respect to personal financial statements required by paragraph 5(B) of the Bank Control Act, an individual may include a statement of assets and liabilities as of a date within 90 days of filing the notice, a brief income summary, and a description of any subsequent material changes, subject to the authority of the Reserve Bank or the Board to require additional information.

(b) *Advice to bank supervisory agencies.*—(1) Upon accepting a notice relating to acquisition of securities of a state member bank, the Reserve Bank shall send a copy of the notice to the appropriate state bank supervisor, which shall have 30 calendar days from the date the notice is sent in which to submit its views and recommendations to the Board. The Reserve Bank shall also send a copy of any notice it accepts to the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

(2) If the Board finds that it must act immediately in order to prevent the probable failure of the bank or bank holding company involved, the Board may dispense with or modify the requirements for notice to the state supervisor.

(c) *Time period for Board action.*—(1) *Consummation of acquisition.* (i) A proposed acquisition may be consummated 60 days after submission to the Reserve Bank of a complete notice under paragraph (a) of this section, unless within that period the Board disapproves the proposed acquisition or extends the 60-day period as provided under paragraph (c)(2) of this section.

(ii) A proposed acquisition for which notice has been filed under paragraph (a) of this section may be consummated before the expiration of the 60-day period if the Board notifies the acquiring person in writing of the Board's intention not to disapprove the acquisition.

(2) *Extensions of time period.* (i) The Board may extend the 60-day period in paragraph (c)(1) of this section for an additional 30 days by notifying the acquiring person.

(ii) The Board may further extend the period for disapproval or return the notice, if the Board finds that the acquiring person has not furnished all the information required under paragraph (a) of this section or has submitted material information that is substantially inaccurate. If the Board so extends the time period, it shall notify the acquiring person of the information that is incomplete or inaccurate.

(d) *Investigation of notice.* In investigating any notice accepted under this subpart, the Board or Reserve Bank may solicit information or views from any person (including any bank or bank holding company involved in the notice, and any appropriate state, federal or foreign governmental authority). No person (other than the acquiring person), whose views are solicited or who presents information, thereby becomes a party to the proceeding or acquires any standing or right to participate in the Board's consideration of the notice.

(e) *Factors considered in acting on notices.* In reviewing a notice filed under this subpart, the Board shall consider the information in the record, the views and recommendations of the appropriate bank supervisor, and any other relevant information obtained during any investigation of the notice. The Board may disapprove an acquisition if it finds adverse effects with respect to any of the factors set forth in paragraph 7 of the Bank Control Act (12 U.S.C. 1817(j)(7)) (*i.e.*, competitive, financial, managerial, banking or incompleteness of information).

(f) *Disapproval and hearing.* Within three days after its decision to issue a notice of intent to disapprove any proposed acquisition, the Board shall notify the acquiring person in writing of the reasons for the action. Within 10 calendar days of receipt of the notice of the Board's intent to disapprove, the acquiring person may submit a written request for a hearing. Any hearing conducted under this paragraph shall be in accordance with the Rules of Practice for Formal Hearings (12 CFR Part 263). At the conclusion of the hearing, the Board shall, by order, approve or disapprove the proposed acquisition on the basis of the record of the hearing. If the acquiring person does not request a hearing, the notice of intent to disapprove becomes final and unappealable.

Appendices to Subparts A Through E

Appendix A—Capital Adequacy Guidelines

Definition of Capital To Be Used in Determining Capital Adequacy of National and State Member Banks and Bank Holding Companies

Primary Components of Capital

The primary components of capital are:
—Common stock
—Perpetual preferred stock
—Surplus
—Undivided profits
—Contingency and other capital reserves
—Mandatory convertible instruments (capital instruments with covenants mandating conversion into common or perpetual preferred stock)
—Allowance for possible loan and lease losses
—Minority interest in equity accounts of consolidated subsidiaries

Secondary Components of Capital

It is recognized that other financial instruments can, with certain restrictions, be considered as part of capital because they possess some, though not all, of the features of capital. These instruments are:
—Limited-life preferred stock
—Bank subordinated notes and debentures and unsecured long-term debt of the parent company and its nonbank subsidiaries

Restrictions Relating to Secondary Components

The secondary components will be considered as capital under the conditions listed below:
—The issue must have an original weighted average maturity of at least seven years
—If the issue has a serial or installment repayment program, all scheduled repayments shall be made at least annually, once contractual repayment of principal begins, and the amount repaid in a given year shall be no less than the amount repaid in the previous year
—For banks only, the aggregate amount of limited-life preferred stock and subordinated debt qualifying as capital may not exceed 50 percent of the amount of the bank's primary capital
—As the secondary components approach maturity, redemption or payment, the outstanding balance of all such instruments—including those with serial note payments, sinking fund provisions, or an amortization schedule—will be amortized in accordance with the following schedule:

Years to maturity	Percent of issue considered capital
Greater than or equal to 5	100
Less than 5 but greater than or equal to 4	80
Less than 4 but greater than or equal to 3	60
Less than 3 but greater than or equal to 2	40
Less than 2 but greater than or equal to 1	20

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Years to maturity	Percent of issue considered capital
Less than 1	0

(No adjustment in the book amount of the issue is required or expected by this schedule. Adjustment will be made by a memorandum account.)

Minimum Capital Guidelines

The Federal Reserve and the Office of the Comptroller of the Currency have developed minimum capital guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks and bank holding companies.[1] The guidelines are used in the examination and supervisory process and will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices.

Objectives of the minimum capital guidelines are to:

—Introduce greater uniformity, objectivity and consistency into the supervisory approach for assessing capital adequacy;
—Provide direction for capital and strategic planning to banks and bank holding companies and for the appraisal of this planning by the agencies; and
—Permit some reduction of existing disparities in capital ratios between banking organizations of different size.

Two principal ratio measurements of capital are used: (1) primary capital to total assets; and, (2) total capital to total assets. Primary capital consists of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments, the allowance for possible loan and lease losses, and any minority interest in the equity accounts of consolidated subsidiaries. Total capital includes the primary capital components plus limited-life preferred stock and qualifying notes and debentures.

The capital guidelines generally will be applied on a consolidated basis. However, for those bank holding companies with consolidated assets under $150 million, the capital guidelines will apply only to the bank if: (1) the company does not engage directly or indirectly in any nonbanking activity involving significant leverage; and, (2) no significant debt of the parent company is held by the general public.

Some bank holding companies are engaged in significant nonbanking activities that require capital ratios higher than those for the bank alone. In these cases, appropriate adjustments will be made in the application of the consolidated capital guidelines.

Institutions affected by the guidelines are categorized as either multinational organizations (as designated by their respective supervisory agency); regional organizations (all other institutions with assets in excess of $1 billion)[2]; or community organizations (less than $1 billion in total assets).

A minimum level of primary capital to total assets is established at 5 percent for multinational and regional organizations and 6 percent for community organizations. Generally, banking organizations are expected to operate above the minimum primary capital levels. Also, those banking organizations that have a higher than average percentage of their assets exposed to risk, or have a higher than average amount of off-balance sheet risk, may be expected to hold additional primary capital to compensate for this risk.

The agencies also have established capital guidelines for the total capital to total assets ratio. These guidelines consist of three broad zones:

	Multinational and regional	Community
Zone 1	Above 6.5 percent	Above 7.0 percent.
Zone 2	5.5 percent to 6.5 percent.	6.0 to 7.0 percent.
Zone 3	Below 5.5 percent	Below 6.0 percent.

Generally, the nature and intensity of supervisory action will be determined by the zone in which an institution falls. While an institution's position in the quantitative capital zones will normally trigger the below specified supervisory responses, qualitative analysis will continue to be used in determining minimum levels of capital for banking institutions.

For banking institutions operating in Zone 1, the agencies will:

—Presume that capital is adequate if the primary capital ratio is acceptable to the regulator and is above the minimum level;
—Intensify analysis and action when unwarranted declines in capital ratios occur.

For banking institions operating in Zone 2, the agencies will:

—Presume that the institution may be under-capitalized, particularly if the primary and total capital ratios are at or near the minimum guidelines;
—Engage in extensive contact and discussion with the management and require the submission of comprehensive capital plans acceptable to the regulator;
—Closely monitor the capital position over time.

The agencies' approach to insitutions operating in Zone 3 will include:

—A very strong presumption that the institutions is under-capitalized;
—Frequent contact with management and a requirement that the institution submit a comprehensive capital plan, including a capital augmentation program that is acceptable to the regulator;
—Continuous analysis, monitoring and supervision.

