

## Federal Reserve System

## § 225.31

data storage and data transmission activities.

[Reg. Y, 62 FR 9329, Feb. 28, 1997, as amended at 68 FR 39810, July 3, 2003; 68 FR 41901, July 16, 2003; 68 FR 68499, Dec. 9, 2003]

### Subpart D—Control and Divestiture Proceedings

SOURCE: 85 FR 12422, Mar. 2, 2020, unless otherwise noted.

#### § 225.31 Control proceedings.

(a) *Preliminary determination of control.* (1) The Board in its sole discretion may issue a preliminary determination of control under the procedures set forth in this section in any case in which the Board determines, based on consideration of the facts and circumstances presented, that a first company has the power to exercise a controlling influence over the management or policies of a second company.

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

(b) *Response to preliminary determination of control.* (1) Within 30 calendar days after issuance by the Board of a preliminary determination of control or such longer period permitted by the Board in its discretion, the first company against whom the preliminary determination has been made shall:

(i) Consent to the preliminary determination of control and either:

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

(B) File an application or notice under this part, as applicable; or

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

(2) If the first company fails to respond to the preliminary determination of control within 30 days or such longer period permitted by the Board in its discretion, the first company will be deemed to have waived its right to present additional information to the

Board or to request a hearing or other proceeding regarding the preliminary determination of control.

(c) *Hearing and final determination.* (1) The Board shall order a hearing or other appropriate proceeding upon the petition of a first company that contests a preliminary determination of control if the Board finds that material facts are in dispute. The Board may, in its discretion, order a hearing or other appropriate proceeding without a petition for such a proceeding by the first company.

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

(3) After considering the submissions of the first company and other evidence, including the record of any hearing or other proceeding, the Board will issue a final order determining whether the first company has the power to exercise a controlling influence over the management or policies of the second company. If a controlling influence is found, the Board may direct the first company to terminate the control relationship or to file an application or notice for the Board's approval to retain the control relationship.

(d) *Submission of evidence.* (1) In connection with contesting a preliminary determination of control under paragraph (b)(1)(ii) of this section, a first company may submit to the Board evidence or any other relevant information related to its control of a second company.

(2) Evidence or other relevant information submitted to the Board pursuant to paragraph (d)(1) of this section must be in writing and may include a description of all current and proposed relationships between the first company and the second company, including relationships of the type that are identified under any of the rebuttable presumptions in §§ 225.32 and 225.33 of this part, copies of any formal agreements related to such relationships, and a discussion regarding why the Board should not determine the first

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company to control the second company.

(e) *Definitions.* For purposes of this subpart:

(1) *Board of directors* means the board of directors of a company or a set of individuals exercising similar functions at a company.

(2) *Director representative* means any individual that represents the interests of a first company through service on the board of directors of a second company. For purposes of this paragraph (e)(2), examples of persons who are directors of a second company and generally would be considered director representatives of a first company include:

- (i) A current officer, employee, or director of the first company;
  - (ii) An individual who was an officer, employee, or director of the first company within the prior two years; and
  - (iii) An individual who was nominated or proposed to be a director of the second company by the first company.
- (iv) A director representative does not include a nonvoting observer.

(3) *First company* means the company whose potential control of a second company is the subject of determination by the Board under this subpart.

(4) *Investment adviser* means a company that:

- (i) Is registered as an investment adviser with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et seq.*);
- (ii) Is registered as a commodity trading advisor with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*);
- (iii) Is a foreign equivalent of an investment adviser or commodity trading advisor, as described in paragraph (e)(4)(i) or (ii) of this section; or
- (iv) Engages in any of the activities set forth in § 225.28(b)(6)(i) through (iv) of this part.

(5) *Limiting contractual right* means a contractual right of the first company that would allow the first company to restrict significantly, directly or indirectly, the discretion of the second company, including its senior management officials and directors, over oper-

ational and policy decisions of the second company.

