

Federal Reserve Board Issues Wide-Ranging FAQ Guidance on Key Regulations

April 14, 2021

On March 31, 2021, the Federal Reserve Board (the “FRB”) published a series of Frequently Asked Questions (“FAQs”) on each of its Regulations H, K, L, O, W and Y.¹

The FAQs mostly consist of existing legal interpretations regarding these regulations, including those found in FRB orders, preambles to proposed and final rulemakings, letters to institutions, and other written and verbal guidance. However, the FAQs also include FRB interpretations “not previously available in written form.” The majority of the 51 questions and answers in the Regulation W FAQs, the most extensive set of FAQs in the series, are new public interpretations. The Regulation W FAQs represent the most comprehensive articulation of FRB staff interpretations of the rule since the preamble to its adopting release in 2002.

The FRB caveats that the FAQs are staff interpretations and have not been approved by the Board of Governors, except as otherwise noted in the FAQs. The FAQs nonetheless serve as a helpful compendium of FRB staff’s views on various issues. The FRB stated that it will provide new FAQs, or update existing FAQs, on an ongoing basis.²

We summarize below key aspects of the new FAQs by regulatory categories, omitting existing interpretations and focusing on guidance that either appears to modify precedent or was previously unpublished.

¹ Press Release, FRB, Federal Reserve Board publishes frequently asked questions (FAQs) comprising existing legal interpretations related to a number of the Board’s longstanding regulations (March 31, 2021), available [here](#). Regulation H FAQs, available [here](#); Regulation K FAQs, available [here](#); Regulation L FAQs, available [here](#); Regulation O FAQs, available [here](#); Regulation W FAQs, available [here](#); Regulation Y FAQs, available [here](#).

² New or updated FAQs will be posted on the FRB’s website. See Legal Interpretations FAQs of the Board’s Regulations, available [here](#) (last updated March 31, 2021).

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Regulation H

The nine FAQs for Regulation H, which governs state-chartered banks that are members of the Federal Reserve System, primarily provide guidance regarding activities or events that would require notice to or approval by the FRB.

- **Non-Controlling Equity Investments.** The FAQs distill from a decades-old fact-specific interpretive letter the circumstances under which FRB staff would not recommend enforcement action against a state member bank for violating the Federal Reserve Act’s prohibition on a non-controlling equity investment in a company. Such circumstances include where “(i) the company’s activities are limited to those that are permissible for the bank; (ii) the bank has the ability to withdraw from or terminate the investment *at any time*; and (iii) the structure of the investment limits the bank’s exposure, as a legal and accounting matter, to liability resulting from the actions of the company’s other investors.”³ As written, the second condition appears to require a bank to negotiate a general exit right, whereas the interpretive letter applied where the charter or agreement enabled the bank “to withdraw from the entity or to prevent the entity from engaging in impermissible activities in the future.”⁴ In addition, the FAQs are silent as to whether notice or approval is required to make such a non-controlling equity investment.
- **Hedging Transactions.** The FAQs provide helpful commentary as to potential factors the Director of the Division of Supervision and Regulation may consider when reviewing a state member bank’s request for approval to acquire equity securities solely for the purpose of hedging exposures arising from equity derivative

³ Regulation H FAQs, 12 CFR 208.21, Q2 (emphasis added).

⁴ Letter from J. Virgil Mattingly, General Counsel of the Board, to Shane B. Hansen, Esq. (July 11, 1996), available [here](#).

transactions. It notes that the FRB historically has looked favorably upon commitments from a bank that (i) the equity hedging activities would be conducted in accordance with the conditions and restrictions applicable to such activities of national banks; (ii) the activities would not involve the acquisition of equity securities for speculative or investment purposes; (iii) the activities would not result in the bank acquiring more than 5% of any class of equity securities of any issuer; and (iv) the bank would not hold itself out to the public as being willing to purchase or sell any equity security or act as a market-maker in any security by continuously quoting “bid” and “ask” prices for the security.⁵ Of course, although not discussed in the FAQ, all such activities remain subject to the applicable provisions of the Volcker Rule.

