FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10193**
September 25, 1987]

PROPOSED AMENDMENT TO REGULATION Y REGARDING THE ACQUISITION OF THRIFT INSTITUTIONS BY BANK HOLDING COMPANIES

Comment Invited by November 20

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

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has requested comment on whether it should permit bank holding companies to acquire healthy thrift institutions and the terms and conditions under which such acquisitions might be permitted.
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> Comment is requested by November 20, 1987.
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> Currently, acquisition of a healthy thrift institution is not a permissible activity for a bank holding company under the Board's rules. However, changes in the economic and regulatory environment have prompted the Board to seek comment on whether this policy should be changed.
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> The Bank Holding Company Act does not specifically authorize or prohibit bank holding companies from acquiring thrift institutions. However, in 1977 with the D.H. Baldwin decision, the Board determined that operation of a healthy thrift institution was closely related to banking but was not a "proper incident thereto." Accordingly, the Board has restricted its approvals to acquisitions of failing thrifts only.
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> The most important motivation for reconsideration of the D.H. Baldwin decision is the major developments in the interstate provision of depository institutions services both by banks and thrifts.
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> In addition to comment on whether bank holding companies may acquire and operate healthy thrifts, the Board requests comment on the terms and conditions under which this activity might be allowed.

Enclosed — for depository institutions and bank holding companies in this District — is a copy of the text of the proposal, which has been submitted for publication in the *Federal Register*; copies will be furnished to others upon request directed to the Circulars Division of this Bank (Tel. No. 212-720-5215 or 5216). Comments on the proposal should be submitted by November 20, 1987, and may be sent to the Board, as indicated in the notice, or to our Domestic Banking Applications Division.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 225

(Regulation Y; Docket No. R-0614)

Bank Holding Companies and Change in Bank Control

Board Policy Regarding the Acquisition and Operation of Thrift Institutions By Bank Holding Companies

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Solicitation of public comment.

SUMMARY: The Federal Reserve Board is soliciting comment on whether, in light of changing economic and regulatory circumstances, the Board should determine that the acquisition and operation of thrift institutions by bank holding companies is, as a general matter, a proper incident to banking under the Bank Holding Company Act, and, on this basis, a permissible activity for bank holding companies under the Act and Regulation Y. 12 C.F.R. § 225.25. The Board has previously determined that the operation of a thrift institution is closely related to banking, but has permitted bank holding companies to acquire thrifts only where the acquisition involved a failing thrift institution. The Board also seeks comment on the terms and conditions under which bank holding companies should be permitted to acquire and operate healthy thrift institutions, if it should determine to allow such acquisitions.

DATE: Comments must be received by November 20, 1987.

ADDRESS: All comments, which should refer to Docket No. R-0614, should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th & Constitution Avenue, N.W., Washington, D.C., between 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: J. Virgil Mattingly, Deputy General Counsel (202/452-3430), Scott G. Alvarez, Senior Counsel (202/452-3583), Michael J. O'Rourke, Senior Attorney (202/452-3288), Legal Division; Roger Cole, Manager (202/452-2618), or Molly Wassom, Senior Financial Analyst (202/452-2305), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. For the hearing impaired only, Telecommunications Service for the Deaf, Earnestine Hill or Dorothea Thompson, (202/452-3544).

[Enc. Cir. No. 10193]

SUPPLEMENTARY INFORMATION:

I. INTRODUCTION: The purpose of this request for comment is to assist the Board in its review of Board policy regarding the acquisition and operation of thrift institutions by bank holding companies, and to obtain the commenters' views as to whether any changes to that policy are appropriate in light of changing economic and regulatory circumstances. The Board is now considering adding to the list of permissible nonbanking activities in Regulation Y the acquisition and operation of thrift institutions. To date, however, the Board has approved only the acquisition of failing thrift institutions, and not thrift institutions generally. Its rationale for adopting that policy was articulated in the Board's 1977 D.H. Baldwin decision,[1] which is discussed below.