The guidelines will be applied in a flexible manner with exceptions as appropriate. The assessment of capital adequacy will continue to be made on a case-by-case basis considering various qualitative factors that affect an institution's overall financial condition. Thus, the agencies retain the flexibility to make appropriate adjustments in the application of the guidelines to individual institutions.

Appendix B—Policy Statement for Formation of Small One-Bank Holding Companies

Assessment of Financial Factors

In acting on applications filed under the Bank Holding Company Act, the Board has adopted, and continues to follow, the 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.

The Board believes that a high level of debt at the parent holding company level impairs the ability of a bank holding company to provide financial assistance to its subsidiary bank and in some cases the servicing requirements on such debt may be a significant drain on the bank's resources. For these reasons, the Board has not favored the use of acquisition debt in the formation of bank holding companies. Nevertheless, the Board has recognized that the transfer of ownership of small 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 multibank 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.

In the interest of furthering its policy of facilitating the transfer of ownership in banks without diluting bank safety and soundness, the Board has reexamined the analytical framework and financial criteria it applies when considering the formation of small one-bank holding companies and has adopted certain revisions in its procedures and standards as described below.

The revised criteria shift the focus from debt repayment to the relationship between debt and equity at the parent holding company. The holding company will have the option of improving the relationship of debt to equity by repaying the principal amount of its debt or through the retention of earnings, or both. Under these procedures, newly organized small one-bank holding companies will 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 multibank holding companies.

In general, this policy is intended to apply only to one-bank holding companies that would not have significant leveraged nonbank activities and whose subsidiary bank would have total assets of

[1] Institutions that are under special supervision and those that have been in operation for less than two years are not included in the program.

[2] May include some other institutions located money centers.

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approximately $150 million or less at the time the application is filed. Small one-bank holding companies formed before the initial effective date of the Board's policy concerning formation of small one-bank holding companies and assessment of financial factors (March 28, 1980) may switch to a plan that adheres to the intent of this policy provided they comply with criteria 2, 3, and 4 set forth below.

The criteria are as follows:

General

In evaluating applications filed pursuant to section 3(a)(1) of the Bank Holding Company Act, as amended, when 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 require applicants to meet the minimum requirements set forth below. As a general rule, failure to meet any of these requirements will result in denial of the application; however, the Board reserves the right to make exceptions if the circumstances warrant.

1. *Minimum Down Payment.* The amount of acquisition debt should not exceed 75 percent of the purchase price of the bank to be acquired. When the owner(s) of the holding company incur debt to finance the purchase of the bank, such debt will be considered acquisition debt even though it does not represent an obligation of the bank holding company, unless the owner(s) can demonstrate that such debt can be serviced without reliance on the resources of the bank or bank holding company.

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 subsidiary bank's ratio of gross capital to assets to fall below 8 percent during the 12-year period following consummation of the acquisition. 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 parent holding company's ratio of debt to equity will decline to 30 percent within 12 years after consummation of the acquisition. The holding company must also demonstrate that it will be able to safely meet debt servicing and other requirements imposed by its creditors.

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

The term "equity," 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" (defined as 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.

Ordinarily the Board does not view redeemable preferred stock as a substitute for common stock in a one-bank holding company formation. Nevertheless, to a limited degree and under certain circumstances the Board will consider redeemable preferred stock as equity in the capital accounts of the holding company if the following conditions are met: (1) The preferred stock is redeemable only at the option of the issuer and (2) the debt to equity ratio of the holding company would be at or remain below 30 percent following the redemption or retirement of any preferred stock. Preferred stock that is convertible into common stock of the holding company may be treated as equity.

4. *Dividend Restrictions.* The bank holding company is not expected to pay any corporate dividends on common stock until such time as its debt to equity ratio is below 30 percent. However, some dividends may be permitted provided all of the following conditions are met: (a) The applicant has begun making scheduled repayments of principal on the acquisition debt; (b) such scheduled repayments of principal are reasonable in amount, will be made at least annually, and will allow for the retirement of the acquisition debt over a period not to exceed 25 years; and (c) the applicant can clearly demonstrate at the time the application is filed that such dividends will not jeopardize the ability of the holding company to reduce its debt to equity ratio to 30 percent within 12 years of consummation of the proposal or cause the gross capital to assets of the subsidiary bank to fall below 8 percent over the same period. Also, it is expected that dividends will be eliminated if the holding company is not meeting the projections made at the time the application was filed regarding the ability of the holding company to reduce the debt to equity ratio to 30 percent within 12 years of consummation of the proposal.

The requirements of this Policy Statement should be read in the context of the Board's Capital Adequacy Guidelines (Appendix A), including the definitions of capital and its components.

Effective date: This revision of Part 225 becomes effective February 6, 1984, except for section 225.14 and 225.23, which become effective for all applications and notices submitted to the Board on and after January 1, 1984.

By order of the Board of Governors of the Federal Reserve System, December 29, 1983.

William W. Wiles,

Secretary of the Board.

Supplementary Information, Appendix A

(Note.—This is an appendix to the Supplementary Information section in the preamble. This appendix will not appear in the Code of Federal Regulations.)

The proposed revision of Regulation Y included the following definition of "bank":

Any institution organized under the laws of the United States that accepts demand deposits and engages in the business of making commercial loans.

This definition essentially reiterates the two-pronged definition of bank in section 2(c) of the BHC Act, which defines a "bank" as "any organization * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." [1] The bank definition is the key to the Act because it supplies the basis for effecting the fundamental purposes for which the legislation was enacted: (1) the separation of the business of banking from commerce to assure impartiality in the granting of credit and avoidance of conflicts of interest; (2) the limitation of risk to the banking system inherent in the unlimited association of banking and commerce; and (3) the prevention of concentration of banking resources.

In order to clarify the coverage of the bank definition consistent with these policies, the Board has interpreted the terms "deposits that the depositor has a legal right to withdraw on demand" [2] and "commercial loans" in section 2(c) of the Act. In approving an application by a bank holding company under the Act to acquire an industrial loan company that offered NOW accounts and made commercial loans, the Board interpreted the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act to include NOW accounts. *First Bancorporation (Beehive Thrift and Loan)*, 68 Federal Reserve Bulletin 253 (1982).

[1] 12 U.S.C. 1841(c). There are a number of statutory exemptions to this definition, *e.g.*, for FSLIC insured thrift institutions.

[2] Hereinafter "demand deposit."

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Similarly, in reviewing a proposal to acquire an FDIC insured state bank by The Dreyfus Corporation, a nonbanking organization engaged in the underwriting and sale of securities, the Board reiterated its view that the term commercial loan in section 2(c) of the Act means any loan the proceeds of which are used for other than personal, family, household, or charitable purposes. The Board also determined that, for this purpose, commercial loans include the purchase of commercial paper, bankers acceptances, and certificates of deposit, and the sale of federal funds and other transactions that establish a debtor-creditor relationship. Letter of December 10, 1982, to the FDIC.

The proposed amendments would incorporate the Board's interpretations into Regulation Y. A number of commenters opposed the definitions. The Independent Bankers Association favored the definitions, and the American Bankers Association supported the proposed definition of "commercial loan."

After careful consideration of the comments, the Board has determined to adopt the "bank" definition with minor modifications, including its interpretations of the terms demand deposit and commercial loan. The Board believes that these interpretations are both necessary and appropriate to carry out the fundamental purposes of the Act. In the Board's judgment, any other interpretation of these important terms would produce a result that is plainly at variance with the purposes of the Act and would preempt Congressional discretion to determine the proper delineation between banking and commerce in this country as well as the scope for interstate banking. The Board's interpretation of the bank definition is directed, towards this end, consistent with its authority under section 5(b) of the Act to issue rules and regulations.

As originally enacted, the BHC Act defined "bank" as "any national banking association, or any State bank, savings bank, or trust company. * * *" In 1966, Congress eliminated this charter test in favor of the functional demand deposit test. The legislative history of these amendments indicates that Congress intended to cover all checking accounts as demand deposits and did not intend to exempt from the definition of "bank" institutions that function like banks. Congress viewed the ability to offer checking accounts as critical in determining whether an institution meets the "demand deposit" portion of the Act's definition of bank and intended demand deposits to include all checking accounts.