Regulation K

The FRB published ten FAQs for Regulation K, which regulates the international banking operations of U.S. banking organizations and the operations of foreign banks in the United States.

- **Permissible Activities Abroad: Islamic Finance Arrangements.** The FAQs formalize elements from prior written guidance on Islamic finance arrangements as requirements. Specifically, FRB staff confirm that engaging in purchase or repurchase arrangements involving goods that are the functional equivalent of extensions of credit is an activity that is permissible as usual in connection with the transaction of the business of banking or other financial operations and is consistent with the supervisory purposes of the Federal Reserve Act, provided that (i) the goods are acquired with an irrevocable commitment from the customer to purchase or repurchase the goods involved and (ii) there is an irrevocable waiver of any customer recourse to the seller of the goods. The FAQ notes that conducting this activity, subject to these conditions, is permissible only in countries where this activity is usual in connection with the business of banking.⁶
- **Issuance of Commercial Paper in the United States by the Domestic Operations of a Foreign Bank.** The FAQs helpfully distill from prior fact-specific written guidance the FRB staff’s view that a foreign bank’s use of a special purpose vehicle, the sole activities of which would be the issuance of commercial paper in the United States and the lending of the proceeds of the commercial paper to the domestic

⁵ Regulation H FAQs, 12 CFR 208.21, Q3.

⁶ Regulation K FAQs, 12 CFR 211.10, Q2.

operations of the foreign bank, would be a permissible activity under section 4(c)(1)(C) of the BHC Act and would not require prior notice to the FRB.⁷

- **Use of Fiduciary Exemption.** The FAQs distill from prior fact-specific written guidance FRB staff's view that the fiduciary exemption in section 211.23(f)(4) of Regulation K permits subsidiaries of a foreign banking organization to hold title to U.S. real estate in connection with the foreign bank's service as trustee of foreign-based investment trusts, sold only to non-U.S. persons, that invest in U.S. real estate.⁸
- **Conversion of a Federal Agency to a State Agency or a State Agency to a Federal Agency.** While prior written guidance made clear that FRB approval under Regulation K is not required for the conversion of a federal agency to a state agency, the FAQ confirms that FRB approval also is not required for the reverse—the conversion of a state agency to a federal agency.⁹

Regulation L

The ten FAQs for Regulation L include interpretations to assist banking organizations in complying with the Depository Institution Management Interlocks Act (“Interlocks Act”)¹⁰ and the FRB's Interlocks Rule (Regulation L and Subpart J of Regulation LL).¹¹ The Interlocks Act and Interlocks Rule generally prohibit a management official of one depository institution or its affiliate from serving as a management official of an unaffiliated depository institution or its affiliate, subject to certain exemptions. Notable FAQs include the following:

- **Joint Ventures.** The FAQs clarify that interlocks between a joint venture in which multiple depository organizations each owns a controlling interest and a parent depository organization would not be prohibited by the Interlocks Act or the Interlocks Rule, as the joint venture and each of the parent depository organizations would be affiliates.¹²
- **Industrial Banks.** The FAQs inform institutions that the Interlocks Act expressly applies to industrial banks. As an affiliate of a depository institution, an industrial

⁷ Regulation K FAQs, 12 CFR 211.23, Q1.

⁸ Regulation K FAQs, 12 CFR 211.23, Q4.

⁹ Regulation K FAQs, 12 CFR 211.24, Q1.

¹⁰ 12 U.S.C. §§ 3201 et seq.

¹¹ 12 CFR 212; 238.91-.99.

