FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 10167
May 7, 1987]

Policy Statement on Responsibility of Bank Holding Companies to Act as Sources of Financial and Managerial Strength to Their Subsidiary Banks

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

The Board of Governors of the Federal Reserve System has issued a policy statement on the responsibility of bank holding companies to act as sources of financial and managerial strength to their subsidiary banks. It reiterates in detail a general policy that has been expressed on numerous occasions in accordance with authority that is provided under the Bank Holding Company Act and the enforcement provisions of the Federal Deposit Insurance Act.

The policy statement is printed on the following pages. It is effective immediately. However, the Board will accept comment, for review by the Board, through July 1, 1987.

Questions on this matter may be directed, at this Bank, to Gerald P. Minehan, Assistant Chief Examiner, Multinational Banking Department (Tel. No. 212-720-5881).

E. Gerald Corrigan,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 261
(Docket No. R-0602)

POLICY STATEMENT ON THE RESPONSIBILITY OF BANK HOLDING COMPANIES TO ACT AS SOURCES OF STRENGTH TO THEIR SUBSIDIARY BANKS

AGENCY: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

ACTION: POLICY STATEMENT

SUMMARY: Pursuant to its authority to regulate bank holding companies under the Bank Holding Company Act, the Federal Deposit Insurance Act, and the International Lending Supervision Act, the Board of Governors of the Federal Reserve System issues a reaffirmation of its long-standing policy that bank holding companies should act as sources of strength to their subsidiary banks by standing ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress or adversity.

EFFECTIVE DATE: April 24, 1987. Comments must be received by July 1, 1987.

ADDRESS: Interested parties may submit comments concerning the policy statement for the Board's review. Comments should include reference to Docket No. R-0602 and should be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551 or delivered to the guard station in the Eccles Building

Courtyard on 20th Street, N.W. (between Constitution Avenue and C Street N.W.) Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays, except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information. (12 C.F.R. §261.6(a)).

FOR FURTHER INFORMATION CONTACT: Stephen C. Schemering, Deputy Associate Director, Division of Banking Supervision and Regulation, (202) 452-2433; or Richard Spillenkothen, Deputy Associate Director, Division of Banking Supervision and Regulation, (202) 452-2594; or for the hearing impaired only, Telecommunications Device for the Deaf ("TDD"), Earnestine Hill or Dorothea Thompson (202) 452-3544, Board of Governors of the Federal Reserve System, Washington D.C. 20551.

SUPPLEMENTAL INFORMATION: The Board has become aware of situations where a bank has been threatened with failure notwithstanding the availability of resources to its parent bank holding company. In order to assure that the Board's policy that bank holding companies serve as sources of strength to subsidiary banks is fully understood by bank holding companies, the Board believes it appropriate to issue a general policy statement reaffirming and articulating these principles, and confirming that the policy applies in failing bank situations. This long-standing policy has been recognized by the Supreme Court in its decision in Board of Governors v. First Lincolnwood Corp., 439 U.S. 234 (1978), and has been incorporated explicitly in the Board's Regulation Y, 12 C.F.R. §225.4(a)(1). The Board invites interested parties to comment on this policy and intends to review the Policy Statement in light of such comments.

POLICY STATEMENT ON THE RESPONSIBILITY OF BANK HOLDING COMPANIES TO ACT AS SOURCES OF STRENGTH TO THEIR SUBSIDIARY BANKS

A fundamental and long-standing principle underlying the Federal Reserve's supervision and regulation of bank holding companies is that bank holding companies should serve as sources of financial and managerial strength to their subsidiary banks. It is the policy of the Board that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks in a manner consistent with the provisions of this policy statement.

Since the enactment of the Bank Holding Company Act in 1956, the Board has formally stated on numerous occasions that a bank holding company should act as a source of financial and managerial strength to its subsidiary banks. As the Supreme Court recognized in the 1978 First Lincolnwood decision, Congress has expressly endorsed the Board's long-standing view that a holding company must serve as a "source of strength to subsidiary financial institutions."1/ In addition to frequent pronouncements over the years and the 1978 Supreme Court decision, this principle has been incorporated explicitly in Regulation Y since 1983. In particular, Section 225.4(a)(1) of Regulation Y provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

The important public policy interest in the support provided by a bank holding company to its subsidiary banks is based upon the fact that, in acquiring a commercial bank, a bank holding company derives certain benefits at the corporate level that result, in part, from the ownership of an institution that can issue federally insured deposits and has access to Federal Reserve credit. The existence of the federal "safety net" reflects important governmental concerns regarding the critical fiduciary responsibilities of depository institutions as custodians of depositors' funds and their strategic role within our economy as operators of the payments

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1/ Board of Governors v. First Lincolnwood Corp., 439 U.S. 234, 252 (1978), citing S. Rep. No. 95-323, 95th Cong., 1st Sess. 11 (1977).

system and impartial providers of credit. Thus, in seeking the advantages flowing from the ownership of a commercial bank, bank holding companies have an obligation to serve as sources of strength and support to their subsidiary banks.

An important determinant of a bank's financial strength is the adequacy of its capital base. Capital provides a buffer for individual banking organizations to absorb losses in times of financial strain, promotes the safety of depositors' funds, helps to maintain confidence in the banking system, and supports the reasonable expansion of banking organizations as an essential element of a strong and growing economy. A strong capital cushion also limits the exposure of the federal deposit insurance fund to losses experienced by banking institutions. For these reasons, the Board has long considered adequate capital to be critical to the soundness of individual banking organizations and to the safety and stability of the banking and financial system.

Accordingly, it is the Board's policy that a bank holding company should not withhold financial support from a subsidiary bank in a weakened or failing condition when the holding company is in a position to provide the support. A bank holding company's failure to assist a troubled or failing subsidiary bank under these circumstances would generally be viewed as an unsafe and unsound banking practice or a violation of Regulation Y or both. Where necessary, the Board is prepared to take supervisory action to require such assistance. Finally, the Board recognizes that there may be unusual and limited circumstances where flexible application of the principles set forth in this policy statement might be necessary, and the Board may from time to time identify situations that may justify exceptions to the policy.

This statement is not meant to establish new principles of supervision and regulation; rather, as already noted, it builds on public policy considerations as reflected in banking laws and regulations and long-standing Federal Reserve supervisory policies and practices. A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary bank(s), including an unwillingness to provide appropriate assistance to a troubled or failing bank, will generally be considered an unsafe and unsound banking practice or a violation of Regulation Y, or both, particularly if appropriate resources are on hand or are available to the bank holding company on a reasonable basis. Consequently, such a failure will generally result in the issuance of a cease-and-desist order or other enforcement action as authorized under banking law and as deemed appropriate under the circumstances.

(signed) Barbara Lowrey

Barbara R. Lowrey
Associate Secretary of the Board