

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7856]
April 13, 1976]

AMENDMENT TO REGULATION Y

Prior Notification By Bank Holding Companies Planning to Purchase Their Own Stock

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

Following is the text of a statement issued April 8 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today amended its Regulation Y to require prior notification by bank holding companies planning to purchase their own stock.

The purpose of the amendment is to assist the Board in supervising bank holding companies by providing advance notice of redemptions of bank holding company stock that could have a significant impact on the company's capital structure.

In particular, the amendment is intended to deter the practice known as "bootstrapping"—whereby a holding company incurs substantial debt in order to purchase or redeem its own outstanding stock, generally to help a shareholder or shareholder group gain control of the company.

Effective May 15, the regulatory amendment will require 45 days advance notice to the Board by a bank holding company planning to redeem its own stock. A proposal to require prior notification was issued for comment by the Board last December 11 and the final amendment includes the following two principal changes from the earlier proposal:

—The period for prior notification was shortened, from 60 to 45 days.

—The threshold requirement for notification, in the amendment as adopted, makes prior notification necessary when the gross consideration in the transaction equals 10 percent or more of the company's net worth, or, when the current transaction combined with the net consideration for similar transactions during the past 12 months (previously five years) aggregates 10 percent (previously 25 percent) of the company's net worth.

Although the Board is aware that there are legitimate reasons for a bank holding company to buy its own stock, it is requiring prior notification of transactions that may result in the following conditions:

—The "bootstrapped" bank holding company is left with heavy debts and much reduced, perhaps very little or no equity.

—Repayment and servicing of the debt depends mainly upon dividends the holding company receives from its subsidiary bank or banks, resulting in substantial pressure on them to pay excessive dividends to the parent company, possibly creating an unsafe or unsound bank condition.

—The need of the holding company to meet heavy debt service obligations may encourage undue risk-taking aimed at increasing the earnings of its subsidiary bank or banks.

The Board also wished to forestall bootstrapping due to the difficulties that may be encountered in unwinding such a transaction once it has taken place.

Where the required pre-notification indicates that consummation of a proposed purchase of its own stock by a bank holding company would violate applicable law, or would create an unsafe or unsound condition in a holding company, the Board would, if necessary, use its cease-and-desist powers to prevent the transaction.

The amendment specified information to be included with notifications.

The Reserve Bank to which the transaction is reported may allow it to take place in less than 45 days if it determines that the transaction would not be an unsafe or unsound practice and would not violate applicable law or regulations.

In submitting the amendment for publication in the *Federal Register*, the Board made the following additional statement:

By notice of proposed rulemaking published in the *Federal Register* on December 19, 1975 (40 F.R. 58866) the Board of Governors proposed for comment an addition to Regulation Y (12 CFR 225) that

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would require prior notification to the Board by bank holding companies planning to purchase or redeem their own stock. Comments were received through January 15, 1976.

The purpose of the proposed amendment was to aid the Board in the performance of its supervision and regulation of bank holding companies by affording it advance notice of stock redemptions that could have a significant impact upon a holding company's capital structure, and, more particularly, to deter "bootstrapping," a practice whereby a holding company incurs substantial debt to purchase or redeem its outstanding equity securities, generally to facilitate a transfer of control by the controlling shareholder or shareholder group.

While banks may be under statutory prohibitions against repurchasing their own shares, as a protection against the reduction of capital (see, *e.g.*, 12 U.S.C. § 83), holding companies are not generally subject to such prohibitions. State corporate laws may forbid a corporation to redeem shares when it is insolvent or when to do so would render it insolvent, but it is possible for such a bank holding company to effect a repurchase or redemption without violating such a statute where the result would nevertheless be to cause a serious drain of equity capital from the company. While the Board has authority under present law to issue cease-and-desist orders to remedy violations of law or unsafe or unsound practices by bank holding companies, the supervisory power may not be fully effective to cure the weakened financial condition of a company caused by a consummated repurchase or redemption.