¹² Regulation L FAQs, 12 CFR 212.2(a); 12 CFR 238.92(a), Q2.

bank holding company may be subject to the major assets prohibition of the Interlocks Rule. The major assets prohibition would prohibit interlocks between two institutions with total assets exceeding \$10 billion, including between their respective affiliates.¹³

Regulation O

Regulation O regulates “extensions of credit” made by banks to “insiders” of such banks and, in some cases, affiliates of such banks, as well as the “related interests” of such insiders. Notable FAQs include the following:

- **Definition of “Extension of Credit.”** The FAQs address a few aspects of the scope of the definition of “extension of credit,” including when an extension of credit to a third party may be treated as an extension of credit to an insider, and when a given extension of credit becomes subject to Regulation O.
- *Guarantee.* The FAQ clarifies that when an insider guarantees an extension of credit issued by a bank to a third party, the amount attributed to the insider for the purposes of Regulation O is the total amount of indebtedness for which the insider has provided such guarantee.¹⁴
- *Treatment of “Transition Loans.”* Building off of longstanding guidance regarding transition loans—that is, loans made to a person that subsequently becomes an insider—the FAQs provide that the qualitative requirements of Regulation O do not apply to transition loans made to a director or principal shareholder that subsequently becomes an executive officer.¹⁵ In each case, however, such loans would count toward the individual and aggregate lending limits for purposes of future application of Regulation O as soon as the person becomes an insider, whether an executive officer, director, or principal shareholder.
- **Loan Workouts/Restructurings.** The FAQs state that, for purposes of the arm’s-length requirement, banks have the option of comparing the terms of restructured loans to insiders either to extensions of credit to non-insiders that are not part of a workout, or to restructured loans to non-insiders.¹⁶

¹³ Regulation L FAQs, 12 CFR 212.2(f), 12 CFR 238.92(f), Q2.

¹⁴ Regulation O FAQs, 12 CFR 215.3, Q1.

¹⁵ Regulation O FAQs, In General, Q2.

¹⁶ Regulation O FAQs, 12 CFR 215.4, Q1.

- **Discount on Loan Origination Fees.** The FAQ clarifies that a bank may not offer a discount on loan origination fees to an insider if the discount is not available to members of the public (presumably subject to the section 215.4(a)(2) exception for any such extensions of credit made pursuant to a benefit or compensation program that is widely available to all employees, provided that the program does not give preference to any insider over other non-insider employees).¹⁷
- **Exception for Loans to Executive Officers for Residences.** The FAQs rely on a decades-old interpretive letter to provide more generalized guidance regarding Regulation O's "residence" exception at section 215.5(c)(2), which permits extensions of credit *in any amount* to executive officers, to the extent secured by a first lien on an executive officer's "residence." Specifically, it clarifies the types of properties that qualify as a "residence," and that the exception is available only for a single property, but that the property does not have to be the executive officer's *primary* residence as long as the property is in fact used as a residence.¹⁸
- **Estates and Trusts as "Insiders."** Building off of longstanding precedent, the FAQs state that estates or trusts can themselves qualify as "insiders" subject to Regulation O. If a trust or estate directly or indirectly, or acting in concert with one or more persons owns, controls or has the power to vote more than 10% of any class of voting securities, the estate or trust would be a "principal shareholder," and thus an "insider" of the bank. Accordingly, any extension of credit made to the estate or trust, or any company controlled by the estate or trust, would be subject to Regulation O.¹⁹ Additionally, to the extent that an estate owns more than 10% of a covered bank, the executor of that estate would also be deemed to be a principal shareholder of the covered bank.²⁰ Finally, consistent with prior interpretations, the FAQs reiterate that extensions of credit to a trust or estate inure to the benefit of the beneficiaries of the trust or estate. Thus, "an extension of credit to a trust or estate in which an insider has a present or contingent beneficial interest of 25% or more will be treated as made to the insider-beneficiary."²¹

¹⁷ Regulation O FAQs, 12 CFR 215.4, Q2. The letter to which the FAQ cites predates the 1996 amendment to Regulation O that added section 215.4(a)(2).

¹⁸ Regulation O FAQs, 12 CFR 215.5, Q1.

¹⁹ Regulation O FAQs, 12 CFR 215.2, Q2.

²⁰ Regulation O FAQs, 12 CFR 215.2, Q3.

²¹ Regulation O FAQs, 12 CFR 215.3, Q2.

