

# Overview of Financial Institution Holding Company Regulation

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The area of financial institution holding company regulation is complicated and ever changing. The intent of this article is to provide an overview discussion, with references, of some of the key issues raised in bank and savings association holding company regulation. Consequently, throughout the article, the author will identify and briefly discuss issues; however, an in depth discussion of the issues is not possible in this limited (i.e., non-treatise) forum. Further, this article will not discuss state financial institution holding company law or regulation.

I. Holding Company Formation.

The Bank Holding Company Act<sup>1</sup> requires the prior approval of the Federal Reserve Board<sup>2</sup> to become a bank holding company by either formation, or acquisition of bank stock. A bank holding company for purposes of the statute is any "company" that has "control" over a bank or any other company if

(A) the company directly or indirectly ... has the power to vote 25 percent or more of any class of voting securities of the bank or company; (B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or (C) the Board determines ... that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.<sup>3</sup>

A "company" includes "any corporation, partnership, business trust, association, or similar

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<sup>1</sup> 12 U.S.C. § 1841 et seq.

<sup>2</sup> Hereinafter, "Board".

<sup>3</sup> Id. § 1841(a)(2).

organization" and certain other trusts.<sup>4</sup> The definition of a company is not intended to include individuals.<sup>5</sup> In addition to the formation of a bank holding company, prior approval from the Board is required for any bank holding company to acquire direct or indirect ownership or control of more than 5% of any class of voting securities of a bank or bank holding company, for the merger of bank holding companies, for any bank holding company or non-bank subsidiary thereof to acquire all or substantially all of the assets of a bank and for non-bank subsidiary acquisitions incidental to holding company acquisitions.<sup>6</sup> Certain stock acquisitions of banks or bank holding companies are exempt from prior Board approval such as bank stock held in a fiduciary capacity, ownership of bank stock as a result of foreclosure on a previously existing debt, and certain stock acquisitions governed by the Bank Merger Act (12 U.S.C. § 1828(c)).<sup>7</sup>

An application in the form prescribed by the Board must be submitted prior to becoming a bank holding company.<sup>8</sup> Upon receipt of the application, the Board must provide the primary banking supervisor a copy of the application. The primary supervisor has 30 days to comment on the application.<sup>9</sup> Additionally, the Board is required promptly to notify the *Federal Register* of the application and have a request for comments on the application published for no more than

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<sup>4</sup> Id. § 1841(b).

<sup>5</sup> Heller, FEDERAL BANK HOLDING COMPANY LAW § 1.01, at 1-4 (1995) [Hereinafter, "Heller"].

<sup>6</sup> 12 C.F.R. § 225.11.

<sup>7</sup> 12 C.F.R. § 225.12.

<sup>8</sup> See generally, 12 C.F.R. § 225.11 et seq.

<sup>9</sup> 12 C.F.R. § 225.14(b)(1).

30 days.<sup>10</sup> The bank holding company applicant is required to publish notice of intent to become a bank holding company and solicit comment from the general public, in a newspaper of general circulation in the affected community in a form prescribed by the Board.<sup>11</sup> The application is deemed to be approved automatically 91 days after the submission of a complete application.<sup>12</sup> If the Board receives a negative recommendation on the application from the primary banking supervisor within the 30 day comment period, the applicant must immediately be notified and an agency hearing is required, unless the Board determines there is a banking emergency in this case, or to prevent the failure of a bank.<sup>13</sup> Upon approval of the application, the Board must immediately notify the United States Attorney General.<sup>14</sup> A transaction approved under these rules may not be consummated until 30 days after the date of approval of the transaction.<sup>15</sup>

Savings and loan holding company<sup>16</sup> formation is governed by the Savings and Loan Holding Company Act.<sup>17</sup> The approval process is substantively similar to the Bank Holding Company Act; however, acquisition of a savings association requires Office of Thrift

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<sup>10</sup> *Id.*, § 225.14(b)(2).

<sup>11</sup> *Id.*, § 225.14(b)(3).

<sup>12</sup> *Id.*, § 225.14(d)(2).

<sup>13</sup> *Id.*, §§ 225.14(f) and 225.14(h).

<sup>14</sup> *Id.*, § 225.14(e).

<sup>15</sup> *Id.*, § 225.14(i).

<sup>16</sup> Hereinafter, "SLHC".

<sup>17</sup> 12 U.S.C. § 1467a.

Supervision Approval.<sup>18</sup> The actual application process contains various procedural variations from the that of the Board. The applicable OTS regulations are found at 12 C.F.R. § 574 et seq.