In 1970, Congress again amended the Act by adding a second requirement for bank status: that the institution also be engaged in the business of making commercial loans. The Board did not propose the amendment in 1970, which limited the definition of bank to those institutions that accept demand deposits and make "commercial loans," although the Board offered no objection to the amendment because it was intended to be narrow in scope, possibly exempting only a single company—Boston Safe Deposit and Trust.[3] The Board's view is reflected in a letter from Federal Reserve Chairman Burns to Chairman Sparkman of the Senate Banking and Currency Committee:

"* * * S. 3823 would amend the definition of "bank" to exclude banks that make no commercial loans. To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution. Since there is less need for concern about preferential treatment in extending credit where no commercial loans are involved, and in view of the very limited application of this amendment, the Board would have no objection to its adoption.[4]

The House conferees agreed to the change of the definition of "bank" (not present in the House passed bill), but the majority of the House conferees cautioned that the Board should construe the 1970 exemptions from the Act "as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest, will, in fact, be covered."[5]

These modifications to the definition of bank in the Act were designed to exclude from coverage under the Act savings banks, trust companies and industrial banks.[6] In both 1966 and 1970, savings banks, trust companies and industrial banks bore little resemblance to commercial banks because these three types of entities did not have bank charters or their activities were confined to fiduciary activities, the taking of savings and time deposits, and the making of home mortgages and consumer loans.

Between 1970 and 1981, the exemption remained within the narrow confines intended by Congress. However, since 1980, the powers of industrial banks have substantially expanded and they are eligible for FDIC insurance, making them for all intents and purposes banks. More importantly, a large number of insurance, securities, industrial and commercial organizations have acquired FDIC insured national or state banks.[7] These acquisitions have been accomplished through the device of divesting a portion of the acquired bank's commercial loan portfolio and continuing to accept demand deposits or through giving up the taking of demand deposits but continuing to make commercial loans. Both techniques are premised on a narrow interpretation of the terms demand deposits and commercial loans in section 2(c) of the Bank Holding Company Act.

These so-called "nonbank banks" acquired through this device continue to take deposits from the public, to make loans, to enjoy the benefits of discount window access and federal deposit insurance, and to have access to the payments system. They remain for all practical purposes banks, but are not subject to the prudential limitations that Congress deemed essential when banks are affiliated with commercial enterprises. Indeed, the charter powers of a "nonbank bank" are identical to those of a full service commercial bank—and it is only different to the extent that the nonbank bank *voluntarily* chooses not to offer commercial loans or demand deposits under a narrow definition of those terms.

Acquisitions of this nature and in the numbers that have occurred were not contemplated by the 1970 Amendments. As noted above, the Board advised Congress that it believed the exemption would be of "very limited application," and the House Conferees admonished the Board to construe the exemption "narrowly." Such a construction is consistent with the broad expansion of the Act's coverage accomplished by the 1970 Amendments to encompass partnerships, one bank holding companies, and control relationships based on a controlling influence. Indeed, the desire to prevent evasion of the Act's purposes in 1970 was sufficiently pervasive for Congress to reject a proposed exemption for very small banks which had no more than $3

[3] 116 Congressional Record S. 6908, 6911 (daily ed. May 11, 1970; 116 Congressional Record H. 7207 (daily ed. July 27, 1970; 116 Congressional Record S. 20642 (daily ed. December 18, 1970).

[4] One Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1664, S. 3823; and H.R. 6778, before the Senate Committee on Banking & Currency, 91st Cong., 2d Sess. 137 (1970).

[5] Statement of the Managers on the Part of the House, H. Rep. No. 1747, 91st Congress, 2d Sess. 23 (1970).

[6] S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966); S. Rep. No. 91–1084, 91st Cong. 2d Sess. 24 (1970).

[7] Since 1980, there have been a number of acquisitions of insured banks by insurance, securities, commercial and industrial companies.

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million in net worth.[8] It is inconsistent with the Congressional intent as expressed in the Act to suggest that at the same time Congress substantially expanded the Act's coverage to ensure the separation of banking and commerce, it took the significant step, almost without debate, of creating a new class of depository institution that could be acquired by all types of nonbanking organizations.

The primary impetus for the 1970 Amendments were two events that occurred in the late 1960s. First, the largest banks in the nation sought to use the then existing one bank holding company exemption to form holding companies and commence various nonbanking activities, at times through the acquisition of going concerns such as large insurance companies. At the same time, large nonbanking organizations such as manufacturing firms, insurance companies, and retailers began to acquire single banks. Congress sought to block both of these trends through the 1970 Amendments.[9] The recent acquisition of banks by large commercial enterprises such as insurance, securities, and industrial companies is completely inconsistent with expressed Congressional intention to prevent such affiliations.[10]

In recognition of the unique and critical role that banks play in the nation's financial system and economy with respect to operation of the payments system, as custodians of the bulk of liquid savings, and as suppliers of credit, Congress has provided these institutions with access to the Federal Reserve as a lender of last resort, and access to federal deposit insurance. However, as a consequence of this special status, banks are subject to prudential limitations designed to limit risk, promote sound operations, assure impartiality in the credit granting process, and prevent excessive concentration of credit resources. The Bank Holding Company Act represents one of the principal mechanisms for accomplishing these goals through its limitations on the commingling of banking and commerce and the concentration of banking resources.

The framework of regulation created by the Bank Holding Company Act is frustrated, however, to the extent that institutions engaged in banking functions are allowed to secure the benefits of bank status while at the same time their corporate parents evade the prudential limitations on the scope of nonbanking activities that Congress established in the Bank Holding Company Act. Moreover, this situation threatens to undermine the system of bank holding company regulation as a whole since bank holding companies that are subject to the Act's prudential limitations are placed at an increasing competitive disadvantage with respect to the securities, insurance, manufacturing and retail companies that own "nonbank banks" and that are free to establish synergistic relationships between their banking and impermissible nonbanking operations.

It has been suggested that these nonbank bank institutions that are chartered as banks are not engaged in demand deposit taking or indirect commercial lending to customers or clients of the bank and therefore the nonbanking activities of their affiliates do not raise the policy concerns that the Act was intended to address. However, as indicated in more detail below, these banks raise the same prudential problems as other banks and, in fact, the operating techniques used by nonbank banks do amount to the taking of demand deposits and the making of commercial loans. Moreover, the Board is also concerned with the difficulty of assuring the enforcement of a self-imposed limitation on direct commercial lending where, for example, close links associated with the common control would be established between the demand deposit-taking function of the nonbank bank and commercial lending activities conducted through separate corporate subsidiaries of the parent organization.

The possibility of "understandings" involving the placing of funds derived from deposit taking by nonbank banks with banking institutions that would agree to take a favorable view toward lending to the nonbank bank's industrial or commercial affiliates would circumvent the purposes of the Act and pose serious enforcement problems. Similarly, as is discussed below, a nonbank bank could lend to consumers on terms aimed at furthering the purchase of goods or services from affiliates of the nonbank banks. The Act was designed to deal with the potential abuses that could result from concentration of resources and/or from conflicts of interest that inherently arise in the common ownership of banks and commercial organizations, and the potential for these abuses is clearly present in the relationship between nonbank banks and their corporate parents and affiliates.

The legislative history of the Act confirms the fact that Congress was concerned about the use of banking powers in tandem with other commercial and industrial enterprises even where these powers were used exclusively for so-called consumer lending. Congress believed that banks exercising these powers should be covered by the Act to assure impartiality in lending and prevent the cartelization of industry and commerce around banks. The 1970 report of the Senate Committee on Banking and Currency quotes, and indicates agreement with, the following remarks by former Federal Reserve Chairman Martin:

> If a holding company combines a bank with a typical business firm, there is a strong possibility that the bank's credit will be more readily available to the customers of the affiliated business than to customers of other businesses not so affiliated. Since credit has become increasingly essential to merchandising, the business firm that can offer an assured line of credit to finance its sales has a very real competitive advantage over one that cannot * * * [I]f we allow the line between banking and commerce to be eased, we run the risk of cartelizing our economy. Just as we have seen the country's largest banks join the new wave of one-bank holding companies, we could later see the country's business firms clustering about banks in holding company systems in the belief that such an affiliation would be advantageous, or perhaps even necessary to their survival.[11]

The Congressional concern that banks which were affiliated with other businesses might make loans designed to further the interests of those affiliates is also evidenced in section 4(d) of the Act. This section allows the Board to grant exemptions from the nonbanking prohibitions of the Act for certain companies, including those whose subsidiary banks are so small "as to minimize the likelihood that the bank's powers to grant or deny credit may be influenced by a desire to further the holding company's other interests." 12 U.S.C. § 1843(d). While Congress was prepared to concede that there could be cases where a bank was so small as not to create a situation that was inconsistent with the basic purposes of the Act, it deliberately avoided a blanket size exemption and instead

[8] Statement of The Managers on the Part of the House, *supra* at 23.

[9] Statement of the Managers on the Part of the House, *supra*, at 11; S. Rep. No. 1084, *supra*, at 2–3; Cong. Rec. S 1696 (1969) (Remarks of Sen. Proxmire); Cong. Rec. H 9776–77 (1969) (Remarks of Cong. Patman).