II. Background:

A. Statutory and Regulatory Framework.

The BHC Act does not specifically authorize or prohibit bank holding companies from acquiring thrift institutions. Rather, the Act contains a general prohibition against bank holding companies acquiring companies engaged in any activity unless the Board has determined the activity to be "so closely related to banking . . . as to be a proper incident thereto" within the meaning of section 4(c)(8) of the BHC Act. 12 U.S.C. § 1843(c)(8). Section 4(c)(8) thus imposes a two step test for determining the permissibility of nonbanking activities for bank holding companies: (1) whether the activity is closely related to banking; and (2) whether the activity is a proper incident to banking -- that is, whether the proposed activity can reasonably be expected to produce benefits to the public that outweigh possible adverse effects.[2]

When the Board adopted the initial list of permissible nonbanking activities for bank holding companies in 1971, it did not include the operation of an S&L. (36 Federal Register 1077 (1971)). Notwithstanding its 1971 decision not to include the operation of S&Ls in the Regulation Y laundry list of permissible nonbanking activities, the Board in 1972 and 1975 approved applications from New England thrifts to become bank holding companies by acquiring commercial banks, in view of the unique, longstanding affiliation between thrifts and commercial

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1/ D.H. Baldwin Company, 63 Federal Reserve Bulletin 280 (1987).

2/ See Board of Governors v. Investment Company Institute, 450 U.S. 46 (1984); National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975).

banks in that region.3/ With these few exceptions, prior to 1982 the Board did not permit bank holding companies to acquire thrift institutions. The reasons for this policy were articulated in the Board's 1977 order denying an application by D.H. Baldwin, at the time a registered bank holding company, to retain ownership of a healthy savings and loan association it had acquired in 1969 before it became a bank holding company.4/

B. The D.H. Baldwin Case.

In D.H. Baldwin, the Board determined that as a general matter operating an S&L is closely related to banking, but ruled that such activities should not be regarded as a proper incident to banking; that is, as a general matter the public benefits associated with the affiliation of a bank and a thrift were not sufficient to outweigh the adverse effects of such an affiliation. This determination was based on three factors: (1) the perception of a competing and conflicting regulatory framework governing banks and S&Ls; (2) the possibility that cross-industry acquisitions would undermine the perceived rivalry between the banking and thrift industries; and (3) the possibility that such acquisitions could undermine the interstate banking restrictions of the Douglas Amendment to the Bank Holding Company Act ("Act" or "BHC Act"). Since that time, in all its orders regarding thrift acquisitions, the Board has continued to maintain the position that, as a general matter, the acquisition of a thrift institution is not a proper incident to banking.

C. Worsening Condition of the Thrift Industry and the First Failing Thrift Acquisitions.

In 1981, in response to worsening conditions in the thrift industry, the Board informed the Congress that it might be forced to allow bank holding companies to acquire failing thrifts, and requested passage of the so-called Regulators Bill, which provided a series of procedures and priorities to guide the Bank Board's discretion in approving such acquisitions and otherwise to provide capital assistance to troubled thrifts.

Before the proposed legislation could be enacted, however, the Board was faced with two proposals by bank holding companies to acquire failing thrifts, proposals which necessitated the Board's immediate consideration in order to

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3/ Newport Savings and Loan Association, 58 Federal Reserve Bulletin 313 (1972); Old Colony Co-Operative Bank, 58 Federal Reserve Bulletin 417 (1972); Profile Bancshares, Inc., 61 Federal Reserve Bulletin 901 (1975).

4/ D.H. Baldwin Company, 63 Federal Reserve Bulletin 280 (1977).