Violations of the Bank Holding Company Act can result in both criminal and civil penalties.<sup>19</sup> An individual who knowingly violates the Act can be imprisoned for not more than 1 year and fined not more than \$100,000 per day for each day during which the violation continues, or both.<sup>20</sup> A violation with intent to deceive, defraud, or profit significantly may result in imprisonment of not more than 5 years and a fine of not more than \$1,000,000 per day for each day during which the violation continues, or both.<sup>21</sup> From a civil money damage perspective, any company or person who participates in a violation of the Act or any order issued under the Act is subject to a penalty of not more than \$25,000 per day for each day during which the violation continues.<sup>22</sup>

## II. Permissible Holding Company Activities.

a. Bank Holding Companies.

Bank holding companies have traditionally been treated as corporations with limited, explicitly enumerated powers to conduct banking activities.<sup>23</sup> These traditional activities

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<sup>18</sup> Hereinafter, the "OTS".

<sup>19</sup> See generally, 12 U.S.C. § 1847.

<sup>20</sup> Id. § 1847(a)(1).

<sup>21</sup> Id. § 1847(a)(2).

<sup>22</sup> Id. § 1847(b)(1).

<sup>23</sup> Heller at § 4.02.

include banking, managing or controlling banks, or furnishing services to subsidiary banks.<sup>24</sup> This authority was expanded by the amendments to the Bank Holding Company Act in the 1980's to allow bank holding companies to participate in activities "closely related to banking."<sup>25</sup> A partial list of exempt, non-banking activities includes: (i) providing servicing activities to allow its subsidiaries to complete their commitments; (ii) services related to internal operations including accounting, advertising, data processing, personnel services, courier services, holding and operating property for the bank or its subsidiaries' future use, liquidating property acquired from a subsidiary, and selling, purchasing, or underwriting insurance such as blanket bond insurance, group insurance for employees, and property and casualty insurance; (iii) conducting a safe deposit business; (iv) acquisitions of property from previously contracted debts; (v) acquisitions of certain securities deemed acceptable by interpretation of the Comptroller of the Currency; (vi) acquisition of securities or properties representing less than 5% of a company subject to certain other provisions; (vii) acquisition of securities in certain investment companies; (viii) acquisition of assets acquired in the ordinary course of business; and (ix) acquisition of the assets of a company, all or substantially all of which relate to loans for personal, family or household purposes.<sup>26</sup> Other activities that are deemed to be so closely related to banking as to be permissible activities include consumer finance, credit card activities, factoring, trust company activities, property leasing activities and certain insurance activities in

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<sup>24</sup> Id.

<sup>25</sup> Id.

<sup>26</sup> See generally, 12 C.F.R. § 225.22.

small communities, among others.<sup>27</sup> Since the passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989<sup>28</sup>, bank holdings companies have also been permitted to acquire a savings and loan association if the association only engages in deposit taking and lending and other activities permitted to bank holding companies.<sup>29</sup>

b. Savings and Loan Holding Companies.

Savings and loan holding companies are also corporations of limited powers. In addition to the requirement that each savings and loan association continue to meet the qualified thrift lender test<sup>30</sup>, savings and loan associations are given generally the same powers as bank holding companies under 12 C.F.R. §§ 225.23 and 225.25.<sup>31</sup> In addition to the activities approved for bank holding companies, thrift holding companies are permitted to conduct a variety of delineated activities which include among many others, such items as the purchase of gold coins minted and issued by the United States, acquisition of property for the prompt development of subdivisions, acquisition of improved real estate and mobile homes held for rental, and underwriting and reinsuring contracts of credit life and credit health and accident insurance in connection with extensions of credit.<sup>32</sup>

To meet the QTL, a savings and loan association's actual thrift investment percentage in

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<sup>27</sup> See generally, 12 C.F.R. § 225.25.

<sup>28</sup> Hereinafter, "FIRREA".

<sup>29</sup> 12 C.F.R. § 225.25(b)(9).

<sup>30</sup> See generally, 12 C.F.R. § 563.51; hereinafter, "QTL".

<sup>31</sup> 12 C.F.R. § 584.2-2.