[10] Moreover, many of the "nonbank banks" that nonbanking companies have formed differ significantly from the institution for which the exemption was written, since Boston Safe was primarily engaged in trust company business in 1970.

[11] S. Rep. No. 1084, *supra*, at 3.

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conferred the exemption judgment exclusively on the Board.

The nonbank bank device allows precisely the conflicts of interest and other adverse effects that Congress sought to prohibit in 1970. A nonbank bank is able to make commercial loans by purchasing such instruments as commercial affiliate bank. 12 CFR 225.4(c) (1983). Under the narrow interpretation of commercial loan relied on by nonbank banks, not only are the activities of the parent of the nonbank bank unlimited, but the nonbank bank itself is free to require that prospective borrowers buy insurance, securities or other goods and services from those affiliates in order to receive an extension of credit from the nonbank bank. The Board believes that the ability of nonbank banks to engage in such coercive practices in order to provide a competitive advantage for their affiliates creates serious competitive inequalities and significantly undermines the structure designed by Congress for the regulation of the nonbanking activities of banks and their holding company affiliates.

In addition, the proliferation of nonbank banks would allow for the expansion of banking across state lines without either state authorization or Congressional approval as is now required by law. While the Board has supported a Congressional reevaluation of the present ban on interstate acquisitions without state approval, interstate acquisitions of so-called nonbank banks would violate both the letter and clear intent of the Douglas Amendment.

In this context the Board has reexamined its interpretation of the terms demand deposits and commercial loan in light of the comments received from the public.

Definition of Demand Deposits. The final amendments interpret the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act as "any deposit with transactional capability that as a matter of practice is payable on demand and that the depositor may withdraw by check, draft, negotiable order of withdrawal, or other similar instrument for payment to third parties."

Several commenters objected to the Board's definition of demand deposits as contrary to the traditional treatment of NOW accounts as savings deposits. These commenters argued that, because institutions offering NOW accounts are required to reserve the right to require 14 days' prior notice of withdrawals, the accounts are not in fact demand deposits. The commenters also objected to the proposed definition as inconsistent with legislative history indicating that certain institutions that currently offer NOW accounts, such as industrial banks and industrial loan companies, were not intended to be treated as banks.

The Board believes, however, that traditional interpretations of the term demand deposits, the regulatory treatment of accounts with transactional capability, the functional equivalency of demand deposits and NOW accounts, and the legislative history and purposes of the Bank Holding Company Act require that NOW and similar accounts be treated as demand deposits for purposes of the BHC Act. The legislative history and purposes demonstrate that the term demand deposits in section 2(c) of the Act cannot be interpreted to turn on the technicality of whether the account is subject to a notice of withdrawal requirement that in practice is never imposed. Such an interpretation would permit the fundamental purposes of the Act to be circumvented or rendered meaningless simply through the offering of checking accounts that perform the same function as demand deposits, that are advertised as checking accounts, and that for all intents and purposes are the equivalent of a conventional demand checking deposit, but that are not treated as demand checking deposits only because they are subject to a never exercised right of the depository institution to require prior notice of withdrawals. It is a fundamental principle of statutory construction that a statute must be interpreted to give effect to its purposes and to avoid an absurd or unreasonable result. *United States* v. *American Trucking Association,* 310 U.S. 534, 543 (1940).

Legislative History. As indicated, the legislative history of the Act reflects that, when Congress eliminated the charter test of "bank" status in 1966 in favor of the demand deposit test, it intended to cover checking accounts, like NOW accounts, as demand deposits and did not intend to exclude institutions that function as banks. In 1963, the Board issued an interpretation regarding the coverage of industrial banking organizations, such as industrial loan companies, under the charter test in the original Act. 49 Fed. Res. Bull. 166 (1963). The Board ruled that industrial banking organizations would be banks for purposes of the Act in two situations: (1) if they issued accounts subject to withdrawal by check; or (2) if in actual practice they permitted a withdrawal of deposits on demand. The second part of this test referred to ordinary passbook savings deposits, which are paid on demand but that are not freely withdrawable by check.

Subsequently, during Congressional hearings on the 1966 Amendments to the BHC Act, representatives of industrial banking organizations requested that certain of these institutions be exempted from the Act on the rationale that industrial banks and similar institutions only made loans to consumers, offered savings certificates, and did not accept checking accounts.[13] The Board endorsed this proposal on the basis that the BHC Act should cover only institutions that accept demand or checking accounts.[14] In effect, the Board favored repeal of the second part of its 1963 industrial bank interpretation that covered an industrial banking organization if such institutions limited their deposit taking activities to the offering of passbook savings accounts. The Board stressed, however, that the first part of this test should be retained and industrial banks should continue to be covered if they accepted checking accounts.

Congress adopted the Board's proposals by eliminating the charter test in favor of the demand deposit definition. The legislative history is clear that Congress did not intend to repudiate the first part of the Board's 1963 industrial bank interpretation, and that the authority to offer checking accounts was regarded as the fundamental characteristic of a "bank" under the Act. The Senate Report accompanying the amendments expressly stated that the bank definition was intended to include an institution that accepts deposits payable on demand, which the report described as checking accounts.[15] Senator Robertson, the sponsor of the bill, stated that the amendment covered only institutions that "accept demand deposits subject to check" and excluded industrial banks because they did not accept deposits subject to check. 112 Cong. Rec. 11,794 (1966). Nothing in the reports of the relevant committees or in the statements of the bill's sponsor ever refers to a notice of withdrawal requirement as a prime characteristic of the deposits covered by the Act.[16] Based on this

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[13] *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418, and H.R. 7371 before a Subcomm. of the Senate Comm. on Banking and Currency,* 89th Cong., 2d Sess. 155, 157 (1966) (testimony of Max A. Denney, American Industrial Bankers Association) (hereinafter "1966 Senate Hearings").

[14] *Id.* at 447.

[15] S. Rep. No. 1179, 89th Cong. 2d Sess. 7 (1966).

[16] While the language adopted in the 1966 Amendments differed from that proposed by the Board ("deposits payable on demand"), there is no

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legislative history, the Board concludes that Congress did not intend to exclude from the concept of demand deposit checking accounts that are subject to a formal requirement of notice where the instrument functions in all other respects in the same manner as one that is not subject to such a formal notice.

Thus, following the 1966 Amendments, the Act continued to apply to institutions accepting deposits subject to withdrawal by check, but no longer applied to institutions offering deposits, such as passbook savings deposits, that are in practice paid on demand but which are not subject to withdrawal by check or similar device. The United States Court of Appeals for the Third Circuit has recently held that the retention of the right to require advance notice of withdrawal is *not* necessarily determinative of whether a particular type of deposit is a demand under the BHC Act:

> Congress did not choose the words "accepts deposits that the depositor has a legal right to withdraw on demand" because it was concerned with the distinction between a depositor's *legal* right to withdraw on demand and the ability *in practice* to withdraw on demand. The more reasonable interpretation of why Congress selected these terms is that stated in the [1966] Senate Report * * * Congress was merely adopting "the commonly accepted test of whether an institution is a commercial bank." [17]

Administrative Interpretations. The term "demand deposit" had been used in many earlier federal banking laws and over the years had uniformly been interpreted to include any deposit, such as a NOW account, that is withdrawable by check regardless of whether the deposit is subject to a notice of withdrawal requirement. As early as 1915, the Board recognized the right of an institution to require advance notice of withdrawal as a distinguishing factor of a savings account, but made clear that, where a notice account was ordinarily subject to withdrawal by check, that account would be treated as a demand deposit and would be subject to the higher level of reserves applicable to demand deposits. 1 Fed. Res. Bull. 38 (1915).[18] In 1933, the Board, in defining demand deposit for purposes of the prohibition against the payment of interest on accounts payable on demand, included savings accounts subject to withdrawal by check, notwithstanding the fact that the savings account had an advance notice of withdrawal requirement. The Board explained that such action was necessary to prevent evasion of the statutory prohibition since accounts subject to a notice requirement typically pay interest and reflected the Board's view that checkable notice of withdrawal accounts were functionally demand deposits.[19] 21 Fed. Res. Bull. 792, 863 (1935).

Thus, at the time of the 1966 amendment of the "bank" definition to cover demand deposits, that term had a well-defined meaning under longstanding agency interpretation and included all checkable deposits, regardless of a notice of withdrawal requirement. The Board believes that, since the legislative history repeatedly refers to demand deposits as "checking accounts," it is likely that Congress meant to incorporate the longstanding agency interpretation into the statute.[20]

Function of NOW accounts as checking accounts. NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits. It is uniformly recognized that NOW accounts operate as demand checking accounts and that checks drawn on these accounts are paid by the drawee institutions on demand, just like conventional checking accounts. *e.g., New York State Bankers Association* v. *Albright*, 38 N.Y. 2d 430, 381 N.Y.S. 2d 18, 343 N.E. 2d 735 (1975) ("Manifestly and unabashedly", the NOW account is intended to be the equivalent of a checking account); Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts*, 91 Banking L.J. 439, 440 (1974) ("NOW accounts permit money transfers to third parties in much the same manner as conventional checking accounts").