avoid the probable failure of the institutions. The first, Scioto Savings Association in Ohio, was acquired by an instate bank holding company at the urging of the Ohio Thrift Commissioner.[5] In the second,[6] the Federal Home Loan Bank Board requested that the Board allow Citicorp to acquire Fidelity Federal Savings and Loan of San Francisco. To allay the concerns of interested trade groups, state regulatory authorities, competing banks, members of Congress, community groups and others, whose opposition could have required the Board to conduct a time consuming formal hearing on the application and thus jeopardize the attempt to rescue the institution, the Board imposed a series of conditions on the operations of an S&L acquired by a bank holding company. Several of these conditions, such as continued operation of the institution as a thrift and branching restrictions, reflect the terms or spirit of the then-pending Garn-St Germain Depository Institutions Act of 1982. As part of this process, the Board also imposed conditions that limited transactions and operations between a thrift institution owned by a bank holding company and its affiliates. These conditions, known as the tandem operations restrictions, have been imposed on all thrift acquisitions since that time.[7] The tandem operation restrictions will be reviewed below with respect to the Board's request for comment regarding the terms and conditions under which bank holding companies should acquire and operate thrift institutions, should the Board determine that, as a general matter, this activity is a proper incident to banking.

D. **The 1982 Garn-St Germain Act.**

Shortly after the Board's approval of the Fidelity acquisition by Citicorp, Congress passed the Garn-St Germain Depository Institutions Act, which authorized the purchase of ailing S&LS by out-of-state bank holding companies, provided the FSLIC follows certain bidding procedures that gave priority to intra-industry acquisitions and in-state organizations. In addition to the bidding priorities, the Garn-St Germain Act required that FSLIC minimize the cost for any S&L rescue;

5/ Interstate Financial Corporation (Scioto Savings Association), 68 Federal Reserve Bulletin 316 (1982).

6/ Citicorp (Fidelity Federal Savings and Loan), 68 Federal Reserve Bulletin 656 (1982).

7/ Citicorp petitioned the Board for relief from these conditions. In response, the Board issued a proposed rulemaking requesting comment on the tandem restrictions. The Board recently has rendered its decision on the conditions. See Letter of William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, to Patrick Mulhern, Senior Vice President and General Counsel, Citicorp (Aug. 10, 1987).

allowed the Board to waive the notice and hearing requirements of section 4 of the BHC Act in approving failing thrift acquisitions; and excluded FSLIC-insured thrifts from the definition of bank in the Bank Holding Company Act, thereby permitting such acquisitions under the interstate banking provisions of the Douglas Amendment. The act also expressly limited the expansion of the acquired S&L to those locations where a national bank could branch in the state.

Throughout the course of the debate leading to passage of the Garn-St Germain Act, the Chairman of the Federal Reserve Board made clear the Board's belief that it could exercise its existing authority to approve acquisitions of thrifts by bank holding companies.8/ As a policy matter, however, the Chairman indicated that the Board had not yet exercised that power, because to do so would open up larger questions of interstate banking and healthy thrift acquisitions generally.9/ This view, that the Board could exercise existing powers to approve such acquisitions, was shared by members of Congress,10/the acting Comptroller of the

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8/ Chairman Volcker stated that: "One of the difficulties -- a major difficulty -- is not that we don't have those powers [to authorize bank holding company acquisitions of thrifts] but that they are not directed and limited. This bill provides a sense of priorities. Without it, we would be forced back on those powers, which I feel quite certain, would open up broader issues than is probably necessary to open up at this particular time. This bill gives us the specific authority to deal just with institutions in serious difficulty." The Deposit Insurance Flexibility Act: Hearing on H.R. 4603 Before the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance of the House Committee on Banking, Finance and Urban Affairs, 97 Cong., 1st Sess. 167, 181 (1981) ("1981 House Hearings").

9/ Id., at 177. (refrain from exercising existing authority.) Chairman Volcker continued his testimony by stating that if the Board used its existing authority to allow bank holding companies to acquire thrifts, it would be difficult or impossible to limit the Board's power to the acquisition of failing thrifts. Id., at 191.

10/ See e.g., 127 Cong. Rec. H7798 (daily ed. Oct. 27, 1981) (remarks of Rep. Vento); 127 Cong. Rec. H7795 (daily ed. Oct. 27, 1981) (remarks of Rep. Wylie).

Currency,[11] the Department of Justice,[12] the Federal Home Loan Bank Board,[13] and groups opposing the pending legislation such as the Independent Bankers Association of America, among others.[14] Without passage of the Garn-St Germain Act, the Chairman and others indicated the Board might be forced to use the Board's more general powers to approve such acquisitions,[15] and there was doubt whether, as a legal matter, the Board could limit its grant of approval to failing institutions only.