Regulation W

As noted above, the Regulation W FAQs are unique in part because, in contrast to some of the other regulations for which FRB staff published FAQs, Regulation W has not been the subject of significant published legal guidance outside of a handful of FRB interpretive letters on the FRB's website, notwithstanding the number of interpretive questions that have arisen since its adoption in 2002 and as marketplace transactions have evolved. The Regulation W FAQs include 51 questions and answers, 38 of which do not cite to an existing source. We highlight below the FAQs that contain new (public) guidance.

- **Dodd-Frank Act Amendments.** The FRB formally acknowledges that the Dodd-Frank Act's amendments to sections 23A and 23B of the Federal Reserve Act apply, notwithstanding that the FRB has not yet revised Regulation W to reflect such amendments. In a March 2021 staff memorandum cited in the FAQs (the "2021 Staff Memorandum"), FRB staff notes that it "currently is revising Regulation W to reflect these changes."²²
- *Exemption Process.* The FAQs and 2021 Staff Memorandum generally do not address the Dodd-Frank Act revisions, although they provide clarification on certain issues. In particular, the FAQs address the revised process by which a member bank may obtain a section 23A exemption, explaining that the Dodd-Frank Act generally authorizes a bank's primary federal regulator "to grant such requests by order, although the Board also is required to make certain findings before an exemption may be granted."²³
- *Calculating Credit Exposures.* In addition, the 2021 Staff Memorandum clarifies that, although Regulation W has not yet been revised to reflect a quantification methodology for credit exposures arising from derivatives or securities lending and borrowing transactions, insured depository institutions should treat those credit exposures as covered transactions "using the same methodology to measure credit exposure that the institution uses with similarly situated third parties." As an example, the 2021 Staff Memorandum states that if a bank includes a calculation for potential future exposure when calculating credit exposure to nonaffiliates, it must do so when determining its credit exposure to affiliates for purposes of Regulation W.

²² FRB Staff Memorandum, Coverage of Sections 23A and 23B of the Federal Reserve Act (March 2021), [available here](#).

²³ Regulation W FAQs, In General, Q1.

- **Accounting Consolidation and Control.** The FAQs state that a “company should be presumed to have a controlling influence over a second company if the first company consolidates the second company on its financial statements prepared under U.S. Generally Accepted Accounting Principles (GAAP).” The FAQs expressly align the treatment of accounting consolidation in a control analysis under Regulation W and Regulation Y. Notably, in the preamble to the final rule implementing the revised control framework in 2020, the FRB stated the final rule “does not extend to ... Regulation W” but the FRB “may in the future consider conforming revisions to other elements of its regulatory framework, including...Regulation W.”²⁴
- **Treatment of Subordinated Debt as Equity Capital.** The FAQs indicate that subordinated debt that counts as regulatory capital would be treated as “equity capital” of a company, including for purposes of applying Regulation W’s rebuttable presumption that a company is an affiliate if the bank’s affiliated financial holding company owns or controls 15% or more of the company’s equity capital pursuant to the merchant banking or insurance company investment authority. As noted in the preamble to the final rule’s adopting release in 2002, Regulation W’s definition of “equity capital” accords “roughly” with the GAAP definition of stockholders’ equity, which does not include subordinated debt.²⁵ However, the preamble provides further that under the definition of “equity capital,” the FRB retains the “authority on a case-by-case basis to require a holding company to treat a subordinated debt investment in a company as equity capital of the company for purposes of applying the 15 percent presumption.”²⁶ Here, FRB staff treats subordinated debt that counts as regulatory capital categorically as equity capital. The FAQ also notes that subordinated debt that is mandatorily convertible or convertible at the option of the holder into equity capital of a company *would* be treated as equity capital, whereas other subordinated debt *may* be considered equity capital after consideration of the facts and circumstances.
- **Confirmation of a Nonaffiliate’s Letter of Credit Issued on Behalf of an Affiliate.** The FAQs state that a member bank that confirms a letter of credit issued by a nonaffiliate on behalf of an affiliate would be viewed as issuing a guarantee or a letter of credit. A letter of credit issued by a bank on behalf of an affiliate is included in section 23A’s definition of a “covered transaction” and is expressly subject to section 23A’s collateral requirement and quantitative limits, as implemented in Regulation W.