Like a conventional checking account, the holder of a NOW account makes withdrawals by means of a demand draft that may be issued to a third party as a means of transferring funds to the third party from the depositor. The payee of the NOW draft deposits it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. *See New York State Banker's Association* v. *Albright, supra.* NOW drafts are cleared through the Federal Reserve check collection facilities as demand items, exactly like conventional checks.

Because of the third party payment feature, NOW accounts are used by depositors to pay bills and to perform other financial transactions, the very function of a conventional demand deposit. A survey conducted by the American Bankers Association of the operation of NOW accounts in New England, where such accounts were first permitted on an experimental basis, concluded that:

> * * * a large number of depositors are using the NOW account as their *main transaction account.* Indeed, some New England banks report that usage of NOW accounts closely resembles the usage of demand deposit accounts.[21]

The Board notes that NOW accounts are uniformly advertised as checking accounts with little, if any, reference to the fact that they may be subject to a 14-day notice of withdrawal requirement. Not only is the right to require advance notice of withdrawal ordinarily not invoked with respect to such accounts, but it is apparent from the nature of a NOW account that, once a draft has been drawn on such an account, the funds in the account that cover the draft cannot effectively be made subject to a notice of withdrawal requirement. Because withdrawals from NOW accounts are made by demand drafts issued directly to third party payees, the drawee institution would face a serious

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indication in the legislative history that this change was intended to be substantive. Indeed, as noted, the Congress consistently referred to the change as encompassing "checking accounts."

[17] *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 737 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982) (emphasis in original).

[18] *See* 1 Fed. Res. Bull. (1915) (savings deposits subject to check); 9 Fed. Res. Bull. 677 (1923) (special savings accounts against which an unlimited number of checks can be drawn); 13 Fed. Res. Bull. 609 (1927) (special reserve savings accounts that "in actual practice" are subject to check).

[19] In *United States League of Savings Associations* v. *Board of Governors*, 595 F.2d 888 (D.C. Cir.) (table), *cert. denied*, 444 U.S. 920 (1979), the District of Columbia Circuit obviously believed that a deposit arrangement that functions as a checking account should be treated as such - regardless of the retention of a notice of withdrawal requirement. The Tenth Circuit has adopted the same view in invalidating a similar deposit arrangement offered by certain savings and loan associations. *Otero Savings & Loan Association* v. *Federal Home Loan Bank Board*, 665 F.2d 279 (10th Cir. 1981).

[20] *See Lorillard* v. *Pons*, 434 U.S. 575, 580–81 (1978) (When Congress incorporated prior statutory language in new statute, Congress is presumed to have incorporated longstanding administrative interpretations of earlier statutory language.)

[21] Hoffman and Herman, *NOW Accounts in New England* in American Bankers Association, Studies on the Payment of Interest on Checking Accounts 31 (1976) (emphasis added). *See also* Cates and Chase, *The Payment of Interest on Checking Accounts: A Report to the South Carolina Bankers Association* 29–30 (1976) (NOW experience in Massachusetts and New Hampshire indicates most holders of commercial bank NOW accounts use them as substitutes for regular demand deposit accounts); Simpson and Williams, *Recent Revisions in the Money Stock*, 67 Fed. Res. Bull. 539, 542 (1981) (70 to 80 percent of funds deposited in new-type checking accounts, *e.g.*, NOW accounts, opened in early 1981 were shifted from conventional demand deposits).

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loss of good will if it attempted to invoke that right against drafts drawn against the NOW account.[22] The Board is aware of no instance in which the notice requirement has been invoked on a NOW account.[23]

The history of the federal NOW account authorization legislation evidences the Congressional understanding of such accounts as demand deposits. The 1974 prohibition of NOW accounts (except in certain New England states) was a direct response to and recognition of the fact that the ability to make withdrawals by check converted the traditional interest-bearing savings account into a demand deposit and represented a device to circumvent Congress' 1933 ban on the payment of interest on demand deposits.[24] In effect, the legislation codified the Board's longstanding view that a checking account is functionally a demand deposit.[25] Indeed, if NOW accounts are not demand deposits, there would have been no need at all for legislation authorizing NOW accounts, since the prohibition on payment of interest applies only to deposits *payable on demand* and not to ordinary savings accounts.[26]

Finally, the Monetary Control Act of 1980 requires depository institutions to maintain the same level of reserves against NOW accounts as are required to be maintained with respect to conventional demand deposits.[27] This requirement reflects the Congressional belief that these accounts are functionally equivalent and form the basis of our country's medium of exchange. H.R. Rep. No. 263, 96th Cong., 1st Sess. 4 (1979). Thus, the Monetary Control Act also in effect codified the Board's early administrative rule that imposed on *checkable* accounts (whether or not subject to a notice of withdrawal requirement) the same reserve requirements applicable to conventional demand deposits.

Several commenters stated that the proposed definition of demand deposit is overly broad and could cover some types of institutions that should not be covered. The Board is aware that, under its interpretation, industrial banks and similar institutions that may currently offer NOW accounts and make commercial loans will be covered as "banks" under the Act. As noted, the legislative history of the Act manifests a Congressional intent not to cover such institutions as they operated in 1966. That intent was premised upon the belief and the testimony of the industrial banking industry before Congress that such institutions did not offer checking accounts or engage in the commercial loan business. In recent years, industrial banks and similar organizations have been authorized to offer NOW checking accounts and to make commercial loans. Clearly, in light of this significant departure from the traditional and commonly accepted functions of industrial banking organizations, these institutions, which function essentially as banks, are not the type of institution Congress intended to exclude from the Act in 1966. Indeed, in the Garn-St Germain Act of 1982, Congress recognized the essential bank-like functioning of industrial banks and specifically made them eligible for FDIC insurance.[28]

The Board believes that institutions that both offer NOW accounts, or other accounts that clearly are the funcitional equivalent of a demand deposit, and make commercial loans must be treated as banks in the interests of competitive equity and to prevent evasion of the Act and to ensure that its fundamental purposes are effected.

Some commenters stated that the proposed definition of demand deposit could call into question the status of certain types of accounts, such as money market deposit accounts, preauthorized transfer accounts, telephone transfer accounts, accounts accessible through ATM machines, various types of bill-payer accounts, and credit balance accounts accessible by negotiable check or draft. Under certain circumstances, it is possible that some of these accounts may fall into the category of deposits that the Board regards as demand deposits, especially if they function as checking accounts or the equivalent thereof. However, the Board does not believe it is necessary to treat such accounts as demand deposits for purposes of the regulation as currently written, since it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts.

In this regard, the inclusion of the definition of demand deposits in Regulation Y should not be interpreted as effecting the present status of credit balances offered by investment companies chartered under Article XII of New York's banking law, which the Board has previously determined are not demand deposits for purposes of the Act. *European-American Bancorp*, 63 Federal Reserve Bulletin 595 (1977). The Board may determine to review the status of such credit balances at some future date upon request or upon the Board's own initiative, but does not intend by this action to address these types of accounts. Similarly, the Board's interpretation of demand deposits does not affect the status of deposits accepted in a *bona fide* fiduciary capacity, which the Board has determined are not demand deposits for purposes of the Act.

In the comments, concern also was expressed that the definition of demand deposit would result in the forced divestiture of some industrial loan company subsidiaries of bank holding companies that do not meet the eligibility requirements for FDIC insurance. Section 3(e) of the BHC Act requires that every bank that is a subsidiary of a bank holding company be insured by the FDIC. 12 U.S.C. 1842(e). This provision was added to the BHC Act at the Board's suggestion

[22] By refusing temporarily to pay NOW drafts on demand, the institution would refuse payment, not to the holder of the NOW account, but to a third party payee, such as a merchant, who has no necessary relationship with the institution and who has given value for the NOW draft. Payees would thereafter refuse to accept NOW drafts drawn on that institution. NOW account depositors would thus be forced to withdraw the NOW account funds and place them in a more acceptable payment vehicle. Also, under federal law, an institution that wishes to invoke the notice of withdrawal requirement is obligated to impose such a requirement on every other account of a similar nature. 12 C.F.R. § 217.5(a).