<sup>32</sup> See generally, 12 C.F.R. § 584.2-1.

at least nine of the last twelve months must equal or exceed 65%.<sup>33</sup> More specifically, savings associations are required to maintain 65% of their "portfolio assets" in "qualified thrift investments," including not less than 45% in loans related to residential real property and manufactured housing, home equity loans and mortgage-backed securities, and up to 20% in certain other loans, including loans to churches, schools, nursing homes and hospitals, and consumer loans (up to 10% of association portfolio assets).<sup>34</sup>

Failure to meet the QTL test will require conversion to a bank charter by noncomplying savings associations or the immediate imposition of restrictions on the payment of dividends, commencement of new activities, establishment of branches and access to Federal Home Loan Bank advances.<sup>35</sup> In addition, within 3 years, the savings association must divest itself of all activities and investments not permissible for both national banks and savings associations.<sup>36</sup> Any holding company for a savings association that fails the QTL test and does not requalify (which is only allowed once) within 1 year must register as a bank holding company and have its activities substantially curtailed.<sup>37</sup>

### III. Permissible Holding Company Investments.

#### a. Bank Holding Companies.

As a general rule, bank holding companies have been allowed to make investments in

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<sup>33</sup> 12 C.F.R. § 563.50(a).

<sup>34</sup> See generally, 12 C.F.R. § 563.51.

<sup>35</sup> 12 C.F.R. § 563.52.

<sup>36</sup> 12 C.F.R. § 563.52(c).

<sup>37</sup> 12 C.F.R. § 563.52(b).

companies whose activities are closely related to banking and which conduct activities that are permissible banking activities.<sup>38</sup> These investments include investments in companies that own bank premises, that conduct a safe deposit business, that furnish services for the holding company or its subsidiaries, for liquidating assets acquired by the holding company or its subsidiaries, for the acquisition of shares of stock on previously contracted debt, and for holding shares in a fiduciary capacity.<sup>39</sup> In addition to investment in companies whose activities are closely related to banking, a bank holding company may invest in companies that are engaged in activities that are not permissible banking activities as long as such investment does not exceed 5% of the outstanding voting shares of such company.<sup>40</sup> Bank holding companies are also authorized to acquire up to 5% of the voting shares of an investment company that is not a bank holding company if the investment company is only engaged in the business of investing in securities.<sup>41</sup> Bank holding companies are also allowed to make certain other investments without Board approval including investments in companies whose activities have been approved by the Board.

b. Savings and Loan Holding Companies.

1. Loans.

Loans and other investments are divided into categories for purposes of percentage

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<sup>38</sup> See generally, 12 C.F.R. § 225.123.

<sup>39</sup> 12 U.S.C. § 1843(c).

<sup>40</sup> 12 U.S.C. § 1843(c)(6); 12 C.F.R. § 225.22(c)(5).

<sup>41</sup> 12 U.S.C. § 1843(c)(7).

of asset limitations.<sup>42</sup> The broadest category does not place any limit on the amount of loans or investments an association may make or invest in. Examples of investments in this category include loans collateralized by residential real estate, government backed securities and deposit accounts.

Commercial loans, whether secured or unsecured, may not exceed 5% of the assets of the association (7.5% for savings banks).<sup>43</sup> Non-residential real property loans are generally limited to 400% of the association's capital unless an exemption is granted by the director of the OTS.<sup>44</sup>

## 2. Insurance Activities and Service Corporations.

A saving association may invest in the capital stock, obligations or other securities of service corporations. An association's investment is limited to 3% of total assets, and any investment over 2% of assets must service primarily community, inner city or community reinvestment act purposes.<sup>45</sup> A service corporation in which a savings association has invested may be an "insurance brokerage or agency for liability, casualty, automobile, life, health, accident, or title insurance, but not private mortgage insurance." <sup>46</sup>

## 3. Trust Powers.

Savings associations are authorized to exercise fiduciary powers, including trust

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<sup>42</sup> 12 U.S.C. § 1464(5)(c).

<sup>43</sup> 12 C.F.R. § 545.46(a).

<sup>44</sup> 12 C.F.R. § 545.35(b).

<sup>45</sup> 12 C.F.R. § 545.74(d)(1).

<sup>46</sup> 12 C.F.R. § 545.74(c)(6)(ii).

powers.<sup>47</sup> The regulations implementing these powers are found at 12 C.F.R. Part 550. A savings association is required to file an application with the OTS prior to exercising any trust powers.<sup>48</sup>

Savings associations are authorized to exercise fiduciary powers to the extent that state banks, trust companies and other corporations that compete with savings associations are granted such powers under state law.<sup>49</sup> Therefore, to determine which trust powers a savings association may exercise, state law must be reviewed. Trust departments are specifically authorized, to the extent not in violation of local law, to hold funds in collective investments.<sup>50</sup>

#### 4. Investments in Real Estate.

Savings associations are permitted to invest in real estate through a number of mechanisms. Without limitation as to percentage of assets, a savings association may invest in obligations of or loans to a state housing corporation if the loans are insured under the National Housing Act. Savings associations may also invest in mortgage backed securities if the securities are sold pursuant to Section 4(5) of the Securities Act of 1933.