²⁴ 85 Fed. Reg. 12398, 12401 (Mar. 2, 2020).

²⁵ 67 Fed. Reg. 76559, 76565 (Dec. 12, 2002) [hereinafter, “Final Rule”].

²⁶ *Id.*

In implementing section 23A's definition of a "covered transaction," the FRB added a bank's confirmation of a letter of credit issued by an affiliate, explaining in the preamble to the final rule's adopting release that "[u]nder the current law applicable to letters of credit, when a bank confirms a letter of credit, it assumes the risk of the underlying transaction to the same extent as if it had issued the letter of credit."²⁷ Treating a confirmation of a nonaffiliate's letter of credit issued on behalf of an affiliate as an issuance of a letter of credit on behalf of the affiliate appears consistent with that reasoning. In both circumstances, the bank would assume the risk of the nonaffiliate's and affiliate's nonperformance.²⁸

- **Definition of "Purchase of an Asset" from an Affiliate.**
 - *Capital Contributions.* The FAQs clarify that an affiliate's transfer of an asset to a member bank solely in exchange for shares in the bank (*i.e.*, a capital contribution) would not be viewed as a "purchase of assets" by the member bank. Regulation W defines a "purchase of an asset" as an acquisition by the bank "of an asset from an affiliate in exchange for cash or any other consideration, including an assumption of liabilities."²⁹ The FAQs confirm that the issuance of shares by a member bank to an affiliate is not considered "other consideration" for these purposes, and suggest that an asset purchase only occurs if accompanied by a reduction in a member bank's assets (other consideration) or an increase in liabilities, as opposed to an increase in an equity account.³⁰
 - *Cash.* The FAQs indicate that an asset exchange between a bank and an affiliate would not constitute a "purchase of an asset" by the bank, which would be treated as a covered transaction, if the bank receives cash in exchange for the asset, such as in a sales transaction. The interpretation suggests that a spot foreign exchange transaction potentially also would not constitute a "purchase of an asset," because the member bank receives cash in such a transaction (albeit potentially in a different currency).

The FAQs also indicate FRB staff would not treat an affiliate's simultaneous transfer to a member bank of both liabilities (that are fixed in amount) and an equal amount of cash, denominated in the same currency, as a covered transaction. Presumably, the transfer would constitute an asset purchase if, and to the extent that, the value of the cash were less than the value of the liabilities the bank received from the affiliate. Per the FAQs, the bank should include

²⁷ Final Rule at 76569.

²⁸ Regulation W FAQs, 12 CFR 223.3, Q15.

²⁹ 12 CFR 223.3(dd).

³⁰ Regulation W FAQs, 12 CFR 223.3, Q25.

contingent liabilities as liabilities assumed in calculating the covered transaction amount in a bank's asset purchase from an affiliate.³¹

- **Scope of the Attribution Rule.** In the preamble to Regulation W's adopting release, the FRB noted that a number of commenters contended that the attribution rule should not apply to transactions where "the bank does not know, or have reason to know, that the proceeds are transferred to or used for the benefit of an affiliate." The FRB declined to adopt such an exclusion, noting that it "is not willing to make the applicability of the attribution rule contingent in all cases on subjective factors such as a member bank's knowledge of the purpose of a transaction or on such ambiguous, though objective, factors such as a member bank's reason to know of the purpose of a transaction."³²

In contrast, the FAQs state that FRB staff "generally would not expect to recommend the Board take enforcement action against a member bank where the bank did not know or have reason to know at the time of the transaction that the proceeds of the transaction would be used for the benefit of, or transferred to, an affiliate; provided that, at the time of the transaction, the bank maintained reasonable policies and procedures to assure compliance with Regulation W." Although this implies that the staff is delineating a much-needed outside boundary (at least as to enforcement) to the theoretically unlimited scope of the attribution rule, open questions remain as to what constitute "reasonable policies and procedures" that, presumably, are designed to identify and prevent or manage transactions implicating the attribution rule.³³ The FAQs are silent as to whether FRB staff would expect a bank to treat a transaction later identified as triggering the attribution rule as a covered transaction for purposes of ongoing compliance with Regulation W's collateral requirements, even if entered into in compliance with the bank's "reasonable policies and procedures" (for example, in the case of an asset purchase), notwithstanding that FRB staff would not recommend an enforcement action with respect to the initial transaction.