E. Thrift Acquisitions Since the 1982 Garn-St Germain Act.

Since passage of the Garn-St Germain Act in October, 1982, the Board has continued to approve the acquisition of failing thrifts, particularly in response to the Ohio and Maryland thrift crises.[16] In all of these instances, the Board imposed conditions substantially similar to those laid out in the First Fidelity Order. The Board has limited its approval to acquisitions of failing thrifts only, and, when

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11/ Financial Institutions Restructuring and Services Act of 1981: Hearings on S.1686, S.1703, S.1720, and S.1721 Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong. 1st Sess. 26 (1981) (Part III) (hereafter, the "1981 Senate Hearings, Parts I, II and III", as appropriate).

12/ Conduct of Monetary Policy: Hearings Before the House Committee on Banking, Finance and Urban Affairs, 97th Cong. 1st Sess. 956 (1981) (hereafter, "1981 House Monetary Policy Hearings').

13/ 1981 House Monetary Policy Hearings at 109.

14/ 1981 House Hearings at 88, 95.

15/ See footnote 9, supra. See also Capital Assistance Act and Deposit Insurance Flexibility Act: Hearings on S.2531 and S.2532 Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 2d Sess. 54 (1982) (hereafter, "1982 Senate Hearings") (remarks of Sen. Riegle); 1982 Senate Hearings at 144 (remarks of Sen D'Amato); and 1982 Senate Hearings at 369 (remarks of Sen. Garn).

16/ These provisions have recently been renewed with the passage of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86 (enacted Aug. 10, 1987) ("CEBA").

presented with an application by Old Stone Corporation to acquire in essence a healthy thrift in June, 1984, the Board denied the application.[17/] Out of the approximately 18 acquisitions of failing thrifts approved by the Board since 1982, currently only 7 remain in operation as thrifts, with the others having been converted to bank status.

III. The Changing Economic and Regulatory Climate.

This request for comment is prompted by certain economic and regulatory changes since 1982 that may implicate possible changes to the Board's current bank/thrift policy. First, interstate banking has become widespread in the last two years. Approximately 23 states have authorized (or will authorize within the next 18 months) nationwide interstate banking, and only seven states have not yet authorized either regional or nationwide interstate banking. The remaining states have entered, or are about to enter, into regional interstate banking compacts. In addition, the FHLBB has approved over 50 acquisitions by thrifts of failing thrifts on an interstate basis, and also has recently allowed interstate branching under certain circumstances. This development tends to undermine one of the basic reasons for the D.H. Baldwin decision -- concern about impairing the Congressional policy embodied in the Douglas Amendment.

Second, recent changes in the law substantially broadening the powers of thrift institutions may have tended to erode the distinction between thrift institutions and banks at which the Board's conditions were directed. For example, thrift institutions have in the past several years been granted broad powers to conduct additional activities, including authority to make commercial and nonhousing related loans and to accept NOW accounts as well as demand deposits in certain circumstances -- all services that are offered by commercial banks. The elimination of the interest rate differential has removed another significant distinction between banks and thrifts.

Third, it has been publicly reported that certain thrifts have considered leaving the FSLIC fund for a number of reasons. Thrifts, if converted to banks, may be attractive acquisition vehicles for bank holding companies to increase their market share on an intra-state basis, or as a cost-effective means to establish a regional banking network. Thrift institutions may also be priced more favorably, in terms of multiples of earnings, than are similarly situated banks. Moreover, there may be enhanced incentives for the thrifts themselves to consider converting their charter and applying for FDIC insurance. The imposition of a special FSLIC insurance premium has been publicly cited by some thrifts as an

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17/ Old Stone Corporation (Catawba), 70 Federal Reserve Bulletin 593 (1984).