The proposed amendment to Regulation Y would require prior notification to the Board of such action by a bank holding company. If such notice were to indicate that consummation of the proposed repurchase or redemption would violate applicable law or would create an unsafe or unsound condition in the holding company, the Board would, in appropriate cases, invoke its authority under the Financial Institutions Supervisory Act of 1966 (Section 8(b) of the Federal Deposit Insurance Act) to institute cease-and-desist proceedings against the company in order to prevent the repurchase or redemption.¹

After consideration of all comments received, several changes in the proposed amendment have been made. The major changes are as follows: (1) The term "equity securities" has been substituted for the term "voting securities," so as to include redemptions and purchases of nonvoting preferred stock and prevent circumvention of the notice requirement by that route. (2) The threshold for giving prior notice has been changed to require notice when the gross consideration involved in a transaction would involve an amount equal to 10 percent of the company's net worth, or when the gross consideration for the transaction when aggregated with the net consideration for similar transactions during the preceding 12 months would equal 10 percent of net worth. This method of calculation would take into account the effect of sales of treasury stock and new equity securities by the company. (3) The requirement of providing the names of the persons from whom the securities will be purchased has been modified to require that the names of the sellers be provided when known to the company. (4) The period of prior notice has been reduced from 60 to 45 days.

¹ Even if a repurchase or redemption were not of sufficient magnitude to require prior notice under this amendment, the Board might nevertheless institute cease-and-desist proceedings with respect to such a transaction that otherwise came to its attention if it were to believe that an unsafe or unsound condition would result or had resulted or that an applicable law or regulation would be or had been violated.

Enclosed is a copy of the amendment to Regulation Y. Questions regarding the amendment may be directed to our Domestic Banking Applications Department.

Additional copies of the enclosure will be furnished upon request.

PAUL A. VOLCKER,
President.

Board of Governors of the Federal Reserve System

BANK HOLDING COMPANIES

AMENDMENT TO REGULATION Y

Regulation Y is amended by adding a new section (225.6) thereto, to read as follows:

SECTION 225.6—CORPORATE PRACTICES

* * *

(a) **Purchase or redemption by a bank holding company of its own shares.** No bank holding company shall purchase or redeem any shares of any class of its outstanding equity securities without giving at least 45 days prior notice thereof to its Federal Reserve Bank if (i) the gross consideration to be paid for such purchase or redemption is equal to 10 percent or more of the company's consolidated net worth as of the date of notification, or (ii) the gross consideration to be paid for such purchase or redemption when aggregated with the net consideration paid by the company for all purchases or redemptions of its equity securities during the 12 months preceding the date of notification¹³ equals or exceeds 10 percent of the company's consolidated net worth as of the date of such notice. The 45-day period shall begin to run from the date such notice is received by the Reserve Bank, which shall promptly acknowledge receipt thereof in writing.

Each notice filed hereunder shall furnish the following information:

(1) the title of the security to be purchased or redeemed, and the purposes of the proposed transaction;

(2) the number of shares of that security to be purchased or redeemed; the total number of shares of equity securities outstanding as of the date of the notice, by class; and the number of shares of all other equity securities of the company purchased or redeemed by it over the preceding 12-month period, by class;

(3) the consideration to be paid for the shares to be purchased or redeemed, and the consideration paid for all other shares of the

company's equity securities purchased or redeemed by it over the preceding 12-month period, by class;

(4) the date upon which, or that period of time during which, the purchase or redemption will occur;

(5) if known, the names of persons from whom shares are to be purchased or redeemed in such transaction, and, if known, the names of persons from whom shares were purchased or redeemed in the preceding 12 months;

(6) if debt is to be incurred or has been incurred by the company or a subsidiary in connection with the purchase or redemption or any other such purchase or redemption over the preceding 12 months, a description of the terms of the debt, including the identity of the obligee, and the interest rate, maturity and repayment schedule of the debt;

(7) if the transaction is related in any way to a transfer of control of the company, a description of the terms of the transfer, including the identity of the transferee and a copy of any agreements relating to such transfer; and

(8) a current and pro forma consolidated balance sheet of the holding company.

The Reserve Bank may permit a purchase or redemption to be accomplished prior to the expiration of the 45-day period if it determines that the repurchase or redemption would not constitute an unsafe or unsound practice and would not violate any applicable law, rule, regulation or order, or any condition imposed by, or written agreement with, the Board.

Effective date. This amendment is effective May 15, 1976, and shall be applicable to all transactions occurring after that date for which prior notice is required under this amendment. Such notice may be given prior to the effective date with respect to a transaction proposed to be consummated within 45 days after the effective date. Any company that prior to the effective date has completed plans to effect a transaction that would be covered by this amendment, but as to which there may be insufficient time to provide 45 days prior notice, may request accelerated consideration of the transaction by its Federal Reserve Bank.

¹³ For the purposes of this regulation "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.

For this Regulation to be complete, retain:

- 1) Printed Regulation Y pamphlet, as amended effective June 24, 1974.
- 2) Corrective amendments effective June 24, 1974 (§§ 225.3 and 225.4).
- 3) Amendment effective December 1, 1975 (§ 225.5).
- 4) This slip sheet.