- **Collateral Requirements for Revolving Lines of Credit.** Regulation W provides an exemption from the rule's collateral requirements with respect to the unused portion of an extension of credit to an affiliate as long as the member bank does not have any "legal obligation" to advance additional funds under the extension of credit until the affiliate provides the amount of collateral otherwise required with respect to the entire used portion of the credit line.³⁴ The FAQs emphasize that, in addition to the

³¹ Regulation W FAQs, 12 CFR 223.3, Q26-27; 12 CFR 223.21-.22, Q2.

³² Final Rule at 76576.

³³ Regulation W FAQs, 12 CFR 223.16, Q1.

³⁴ See 12 CFR 223.14(f)(2).

bank not having a contractual obligation to advance funds, the exemption also requires the bank to ensure no funds are in fact drawn until the collateral requirement is met.³⁵

- **Payment for Services to Affiliates.** The FAQs state that, consistent with the market-terms requirement of section 23B as implemented in Regulation W, a member bank must apply the same invoicing and payment collection practices, including receiving prompt payment, when furnishing services to affiliates as it would when furnishing services to nonaffiliates (or practices that are more favorable to the bank). If a member bank does not provide similar services to nonaffiliates, FRB staff would regard payment as being prompt where the member bank receives payment within 60 days of providing the service (for example, bank invoices affiliate for services within 30 days and affiliate pays bank within 30 days of invoice). The FAQs also reiterate guidance in the preamble to the final rule suggesting that when a member bank does not receive prompt payment for services provided to an affiliate, the amount owed to the bank would be considered an extension of credit subject to Regulation W requirements until payment is made.³⁶

Regulation Y

The FAQs include interpretations on a variety of issues, including application of the BHC Act activities restrictions and the scope of a financial holding company's merchant banking authority. FRB staff clarifies that although the FAQs refer at times to bank holding companies, they also apply to foreign banking organizations that are subject to the BHC Act's limitations.

- **Definition of "Company."** FRB staff reiterates previous written guidance that the definition of "company" in section 2 of the BHC Act generally does not include a voting trust, buy-sell agreement, or other similar agreement among shareholders in a bank holding company if the trust or agreement: (i) relates only to the shares of a single bank; (ii) terminates within 25 years; (iii) involves parties who are not participants in any similar voting trust or agreement with respect to any other bank or nonbank business; and (iv) in the case of a voting trust, engages in no other activity except to hold and vote the shares of a single bank.³⁷

FRB staff goes on to explain that a trust (that is not a business trust) excluded from the definition of "company" may include as a beneficiary a new trust that is formed

³⁵ Regulation W FAQs, 12 CFR 223.14, Q4.

³⁶ Regulation W FAQs, 12 CFR 223.51-.56, Q2.

³⁷ Regulation Y FAQs, 12 CFR 225.2, Q2.

upon termination of the original trust (a “springing trust”), as long as the original trust terminates within the applicable statutory time period.³⁸

FRB staff further provides that the exclusion for a non-business trust requires that the original trust terminate within the timeframe specified by regulation, even if the law of the state governing the trust does not observe the rule against perpetuities. Where such a trust does not meet the termination requirement, but would meet this requirement if measured from the date of the trust's acquisition of shares in a bank or bank holding company (rather than from the effective date of the trust), FRB staff would not recommend enforcement action against the trust for violation of the termination requirement.³⁹