incentive to leave the fund. Although the recent passage of CEBA imposes a temporary moratorium on such conversions, upon its expiration thrifts would be eligible to convert their charters and opt for FDIC insurance upon payment of twice their regular and annual premiums to the FSLIC, among other requirements.[18] See CEBA, Pub. L. No. 100-86, § 306(h); § 302(b)(4)(B). With this recent increased interest in the conversion of FSLIC-insured thrifts to bank status, the FHLBB has indicated that such conversions may affect the FSLIC's recapitalization plans by reducing the flow of insurance premiums to FSLIC.[19]

Finally, it can be argued that the Board's existing policy itself serves as an incentive for healthy thrifts to seek to leave the FSLIC fund. Under current Board policy, a bank holding company wishing to acquire a healthy thrift in the holding company's home state or banking region has no alternative but to convert the thrift into a bank which it may acquire, because the Board's D.H. Baldwin policy will not permit the holding company to acquire and operate the healthy thrift as a thrift.

Accordingly, in light of the above factors, it appears that current (and changing) financial and regulatory circumstance may warrant a review of the Board's policies regarding the acquisition and operation of thrift institutions by bank holding companies. The Board requests comment on the implications of such changing circumstances for its current policies, as well as commenters' views on what additional factors, if any, the Board should consider in reaching its determination.

A. Public Benefits Considerations.

Commenters may also wish to consider the nature of any impact on the FSLIC fund if the Board were to approve the acquisition of healthy thrifts. On the one hand, it could be argued that Board approval of the acquisition by bank holding companies of healthy thrifts could lower the incentive for those companies to bid on failing thrift institutions. On the

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18/ Other provisions of CEBA might serve as a disincentive for particular thrifts to leave the FSLIC fund, depending on the extent of that institution's so-called "secondary reserves". See New Law Punishes Thrifts Leaving FSLIC Before 1993, Am. Banker, Sept. 2, 1987, at 3 ("Thrift Article").

19/ See Testimony of Edwin Gray, Chairman, Federal Home Loan Bank Board, Before the Subcommittee on General Oversight and Investigations of the House Committee on Banking, Housing and Urban Affairs 10-13 (May 14, 1987); and a similar statement before the Senate Committee on Banking, Housing and Urban Affairs 3-4 (May 21, 1987).

other hand, bank holding company acquisition of healthy thrifts, and their continued operation as thrifts, could provide the FSLIC with a continued, stable source of insurance premiums.

At this juncture, it should be noted that bank holding companies' acquisition of thrifts has not to date provided the solution to the problems of the thrift industry. Currently, in addition to Citicorp's 4 S&Ls, only three additional thrifts acquired by bank holding companies are still operating as thrift institutions, and they are relatively small institutions. Moreover, most thrift problems to date have been resolved on a intra-industry basis through mergers with other S&Ls.

As noted above, one of the important motivations for a reconsideration of the D.H. Baldwin decision is the major developments in the interstate provision of depository institution services by both banks and thrifts. Nevertheless, this development is still circumscribed by the decisions of most states that have authorized some form of out-of-state acquisitions to keep interstate expansion within specific regions. In view of the fact that the Board considered that the D.H. Baldwin decision was necessary in order to prevent the undermining of the Douglas Amendment, the question arises, with respect to the scope of any authorization for acquisition of healthy thrifts, whether the Board should limit the acquisition of healthy thrifts to those geographic areas where a bank holding company would be permitted to buy a bank under the Douglas Amendment. Such an approach would allow bank holding companies to purchase healthy thrifts in their home state, or in those states where acquisitions are permitted because of a regional arrangement, or a reciprocal or other authorization of interstate banking. Comment is requested on whether such a limitation is necessary to carry out the Board's original intention of giving effect to the intent of the Douglas Amendment, and on whether such a limitation is still necessary in the light of present interstate banking arrangements. Comment is also requested on whether such a policy would be effective in accomplishing the public benefits of encouraging the acquisition of failing thrifts, and of avoiding the creation of artificial incentives for healthy thrifts to withdraw from participation in the FSLIC.

B. Conditions Under Which the Board Should Allow the Acquisition and Operation of Thrift Institutions Generally.

If the Board should determine that the operation of a thrift institution as a general matter is a proper incident to banking, then the issue remains as to the terms and conditions under which it should allow the conduct of this activity.