[23] The notice requirement on occasion has been invoked with respect to ordinary savings accounts, which do not contain funds used to pay bills and are not checkable. *See* American Banker, June 22, 1976, p. 1, col. 2. Because the Board's interpretation concerns only accounts subject to the notice of withdrawal requirement that are *withdrawable by check*, it does not cover savings deposits, which are subject to the notice of withdrawal requirement but may not be withdrawn by negotiable order and thus that do not have transactional capability. *See* 22 C.F.R. § 217.5(c)(1).

[24] 119 Cong. Rec. 16,071 (1973) (Remarks of Senator Brock stating, "Failure to ban "NOW" accounts infringes on a *40-year old statutory prohibition on the payment of interest on checking accounts.*"); *Id.* at 15,005 (Remarks of Cong. Johnson stating, unless NOW accounts are limited, "the net result will be nationwide, all banks will pay interest on *checking accounts.*"); *Id.* at 15,002 (remarks of Rep. Patman, characterizing NOW accounts as permitting interest on *demand deposits*); *Id.* at 16,486 (remarks of Sen. Proxmire to the effect that NOW accounts permit "one to earn interest on his *demand* deposits").

[25] S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). "[NOW accounts] are the functional equivalent of interest bearing checking accounts." *Accord* 125 Cong. Rec. H7613 (daily ed. Sept. 10, 1979) (Remarks of Cong. St Germain).

[26] The fact that NOW accounts are limited to consumers has no significance under the BHC Act, in which the definition of "bank" depends on the *demand checking* feature of *deposits*, not on the commercial or consumer nature of the depositor (unlike the loan part of the "bank" definition).

[27] 12 U.S.C. 461(b)(1)(C). In contrast, Congress mandated no reserve requirement for traditional savings deposits. *See* 12 C.F.R. § 204.9(a).

[28] Pub L. No. 97-320, § 703, 96 Stat. 1469, 1538-39, S. Rep. No. 536, 97th Cong., 2d Sess. 43 (1982).

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based on the Board's belief that the value of federal deposit insurance to the public is such that all banks should offer this service to their coustomers. *See Mercantile Bankshares Corporation*, 56 Federal Reserve Bulletin 596 (1970). The Board notes that, under that Act, an institution that qualifies as a bank under the Board's interpretation and that is owned by a company would be allowed two years to obtain FDIC insurance. This will provide time for Congress to consider amending section 3(e) of the Act to allow other types of qualified insurance as a alternative to FDIC insurance.

Concern also was expressed in the comments that, if NOW accounts are deemed to be demand deposits, banks would no longer be permitted to pay interest on such accounts. The Board stresses, however, that a determination that NOW accounts are demand deposits for purposes of the BHC Act does not affect their status under other federal statutes. In particular, the Board's interpretation does not prevent institutions from continuing to pay interest on NOW accounts.

For the above reasons, the Board concludes that demand deposits in the bank definition include NOW accounts and similar deposits that the depositor may withdraw by check, draft, negotiable order of withdrawal, or similar instrument. Accordingly, the Board is adopting in Regulation Y the definition of the term demand deposit as proposed, with certain technical modificaions.

Definiton of Commercial Loan. In order to qualify as a bank under the BHC Act, an institution must, in addition to accepting demand deposits, be engaged in the business of making commercial loans. The final regulation reflects the Board's definition of commercial loan as a loan the proceeds of which are used other than for personal, family, household or charitable purposes. Moreover, as noted above, even consumer loans, when made to further a commercial purpose, such as to promote an affiliate's business, would be considered a commercial loan under the Act.

The final regulation includes as a commercial loan the purchase of such instruments as commercial paper, bankers acceptances and certificates of deposit, the extension of broker call loans, the sale of federal funds, and similar transactions. Some commenters have objected to the proposed inclusion of commercial paper, certificates of deposit, bankers acceptances and federal funds as commercial loans as beyond the scope of the Board's authority under the Act and contrary to the terms of the Act and established Board interpretations thereof. The commenters state that these transactions are not loans, but rather passive investment, which typically are short term and effected through a secondary market as a means of investing idle funds or maintaining liquidity, and that these transactions do not present the evils of credit abuse and concentration of economic power at which the Act is aimed. These commenters also state that the definition would bring under the Act many institutions that were not intended to be covered.

The Board has considered these comments and, for the reasons set out below, has determined to adopt the definitions as proposed with certain modifications.

In the Board's judgment, these instruments as a matter of law establish a debtor-creditor relationship and constitute an extension of credit or loan. Since these loans result in the provision of funds to commercial enterprises, including banks, which are also commercial enterprises, and since they are not made for personal, family, household or charitable purposes, these loans are commercial loans for purposes of the bank definition in the Act.[29] Moreover, as set forth above, the Board believes this interpretation to be consistent with and necessary to ensure implementation of the Act, prevent evasions of its fundamental purposes, and carry out expressed legislative policies.

Some commenters argue that the term commercial loan must be applied to encompass only those transactions traditionally denominated "commercial loans" by the parties to the transactions. There is nothing in the legislative history that supports such a proposition. On the contrary, the thrust of the 1970 Amendments was to cover all banking institutions regardless of size because such action was necessary to prevent the potential for the abuses about which Congress was concerned—conflicts of interest, risk, partiality in the granting of credit, and concentration of resources. In fact, the instruments covered by the Board's definition are loans to commercial enterprises, and institutions which engage in banking functions by accepting demand deposits and making such commercial loans are subject to the potential abuses which Congress sought to prevent through a broadly applicable Bank Holding Company Act.

[29] Federal, state and local governments and their agencies are not regarded as commercial enterprises by the Board, and their debt obligations therefore would not be regarded as commercial loans.

Moreover, the interpretation proposed by the commenters would deny to the Board any authority to prevent evasion of the Act by covering instruments that are in fact loans to commercial enterprises but take non-traditional forms. This approach would permit banks to structure their lending transactions to avoid the coverage of the Act and to circumvent its purposes. The courts, however, have recognized the authority of the Board to look beyond form to the substance of a transaction in order to prevent an evasion of the purposes of the Act.[30]

As a first and preliminary matter, all of the instruments covered by the Board's definition are in a technical legal sense "loans" since a debtor-creditor relationship is created in each. The term "loan" is generally defined as any transaction as a result of which a party advances money and obtains an absolute promise to repay, and generally involves the following elements: a principal sum placed with a borrower, an agreement that interest is to be paid on that sum, and a recognition by the receiver of the money of a liability for the return of the principal amount with interest. *See e.g.* Black's Law Dictionary 1085 (4th rev. ed. 1968). As explained in detail below, each of the instruments creates a debtor-creditor relationship meeting these standards and thus falls within the term "loan" in section 2(c) of the Act.

Second, the definition in section 2(c) requires that the loan be "commercial." The Supreme Court has stated that "[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital." *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974). As indicated, the instruments listed in the regulation provide funds to commercial organizations, as in the case of commercial paper and bankers acceptances, or, as in the case of certificates of deposit or federal funds, to banks, which also are commercial enterprises.[31] Moreover, the maturity, interest rate, and credit risk of all of these instruments is generally comparable to that of a short-term, prime quality commercial loan.[32] Each of

[30] *See Wilshire Oil Co., supra* at 739–40. Indeed, the court agreed that section 5(b) of the Act enables the Board to prohibit activities that are technically outside the literal terms of the Act in order to prevent a clear evasion of the purposes of the Act. *Id.* at 740.

[31] *See United States* v. *Philadelphia National Bank*, 374 U.S. 321, 343 (1963).

[32] Although some commercial loans are of medium term, the traditionally commercial loan is a short

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these instruments typically provides short-term funding for working capital or current operations such as the financing of inventory. In addition, for each of these instruments, the lender generally will not extend funds unless it or a third party has accomplished a credit analysis to demonstrate that the borrower is capable of repaying the extension of credit from current income. In short, the instruments described in the Board's definition are loans for a commercial purpose—in other words, commercial loans.

The following discussion demonstrates that, both in terms of function and in terms of the legal obligation created, the instruments covered by the regulation are commercial loans for purposes of the BHC Act.