(1) Examples of limiting contractual rights may include, but are not limited to, a right that allows the first company to restrict or to exert significant influence over decisions related to:

(A) Activities in which the second company may engage, including a prohibition on entering into new lines of business, making substantial changes to or discontinuing existing lines of business, or entering into a contractual arrangement with a third party that imposes significant financial obligations on the second company;

(B) How the second company directs the proceeds of the first company's investment;

(C) Hiring, firing, or compensating one or more senior management officials of the second company, or modifying the second company's policies or budget concerning the salary, compensation, employment, or benefits plan for its employees;

(D) The second company's ability to merge or consolidate, or its ability to acquire, sell, lease, transfer, spin-off, recapitalize, liquidate, dissolve, or dispose of subsidiaries or assets;

(E) The second company's ability to make investments or expenditures;

(F) The second company achieving or maintaining a financial target or limit, including, for example, a debt-to-equity ratio, a fixed charges ratio, a net worth requirement, a liquidity target, a working capital target, or a classified assets or nonperforming loans limit;

(G) The second company's payment of dividends on any class of securities, redemption of senior instruments, or voluntary prepayment of indebtedness;

(H) The second company's ability to authorize or issue additional junior equity or debt securities, or amend the terms of any equity or debt securities issued by the second company;

(I) The second company's ability to engage in a public offering or to list or de-list securities on an exchange, other than a right that allows the securities of the first company to have the same status as other securities of the same class;

(J) The second company's ability to amend its articles of incorporation or

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by-laws, other than in a way that is solely defensive for the first company;

(K) The removal or selection of any independent accountant, auditor, investment adviser, or investment banker employed by the second company; or

(L) The second company's ability to significantly alter accounting methods and policies, or its regulatory, tax, or liability status (*e.g.*, converting from a stock corporation to a limited liability company); and

(ii) A limiting contractual right does not include a contractual right that would not allow the first company to significantly restrict, directly or indirectly, the discretion of the second company over operational and policy decisions of the second company. Examples of contractual rights that are not limiting contractual rights may include:

(A) A right that allows the first company to restrict or to exert significant influence over decisions relating to the second company's ability to issue securities senior to securities owned by the first company;

(B) A requirement that the first company receive financial reports or other information of the type ordinarily available to common stockholders;

(C) A requirement that the second company maintain its corporate existence;

(D) A requirement that the second company consult with the first company on a reasonable periodic basis;

(E) A requirement that the second company provide notices of the occurrence of material events affecting the second company;

(F) A requirement that the second company comply with applicable statutory and regulatory requirements;

(G) A market standard requirement that the first company receive similar contractual rights as those held by other investors in the second company;

(H) A requirement that the first company be able to purchase additional securities issued by the second company in order to maintain the first company's percentage ownership in the second company;

(I) A requirement that the second company ensure that any security holder who intends to sell its securities of the second company provide other

security holders of the second company or the second company itself the opportunity to purchase the securities before the securities can be sold to a third party; or

(J) A requirement that the second company take reasonable steps to ensure the preservation of tax status or tax benefits, such as status of the second company as a Subchapter S corporation or the protection of the value of net operating loss carry-forwards.

(6) *Second company* means the company whose potential control by a first company is the subject of determination by the Board under this subpart.

(7) *Senior management official* means any person who participates or has the authority to participate (other than in the capacity as a director) in major policymaking functions of a company.

(f) *Reservation of authority*. Nothing in this subpart shall limit the authority of the Board to take any supervisory or enforcement action otherwise permitted by law, including an action to address unsafe or unsound practices or conditions, or violations of law.

### § 225.32 Rebuttable presumptions of control of a company.

(a) *General*. (1) In any proceeding under § 225.31(b) or (c) of this part, a first company is presumed to control a second company in the situations described in paragraphs (b) through (i) of this section. The Board also may find that a first company controls a second company based on other facts and circumstances.

(2) For purposes of the presumptions in this section, any company that is a subsidiary of the first company and also a subsidiary of the second company is considered to be a subsidiary of the first company and not a subsidiary of the second company.

(b) *Management contract or similar agreement*. The first company enters into any agreement, understanding, or management contract (other than to serve as investment adviser) with the second company, under which the first company directs or exercises significant influence or discretion over the general management, overall operations, or core business or policy decisions of the second company. Examples of such agreements include where the