Commencing with the 1982 acquisition by Citicorp of Fidelity Federal Savings and Loan of San Francisco and continuing to the present, the Board has imposed a series of conditions on the operation of thrift institutions by bank holding companies. These conditions were imposed in direct response to the concerns voiced by banking organizations, thrift institutions, their trade groups, state regulators, and others opposed to the acquisitions that: (1) the bank holding companies would divert funds from the S&Ls and housing needs in the home states of the S&Ls to other areas served by the bank holding company or its affiliates; (2) the bank holding companies would use the S&Ls to advance the business or operations of other holding company subsidiaries; (3) the acquisitions would erode interstate banking prohibitions and the statutory distinctions between banks and thrift institutions; (4) the thrifts would be operated as banks or branches of bank affiliates in violation of statutory limitations on interstate banking and bank branching; and, (5) the acquisitions would give the bank holding company and its S&Ls an unfair competitive advantage over other banks and thrifts.

Among the conditions established were requirements that:

(1) the bank holding company would operate the S&Ls as savings and loan associations having as their primary purpose the provision of residential housing credit;

(2) the S&Ls would not engage in any activities not permissible for a bank holding company;

(3) the S&Ls would not establish new branches at locations not permissible for national or state banks located in the state where the S&L is located (a specific requirement of the Garn-St Germain Act, which authorizes acquisitions by bank holding companies of failing thrifts);

(4) the S&Ls would be operated as separate, independent, profit-oriented corporate entities and would not be operated in tandem with any other subsidiary of the bank holding company. In order to carry out this condition, the bank holding company and S&Ls would limit their operations so that:

(a) no banking or other subsidiary of the bank holding company would link its deposit-taking activities to accounts at the S&Ls in a sweeping arrangement or similar arrangement;

(b) the S&Ls would not directly or indirectly solicit deposits or loans for any other subsidiary of the bank holding company and the bank holding company and its subsidiaries would not solicit deposits or loans for the S&Ls;

(5) to the extent necessary to insure independent operation of the S&L and prevent the improper diversion of funds, the S&Ls would not engage in any transactions with the bank holding company or its other subsidiaries without prior approval of the appropriate Federal Reserve Bank;

(6) the S&L would not establish or operate remote service units at any location outside of the home state of the S&L;

(7) the bank holding company would not change the name of the S&L to include the word "bank" or any other term that might confuse the public regarding the S&Ls status as a nonbank, thrift institution; and

(8) the S&L would not convert its charter to a bank charter or a state thrift charter without prior Board approval.

Board approvals of all thrift acquisitions by bank holding companies since 1982 have contained substantially similar restrictions. In response to a request by Citicorp for relief from the tandem operation restrictions (conditions 4 and 5 above), the Board requested public comment on whether it should retain, modify or remove the fourth and fifth conditions.20/

On August 10th of this year, the Board granted certain limited relief from those restrictions, principally with respect to allowing such tandem operations where a bank holding company could otherwise acquire and operate a commercial bank in the state where the thrift is located, on the basis that such joint operations would not implicate the Board's concerns regarding the preservation of the integrity of the Douglas

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20/ Citicorp contended that the requested relief is necessary to enable its S&Ls to offer a broader range of services and to utilize the advantages inherent in the bank holding company structure (particularly, economies of scale and cross-marketing) in order to maintain its S&Ls as competitive institutions in the S&L industry.

Amendment in such situations.21/ The Board also allowed the Citicorp S&L to affiliate with the Citishare ATM switch in order to reduce the cost to the thrifts of joining certain ATM networks.