- **Section 4(c)(6).** FRB staff confirms the commonly held understanding that section 4(c)(6) of the BHC Act imposes no restrictions on the activities of the company in which the bank holding company invests under such authority. Accordingly, a bank holding company may acquire an interest in a company that engages in commercial or industrial activities pursuant to section 4(c)(6). Section 4(c)(6) permits bank holding companies to make investments in shares of voting securities of a company that, in the aggregate, represent 5% or less of the outstanding shares of any class of voting securities of the company, subject to section 225.137 of Regulation Y. FRB staff confirms the investment must be noncontrolling within the meaning of the BHC Act and the Regulation Y control framework.⁴⁰
- **DPC Lease.** FRB staff details the requirements of the BHC Act's authority for assets acquired in satisfaction of a debt previously contracted (“DPC”), which carries a requirement that such assets be disposed of within two years of acquisition, as applied to real property leases.⁴¹ Specifically, the FAQ provides that a bank holding company effectively disposes of a DPC lease in real property if it enters into a coterminous sublease. If a sublease is not coterminous with the DPC lease, the applicable holding period of the lease is suspended during the term of the non-coterminous sublease and restarts upon termination of the sublease. To constitute an effective disposal, or to suspend the holding period, the sublease or subleases must cover 100% of the physical area under the DPC lease.⁴²
- **Control.** The FAQs include previously published FAQ guidance regarding the FRB's recently revised control framework, including regarding the calculation of total equity, treatment of legacy investments, and treatment of activity restrictions and

³⁸ Regulation Y FAQs, 12 CFR 225.2, Q3.

³⁹ Regulation Y FAQs, 12 CFR 225.2, Q4.

⁴⁰ Regulation Y FAQs, 12 CFR 225.22, Q1.

⁴¹ See 12 U.S.C. § 1843(c)(2); 12 CFR 225.22(d)(1).

⁴² Regulation Y FAQs, 12 CFR 225.22, Q3.

loan covenants as limiting contractual rights. Although these FAQs are noted as “revised,” the changes appear to be minor wordsmithing edits rather than substantive amendments.⁴³

- **Asset Management Control Relief.** One FAQ highlights that FRB staff has issued targeted written relief to an asset management company indicating it would not recommend that the FRB find that the asset management company controls a bank holding company, bank, savings and loan holding company, or savings association (collectively, “regulated companies”) for purposes of the BHC Act or Home Owners’ Loan Act, despite being subject to a presumption of control. The FAQ indicates that FRB staff would be prepared to extend similar relief to other asset management companies in certain circumstances.⁴⁴ To support a staff recommendation that an asset management company does not control a regulated company, the asset management company must provide commitments and become subject to conditions regarding its investments in and relationships with the regulated company. FRB staff expects that such commitments generally would impose stricter limits on the asset management company’s relationships with a regulated company than would apply under the regulatory presumptions of control (for example, with respect to limits on director representatives and the solicitation of proxies) but would allow levels of certain relationships to exceed the limits under the regulatory presumptions of control in certain narrow respects (for example, with respect to permissible business relationships).

This FAQ is notable in that FRB staff explicitly incorporates prior guidance into the new control framework and indicates that passivity commitments may be used in certain circumstances to rebut a presumption of control.⁴⁵

- **Acting in Concert.** FRB staff describes certain circumstances in which people party to an agreement among all or substantially all of a state member bank’s or bank holding company’s shareholders are not a “group acting in concert” for purposes of the Change in Bank Control Act and Regulation Y. Under Regulation Y, there is a rebuttable presumption that investors in a state member bank or bank holding company that are parties to any agreement, contract, understanding, relationship, or other arrangement, whether written or otherwise, regarding the acquisition, voting,

⁴³ Regulation Y FAQs, 12 CFR 225.31, Q1-Q2; 12 CFR 225.32, Q1; 12 CFR 225.34, Q1. For additional information on the “control” FAQs, please see our prior Debevoise Debrief [here](#).

⁴⁴ The relief would be available to an asset management company that is not itself, and is not affiliated with, a bank holding company or savings and loan holding company and whose primary business involves sponsoring, managing, or advising investment companies registered under the Investment Company Act of 1940, other pooled investment vehicles, and institutional accounts.