A saving association may also invest in real estate for office or other facilities if the investment is made under a prudent program of property acquisition. However, the total real estate investment combined with the book value of all other investments may not exceed the

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<sup>47</sup> 12 U.S.C. § 1464(n).

<sup>48</sup> 12 C.F.R. § 550.2.

<sup>49</sup> 12 C.F.R. § 550.1(k).

<sup>50</sup> 12 C.F.R. § 550.13(a).

association's total capital.<sup>51</sup>

#### IV. Branching.

##### a. Banks.

The Congress approved and the President signed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 in the 103rd Congress. Pursuant to the terms of the bill, the Board is authorized to allow adequately capitalized and managed bank holding companies to "undertake the interstate acquisition or establishment of a bank in any state."<sup>52</sup> Approval by the Board is governed by separate nationwide and statewide banking concentration limits (10% of the nationwide total insured deposits after consummation of the transaction, 30% of the statewide total insured deposits after the transaction). Interstate bank mergers are authorized to commence beginning on June 1, 1997 in all states; however, each state is given the option to opt out of the act prior to its commencement, as long as the opt out is non-discriminatory to out-of-state banks.

##### b. Savings and Loan Associations.

A federal association may branch in any state or territory of the United States. However, no branching is allowed in a state outside the state in which the association has its home office.<sup>53</sup> These restrictions do not apply in certain circumstances such as emergency acquisitions approved by the Federal Deposit Insurance Corporation.<sup>54</sup>

Prior to opening a branch, an association must obtain OTS approval. The OTS will

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<sup>51</sup> 12 C.F.R. § 545.77.

<sup>52</sup> Report of the Committee on Banking, Housing, and Urban Affairs of the United States Senate, March 23, 1994.

<sup>53</sup> 12 C.F.R. § 556.5(a).

<sup>54</sup> 12 U.S.C. § 1823(k).

consider factors such as the association's regulatory capital levels and Community Reinvestment Act record in determining whether to approve the application. Federal law regarding branching expressly preempts state law on the subject.<sup>55</sup>

V. Bank and Savings and Loan Holding Company Capital Requirements.

a. "Tangible" or "Tier 1" or "Core" Capital.<sup>56</sup>

This classification is composed of Tangible Capital<sup>57</sup> plus other qualifying intangible assets that meet a three-part test of separability, cash flow and marketability.

b. "Supplementary" or Tier 2 Capital.<sup>58</sup>

This classification includes cumulative perpetual preferred stock (if the institution has the option to defer dividends), hybrid debt-equity instruments (such as perpetual debt) and qualifying subordinated debt.

c. "Risk-based Capital".<sup>59</sup>

At least half of the Risk-based Capital requirement must be met with Tier 1 Capital, while the remainder may be met with supplementary or Tier 2 Capital. Total risk-weighted assets of an institution are determined by assigning a risk-weight to each asset of the institution. In addition, certain off-balance sheet risks, such as potential obligations under letters of credit or recourse agreements, are also risk-weighted. The risk-weight of an asset is

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<sup>55</sup> 12 C.F.R. § 556.5.

<sup>56</sup> 12 C.F.R. § 567.5(a); see generally, 12 C.F.R. Part 225, Appendix A.

<sup>57</sup> 12 C.F.R. § 567.9.

<sup>58</sup> 12 C.F.R. § 567.5(b); see generally, 12 C.F.R. Part 225, Appendix A.

<sup>59</sup> 12 C.F.R. § 567.6; 12 C.F.R. Part 225, Appendix A (III).

expressed in terms of a percentage. Multiplying the value of an asset by its risk-weight produces its risk-weighted value, and the sum of such risk-weighted values represents an institution's total risk-weighted assets. The Risk-based Capital regulations require the inclusion of 100% of mortgage loans sold with recourse for purposes of calculating risk-weighted assets. The assets are then to be included in the appropriate risk-weighted category based on the requirements of the regulation for mortgage loans.

Bank holding company risk-weights are divided into four (4) categories: 1) zero percent; 2) twenty percent; 3) 50 percent; and 4) one-hundred percent.<sup>60</sup> The zero percent category includes such items as cash held, claims backed by government guaranties (i.e., GMNA securities), and gold bullion held.<sup>61</sup> The twenty percent category includes cash items in the process of collection, certain short-term claims guaranteed by U.S. depository institutions and foreign banks, portions of long-term claims guaranteed by U.S. depository institutions, as well as certain claims conditionally guaranteed by the U.S. government, U.S. governmental agencies and other international credit organizations.<sup>62</sup> The fifty percent category includes loans fully secured by first liens on one to four family residences that meet certain criteria, certain privately issued mortgage-backed securities, and revenue bonds of U.S. states or other political subdivisions.<sup>63</sup> The one-hundred percent category includes all other assets that do not fall

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<sup>60</sup> 12 C.F.R. Part 225, Appendix III(C).