At this time, in connection with the proposed addition of the operation of a thrift institution to Regulation Y's list of permissible nonbanking activities, the Board will consider more generally the terms and conditions under which bank holding companies may be permitted to acquire and operate thrift institutions. The first and third of these conditions listed above -- continued operation of the thrift as a thrift, and restrictions on establishment of new thrift branches to those locations permissible for banks in the state -- reflect the terms or spirit of the Garn-St Germain Act emergency thrift acquisition provisions. Retention of the first condition would reflect the Congressional intent behind that Act to maintain a separate thrift industry to serve the nation's housing needs. The limitation on branching except as permitted for national banks (the third condition) appears necessary to maintain the integrity of the Garn St Germain Act's emergency thrift acquisition provisions. If a bank holding company could acquire a healthy thrift without such a branching limitation, the incentive for bank holding companies to acquire failing thrifts would decrease, and the cost to the FSLIC of resolving those situations could well increase. Finally, commenters should direct their attention to whether these conditions are necessary to preserve the integrity of the Douglas Amendment to the BHC Act, which reserves to the states the decision to allow out-of-state bank holding companies to acquire banking institutions in the state. Continued imposition of the second condition -- that a thrift subsidiary of a bank holding company should engage only in activities permissible for bank holding companies -- is required by the BHC Act.22/

The Board is prepared to entertain comments with respect to any terms or conditions under which bank holding companies may acquire and operate thrift institutions.
CONCLUSION: In sum, the Board believes that changing economic and regulatory circumstances render it appropriate to review the Board's overall policy regarding the acquisition and operation of thrift institutions by bank holding companies.

21/ See Letter of William W. Wiles, Secretary, Federal Reserve Board, to Patrick Mulhern, Senior Vice President and General Counsel, Citicorp (Aug. 10, 1987).

22/ Central Pacific Corporation, 68 Federal Reserve Bulletin 382 (1982).

The Board will consider the following options with respect to this issue:

1. maintain the current D.H. Baldwin policy;

2. modify the D.H. Baldwin policy to allow the acquisition of thrifts where a bank holding company could otherwise own a bank; and

3. overrule the D.H. Baldwin policy and allow the acquisition of healthy thrifts nationwide.

The Board requests comment on the advisability of selecting one of these options, or the availability of additional courses of action for its consideration. The Board also requests comment on the terms and conditions under which thrift institutions may be acquired and operated by bank holding companies, if the Board determines to allow such acquisitions a general matter.

REGULATORY FLEXIBILITY ACT ANALYSIS

This proposal to expand the permissible nonbanking activities of bank holding companies is not expected to have a significant economic impact on a substantial number of small business entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. § 601 et seq.). The Board is required by section 4(c)(8) of the BHC Act, 12 U.S.C. § 1843(c)(8), to determine whether nonbanking activities are closely related to banking and a proper incident thereto, and thus are permissible for bank holding companies. This proposal, if adopted, would permit bank holding companies to acquire and operate healthy thrift institutions -- an activity bank holding companies are not now permitted to conduct. The proposal does not impose more burdensome requirements on bank holding companies than are currently applicable, and these provisions provide no barrier to meaningful participation by small bank holding companies in the proposed activity.

The Board notes that there are not a significant number of small bank holding companies engaged in the operation of thrift institutions at this time. As noted, bank holding companies have not previously been permitted to acquire healthy thrift; the proposal, if adopted, would expand the powers of bank holding companies by authorizing bank holding companies to cquire healthy, in addition to failing, thrift institutions.

List of Subjects in 12 C.F.R. 225

Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements.

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)), the Board solicits comment regarding the possible amendment of 12 C.F.R. Part 225.

The Board solicits comment regarding a proposed amendment to Section 225.25(b), to add a paragraph (9) to the Board's list of permissible nonbanking activities, which may read as follows:

> (9) Thrift Institutions. Acquiring and operating thrift institutions, including savings and loan associations, building and loan associations, and FSLIC - insured savings banks, so long as the institution is not a bank.

In connection with solicitation of comment regarding a possible amendment to Regulation Y to authorize the acquisition and operation of healthy thrift institutions, the Board also seeks comment regarding the terms and conditions which the proposed activity should be conducted, should the Board determine to allow such acquisitions as a general matter. In that regard, the commenters' particular attention is drawn to the terms and conditions specified above that the Board traditionally has imposed on failing thrift acquisitions, and, as well, the Board's August 10, 1987 determination to grant certain limited relief from those conditions.

Board of Governors of the Federal Reserve System, September 18, 1987.

(signed) James McAfee

James McAfee
Associate Secretary of the Board