Commercial Paper. Commercial paper is a prime quality, short-term unsecured promissory note establishing a debtor-creditor relationship between lender and borrower. It is generally used as a financial device by large, financially strong corporate borrowers to obtain funds for seasonal or working capital purposes such as the financing of inventory. The maturity of commercial paper is generally 60 days or less, although it can have a maturity of up to 270 days. Commercial paper is generally sold in denominations of $100,000 or more. Although it is negotiable, it is generally held to maturity and interest rates are fixed.[33]

It is uniformly agreed that the purchase of commercial paper by a bank is a commercial lending transaction. Indeed, the Comptroller of the Currency has taken the position that the purchase of commercial paper is "after all nothing but [a] loan to industrial corporations" and thus qualifies as a loan under the lending limitations in the National Bank Act and under the Glass-Steagall Act. Letters of February 24, 1972, and November 19, 1971. The term and denomination of commercial paper, its status as a promissory note, the uses to which the funds are put, and the type of credit analysis involved, all mean that commercial paper is a commercial loan for purposes of the BHC Act.[34]

Certificates of Deposit. A certificate of deposit ("CD") is an instrument evidencing a deposit with a bank for a specified period of time, generally at a fixed rate of interest. The legal relationship established between the purchaser of a certificate of deposit and the bank that issues it is that of creditor and debtor, and the loan that the purchaser of the instrument effectively makes to the bank is an unsecured loan.[35] As is the case with commercial paper, large denomination CDs that are traded in the money market are usually short-term, negotiable instruments, and typically have a maturity of from one to six months. The minimum denomination of such CDs is usually $1 million.[36]

The use of large denomination CDs with negotiable rates and maturities was originated by large banks in the 1960s as a method of providing additional funding for their operations, and has now become a key funding source for banks.[37] Banks use large denomination CDs to provide short term funding for their commercial operations in the same manner that other business organizations use commercial paper to raise working capital.[38] Moreover, as is the case with purchasers of commercial paper, purchasers of large denomination CDs engage in credit analysis of the issuers of these instruments, and establish limits for the amount that they are prepared to purchase from any particular issuer.[39] In sum, for purposes of the Bank Holding Company Act, a large denomination certificate of deposit is a commercial loan.

Some banks purchase CDs in denominations as small as $100,000. Since such CDs are fully insured by the FDIC, they involve no credit risk. In all other respects, however, such CDs function as commercial loans to other banks, presenting the same potential for conflicts of interest and concentration of resources as other commercial loans. When a bank regularly purchases CDs of other banks, or otherwise makes interest bearing deposits on a regular basis, the Board believes the purchasing bank is engaged in the business of making commercial loans.[40] The Board's commercial loan definition therefore encompasses the regular purchase of smaller CDs or other interest bearing deposits.[41]

Federal funds transactions. Federal funds transactions represent interest bearing loans by one depository institution of its deposits with a Federal Reserve Bank to another depository institution, generally on an overnight basis.[42] The so-called "sale" of federal funds in not only legally the making of an unsecured loan to the purchasing bank, but it is so regarded by bankers.[43] Consequently, banks assess the credit risk associated with these transactions, and they will normally lend federal funds only to banks to which they have granted a line of credit.[44] Indeed, the Board has stated that the sale of federal funds is an unsecured loan from one depository institution to another.[45]

term instrument. *United States* v. *Connecticut National Bank,* 418 U.S. 656, 665 (1974); Munn and Garcia, *Encyclopedia of Banking and Finance* 572 (8th rev. ed. 1983); Stigum, *The Money Market* 76 (1983).

[33] Stigum, supra, at 625–41; Hurley, *The Commercial Paper Market,* 63 Federal Reserve Bulletin 525 (1977); Munn and Garcia, *supra* at 196. Interest is usually paid on commercial paper on a discount basis.

[34] Morover, in terms of function, commercial paper is an important substitute for commercial loans from banks, and the amount of such paper outstanding often increases or decreases as a result of changes in the cost and availability of bank loans. Hurley, *supra,* at 525. Indeed, the origins of commercial paper in the early 19th century can be traced directly to the inability of the U.S. banking system to provide sufficient credit for larger corporations that experienced significant seasonal swings in their need for credit. Stigum, *supra,* at 626.

[35] Bankers Desk Reference 84 (1978). *See Sutter* v. *Groen,* 687 F.2d 197, 200 (7th Cir. 1982) (certificate of deposit issued by bank and insured by FDIC is "a type of promissory note"); *Wightman* v. *American National Bank,* 610 P. 2d 1001, 1004 (Wyo. 1980) ("a certificate of deposit is simply a commercially glamorous name for a promissory note"); 2 *Anderson on the Uniform Commercial Code* 615 (1971) ("The differences between a certificate of deposit and a promissory note are merely formal. In substance and legal effect the two instruments are the same. . . .").

[36] Stigum, *supra* at 525–26; Munn and Garcia, *supra,* at 608.

[37] Stigum, *supra* at 107. By 1960, the demand for loans at large New York City banks significantly exceeded the ability of those banks to fund loans from traditional sources such as savings deposits. At the same time, many large corporations had money they would be prepared to lend to large banks if the instrument evidencing the loan provided a relatively high rate of return and was negotiable. The large denomination CD satisfied this need. *Stigum, supra* at 35–36, 107–08.

[38] Controlling the amount of CDs that it issues is one of the principal devices by which a bank can make short term adjustments to the volume of loans it has outstanding. Thus, when loan demand is up, bank issue more CDs is in order to make more loans. Stigum, *supra* at 36, 107.

[39] Stigum, *supra* at 530. As a result of this fact, even the largest banks can experience difficulty in issuing CDs if their performance raises market concerns.

[40] The Board regards this construction of the term "engaged in the business" as being necessary to prevent evasion of the statute. It is also consistent with judicial construction of similar language in other statutes. *SEC v. Fifth Avenue Coach Lines,* 289 F. Supp. 3, 30–31 (S.D.N.Y. 1968). *Cf. Buckley v. New York Times,* 215 F. Supp. 894 (E.D. La. 1963). Although the Board used a somewhat higher threshold with regard to Boston Safe, and certain savings and loan associations, the status of Boston Safe as a trust company and the independent regulatory scheme for savings and loan associations distinguishes those prior decisions.

[41] On the basis of existing evidence, however, the Board does not believe that a non-interest bearing demand deposit is likely to function as a commercial loan, and such deposits are not covered by the definition of commercial loan.

[42] *Bankers Desk Reference,* 301–02, 367 (1978); Stigum, *supra* at 33–34, 105.

[43] Stigum, *supra* at 105.

[44] *Id.*

[45] Letter of June 8, 1972, to Laurence H. Stone regarding Boston Safe Deposit and Trust Company. In the context of Boston Safe's trust company activities, the Board concluded that sales of federal funds by Boston Safe were loans but were not commercial loans.

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Moreover, the purchase of Federal funds in substantial amounts on a regular basis is viewed by large financial institutions (which are themselves commercial enterprises) as a method of satisfying their basic funding needs.[46] In view of these facts, the Board concludes that Federal funds should be regarded as commercial loans for purposes of the Act.

Bankers' Acceptances. A bankers' acceptance is an interest bearing loan—a debtor-creditor relationship—in the form of a draft with a payment date several months in the future that is drawn by a business on a specified bank, and that has been accepted for payment by that bank.[47] The use of bankers acceptances provides an alternative to a direct extension of commercial credit for the business which initially secures the letter of credit under which the draft is drawn.[48] By accepting the draft, the issuing bank has made the draft a primary obligation of the bank. After creating the acceptance, the bank may discount it and retain the instrument until maturity as part of its commercial loan portfolio. Alternatively, in order to raise funds to be used in the bank's current business, it may sell the acceptance in the money market. The buyer of the acceptance receives an unconditional promise from the selling/accepting bank that it will pay the draft at maturity. In turn, the accepting bank looks to the business that is the account party on the draft for repayment; the purchaser of the acceptance may also recover from the account party if the accepting bank defaults.

The direct effect of purchasing a bankers' acceptance is to provide funds to the accepting bank, which is itself a commercial enterprise.[49] Moreover, in view of the liability of the business that is the account party on the draft, the purchase of a banker's acceptance from the accepting bank or any other party is the functional equivalent of purchasing a commercial loan that is guaranteed by the accepting bank. On the basis of the preceding discussion, the Board concludes that the purchase of a bankers' acceptance should also be regarded as a commercial loan.

Some commenters have objected to the inclusion of these money market instruments as commercial loans on the basis that they are often purchased through brokers with no direct negotiation with the issuer, and should therefore be classified as passive investments rather than commercial loans.[50] However, a substantial portion of the transactions in all of these instruments occurs through direct negotiations between lenders and borrowers and, even when purchased through brokers, the lender knows the borrower's identity. Based on its experience, the Broad is aware that holders of large amounts of so-called money market instruments relative to the size of the borrower are in a position to influence the conduct of the borrower, and do at times exercise this influence.[51] Moreover, a "nonbank bank" could, for example, favor its affiliates by purchasing the CDs or commercial paper of those affiliates, or by purchasing such instruments from customers of its affiliates. Similarly, it could refuse to purchase such instruments from competitors of its affiliates and, as noted above, "understandings" could well develop that would lead to commercial lending by indirect means, *e.g.,* through affiliated commercial finance companies or other reciprocal lending arrangements.