⁴⁵ Regulation Y FAQs, 12 CFR 225.32, Q2.

or transfer of control of voting securities of a state member bank or bank holding company, other than through a revocable proxy, are a group acting in concert.

In particular, the FAQ indicates that, in limited circumstances, FRB staff would not recommend that the FRB find that parties to a shareholders' agreement are a group "acting in concert" within the meaning of 12 CFR 225.41(b)(2), including where the agreement is: (i) entered into by all or substantially all of the shareholders of the state member bank or bank holding company (which may include the state member bank or bank holding company as a party to the agreement); (ii) the agreement relates only to the shares, and not to the management or operations of, the state member bank or bank holding company; (iii) the agreement is entered into for a purpose other than to acquire or exercise control of a state member bank or bank holding company, such as (a) preserving the S Corporation status of the state member bank or bank holding company under the Internal Revenue Code, (b) preserving tax benefits of the state member bank or bank holding company, or (c) providing existing shareholders a right of first refusal to acquire shares of the state member bank or bank holding company from other shareholders for a reasonable period of time before the shares are offered to non-shareholders; and (iv) the agreement does not impose other limits on shareholders' ability to acquire, vote, or transfer shares of the state member bank or bank holding company for reasons unrelated to those described above.⁴⁶

FRB staff advises that if the shareholders' agreement includes provisions other than those described in the FAQ, a party may consult with FRB staff as to whether the agreement would result in the parties being a "group acting in concert." The FAQ suggests that one may also consult with FRB staff as to whether the period during which existing shareholders may exercise a right of first refusal is reasonable under the facts and circumstances.

- **Reorganization of Activities.** FRB staff gives examples of reorganizations that are permissible for financial holding companies subject to activities restrictions under 12 CFR 225.83(d) or a BHC Act Section 4(m) agreement without prior FRB approval, provided that the financial holding company does not commence any new activities in connection with the reorganization and does not acquire the shares of any non-subsidiary company.⁴⁷ We have included these examples below:
 - *Example 1.* A financial holding company that is operating under a section 4(m) agreement has a wholly owned asset management subsidiary that is not a subsidiary of a bank. The financial holding company seeks to move this

⁴⁶ Regulation Y FAQs, 12 CFR 225.41, Q1.

⁴⁷ Regulation Y FAQs, 12 CFR 225.83, Q1.

subsidiary to another part of the holding company organization. In connection with the movement of the subsidiary, the financial holding company would not commence any new activities and would not acquire any shares of any unaffiliated company. The reorganization involves only companies that are wholly owned by the financial holding company.

- *Example 2.* Assume the same facts as Example 1, except that the financial holding company's subsidiary bank has a wholly owned subsidiary organized under section 25A of the Federal Reserve Act (an "Edge corporation"), and the asset management company is a subsidiary of the Edge corporation. The financial holding company seeks to move the asset management subsidiary to another part of the holding company organization through dividends in kind and contributions of shares such that the asset management company would no longer be a subsidiary of the bank or of the Edge corporation. (Note that the prior approval of the FRB would be required for a state member bank or Edge corporation to declare or pay a noncash dividend.)
- *Example 3.* Assume the same facts as Example 1, except that the asset management activities are conducted directly by the subsidiary bank of the financial holding company. The bank seeks to move the asset management activities to a newly formed, wholly owned subsidiary in the holding company organization through a purchase-and-assumption agreement. The newly formed subsidiary would not be a subsidiary of the bank.
- **Merchant Banking.** FRB staff clarifies that where a company acquires ownership or control of shares, assets, or other ownership interests prior to becoming a bank holding company and electing financial holding company status and seeks to retain such interests in reliance on merchant banking authority, the relevant investment holding period applies starting on the date that the company becomes a financial holding company.⁴⁸

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⁴⁸ Regulation Y FAQs, 12 CFR 225.171, Q2.

Please do not hesitate to contact us with any questions.

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