Thus the Board finds that the financial instruments discussed above are, in fact, properly categorized as loans providing for the extension of credit from one commercial enterprise to another. Moreover, the Board believes it is proper to include these instruments within the scope of the term commercial loan as used in the Act in order to carry out the Act's basic purposes: to maintain the impartiality of banks in providing credit to business, to prevent conflicts of interest, and to avoid concentration of control of credit. As noted above, the proliferation of nonbank banks owned by companies of very substantial size outside the prudential rules of the Bank Holding Company Act suggests that the dangers of evasion of the Act are real and that action to remedy potential abuses is both necessary and desirable.

Several commenters asserted that commercial paper, certificates of deposit and other money market instruments are merely passive investments having the characteristics of a security rather than a loan. Although an occasional purchase of commercial paper, a certificate of deposit or other money market instrument would not mean that the purchaser is engaged in the business of making commercial loans, this has little relevance for a bank that regularly purchases such instruments as one of its basic business operations.[52] Moreover, a commercial loan may be characterized as an investment and vice versa.[53]

Although for purposes of the Bank Holding Company Act, the distinction between a commercial loan and an investment appears largely irrelevant, the distinction has been made for the purposes of certain Federal securities laws.[54] The cases interpreting these statutes have set forth certain criteria for distinguishing a transaction that is essentially a commercial loan from a transaction that is essentially an investment embodied in a security regulated by the Federal securities laws. Under the criteria employed in these cases, the purchase by a financial institution of commercial paper, certificates of deposit, bankers acceptances or the sale of Federal funds possesses the qualities primarily associated with a loan rather than these qualities associated with a security.[55]

Some commenters asserted that the purchase of retail installment loans by bank should not be regarded as

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[46] Stigum, *supra* at 374–76.

[47] *Bankers Desk Reference* 304 (1978); Munn and Garcia, *supra* at 69–71. Interest is paid on a discount basis.

[48] Stigum, *supra* at 39.

[49] The purchase of a bankers acceptance from a dealer in such instruments similarly provides funds to the dealer, which is a commercial enterprise.

[50] The absence of direct negotiation with the borrower is a characteristic of the purchase of a participation interest in a direct extension of commercial credit, a technique commonly used by commercial banks to spread the risk of default and increase the total amount of funds that may be loaned to one customer. It is only the "lead" bank in a participated lending transaction that typically negotiates directly with the borrower. However, most courts that have considered the issue have concluded that a bank that purchases a participation in a commercial loan is purchasing a commercial loan rather than a security. *E.g., Union Planters National Bank* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir.), *Cert. denied*, 45 U.S. 1124 (1981).

[51] For the most part, the influence that any lender has over a borrower in an arms-length transaction is likely to be an influence that encourages moderation and prudence. It is the potential for abuse of this relationship, however, that prompted Congress to enact the bank Holding Company Act. Indeed, in deciding to extend the Acts' coverage to one-bank holding companies, Congress stated that there had been "no major abuses effectuated through the one-bank holding company device . . . the legislation is to prevent possible future problems rather than to solve existing ones." S. Rep. No. 1084, *supra*, at 4.

[52] The Board regards an institution that engages in such transactions on anything more than an occasional basis as being engaged in the business of making commercial loans. See n. 40, *supra*.

[53] In *C.N.S. Enterprises, Inc.* v. *G & G Enterprises, Inc.*, 508 F.2d. 1354, 1359, *cert. denied*, 423 U.S. 825 (1975), the U.S. Court of Appeals for the Seventh Circuit made precisely this point when it stated: "In one sense every lender of money is an investor since he places his money at risk in anticipation of a profit in the form of interest. Also in a broad sense every investor lends his money to a borrower who uses it for a price and is expected to return it one day."

[54] *See, e.g., American Bank & Trust Company* v. *Wallace*, 702 F.2d 93 (6th Cir. 1983); *Bellah* v. *First National Bank of Hereford, Texas*, 495 F.2d 1109 (5th Cir. 1974); *Great Western Bank & Trust.* v. *Kotz*, 532 F.2d 1252 (9th Cir. 1976). *Cf. Marine Bank* v. *Weaver*, 455 U.S. 551 (1981); *Exchange Nat. Bank* v. *Touche Ross & Co.* 544 F.2d 1126 (2d Cir. 1976).

[55] *Id.*

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involving commercial lending, because the ultimate recipient of the funds are consumers. However, the effect of purchasing an installment loan is to finance the day-to-day operations of the retailer involved, and to provide funds with which the retailer may purchase additional inventory or finance retail sales. Thus, the effect of the purchase is to promote the retailer's commercial business. Moreover, if the retailer is an affiliate of the lending bank, the purchase of its retail installment paper by the bank is precisely the type of transaction criticized in the legislative history of the Act, as discussed above—the retail affiliate has an assured line of credit to finance its sales, thereby giving it an advantage over its competitors. Even though a purchase of such loans may not involve an affiliate, and may be without recourse, the bank is supplying funds to a commercial enterprise, and the retailer generally maintains an ongoing business relationship with the bank, which provides the bank with an opportunity to influence the retailer's affairs through its willingness to continue to provide or deny additional credit. Thus, consistent with a 1976 Board staff opinion, the Board regards the purchase of retail installment loans as a commercial lending transaction, and is so modifying its commercial loan definition in the regulation.

One other type of loan specified as a commercial loan in the regulation adopted by the Board is a broker call loan. A broker call loan is a loan to a securities broker or dealer that is payable on demand and is made for the purchase or carrying of securities. Munn and Garcia, *supra*, at 137, 154. The Board's staff issued an opinion in 1976 that such loans are not commercial loans on the basis that such loans are a passive medium of investment that do not involve a close lender-borrower relationship. Letter of January 26, 1976.

However, broker call loans are loans; they are clearly made for commercial purposes; and they thus fall within the Bank Holding Company Act's definition of commercial loan. While the staff's interpretation may have been appropriate in a different factual context, in view of the rapidly expanding use of the nonbank bank loophole to evade the BHC Act as described above, the Board believes it is appropriate to regard broker call loans as commercial loans.[56]

Several commenters asserted that the Board's proposed commercial loan definition represented an abrupt and unwarranted reversal of prior positions taken by the Board. The fundamental rule which the Board established in 1971 is that the term "commercial loan" should encompass all loans other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes. Letter of July 1, 1971, to Greater Providence Deposit Corporation. In only three subsequent cases[57] over a ten-year period was the Board prepared to allow companies that could not qualify as bank holding companies to engage in demand deposit-taking while placing those deposits in money market commercial loans. The decisions in these cases represented a willingness by the Board to refrain from applying the full scope of the Act in conditions that did not appear to generate the potential for its evasion. Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary.

The courts have held that an agency may alter its interpretations in response to changing circumstances if it provides a reasoned explanation for its action. In *American Trucking Association, Inc.* v. *Atchinson, Topeka & Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967), the Supreme Court ruled that:

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adopt their rules and practices to the nation's needs in a volatile, changing economy.

In its *Dreyfus* decision and in this notice, the Board has detailed the factors and considerations that underlie its interpretation and believes that its action, as explained herein, is both appropriate and necessary in light of the purposes of the Act and is within the Board's express authority under section 5(b) of the BHC Act. Moreover, the Act clearly contemplates changes in interpretation to address changes in market conditions in order that the fundamental purposes of the Act be maintained and to prevent a serious competitive imbalance between competing institutions fostered by the change in market conditions. The definition of demand deposit and commercial loan that the Board has adopted will accomplish these objectives.

The Board's action on the definition of the term "bank" as used in the Act is also intended for the purpose of maintaining the structure established by Congress for limiting the association of banking and commercial enterprises in order to avoid the preemption of Congressional discretion through actions that have the effect of evading the Act. Various proposals to confirm or change the present structure are now before the Congress and the ability of Congress to act on these proposals would be limited by rapid expansion of the use of nonbank banks. Changes in the basic framework established by Congress are properly a matter for Congressional decision and the Board looks to legislative action in the near future to clarify both the proper dividing line between commerce and banking and to establish the proper scope of bank holding company powers to deal with changed market conditions.

Accordingly, for the reasons set out above, the Board is adopting in Regulation Y, with certain technical modifications, the definition of the term "commercial loan" as proposed, and in addition is incorporating in that definition the purchase of retail installment loans.

[56] Trust company subsidiaries of bank holding companies are permitted to make broker call loans and purchase money market instruments. However, such subsidiaries are not permitted to accept general purpose demand deposits, and therefore are not "banks" under the bank definition.

[57] Letters of June 8, 1972, to Laurence H. Stone; March 11, 1981 to Mr. Robert C. Zimmer; and May 28, 1981, to Mr. R. S. Miller, Jr

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