<sup>61</sup> Id.

<sup>62</sup> Id.

<sup>63</sup> Id.

within one of the above referenced categories.<sup>64</sup> Certain off-balance sheet items are also converted into the risk-based capital ratio. Items are converted at differing rates based on their potential for loss liability to the institution.<sup>65</sup> Off-balance sheet items that may be converted include loan commitments, letters of credit, and bank guarantees.<sup>66</sup>

d. Interest Rate Risk.

A savings association's interest rate risk ("IRR") is the measure of the decline in the net portfolio value ("NPV") that would result from a 200 basis point increase or decrease in market interest rates (whichever results in a the lower NPV) divided by the estimated economic value of assets (as calculated by the OTS Model). To the extent that the decline in value exceeds 2% of the NPV of the association, the association must deduct a IRR component to determine whether it meets the required risk-based capital requirement. The IRR component is equal to one-half the difference between its measured IRR and .02, multiplied by the estimated total economic value of its total assets.<sup>67</sup>

e. FDICIA Capital Requirements and Restrictions.

1. Prompt corrective action.

The Federal Deposit Insurance Corporation Improvement Act of 1991<sup>68</sup> added a new section to the Federal Deposit Insurance Act that became effective December 19, 1992

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<sup>64</sup> Id.

<sup>65</sup> 12 C.F.R. Part 225, Appendix III(D).

<sup>66</sup> Id.

<sup>67</sup> 12 C.F.R. § 567.7(a).

<sup>68</sup> Hereinafter, "FDICIA".

and is intended to resolve problem institutions at the least possible long-term cost to the deposit insurance funds.

2. Prompt corrective action categories.

An institution is deemed to be:

(i) "well capitalized," if it has a total Risk-based Capital ratio of 10% or greater a Tier 1 Risk-based Capital ratio of 6% or greater (Tier 1 Capital is defined as Core Capital), a Leverage ratio of 5% or greater and is not subject to any order to meet and maintain a specific capital level<sup>69</sup>;

(ii) "adequately capitalized", if it has a total Risk-based Capital ratio of 8% or greater, a Tier 1 Risk-based Capital ratio of 4% or greater and a Leverage ratio of 4% or greater (or, if it is MACRO 1 rated, 3% or greater) and does not meet the definition of a "well capitalized" thrift institution<sup>70</sup>;

(iii) "undercapitalized", if it has a total Risk-based Capital ratio under 8%, and a Tier 1 Risk-based Capital ratio under 4% and a Leverage ratio under 4% (or 3% if it is MACRO 1 rate)<sup>71</sup>;

(iv) "significantly undercapitalized" if it has a total Risk-based Capital ratio under 6%, a Tier 1 Risk-based Capital ratio under 3% or a Leverage ratio under 3%<sup>72</sup>; and

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<sup>69</sup> 12 C.F.R. § 565.4(b)(1); 12 C.F.R. § 6.4(b)(1).

<sup>70</sup> 12 C.F.R. § 565.4(b)(2); 12 C.F.R. § 6.4(b)(2).

<sup>71</sup> 12 C.F.R. § 565.4(b)(3); 12 C.F.R. § 6.4(b)(3).

<sup>72</sup> 12 C.F.R. § 565.4(b)(4); 12 C.F.R. § 6.4(b)(4).

(v) "critically undercapitalized", if it has a ratio of Tangible Capital to total assets equal to or less than 2%.<sup>73</sup>

3. Under-capitalized institutions.

With certain exceptions, an institution will be prohibited from making capital distributions or paying management fees if the payment of such distributions or fees will cause the institution to become undercapitalized.<sup>74</sup> Furthermore, undercapitalized institutions will be required to file capital restoration plans with the appropriate federal regulator. Pursuant to FDICIA, undercapitalized institutions also will be subject to restrictions on growth, acquisitions, branching and engaging in new lines of business unless they have an approved capital plan that permits otherwise.<sup>75</sup> The primary regulator also may, among other things, require an undercapitalized institution to issue shares or obligations, which could be voting stock, to recapitalize the institution or, under certain circumstances, to divest itself of any subsidiary.

4. Critically undercapitalized institutions.

These institutions may be subject to more extensive control and supervision and the primary regulator may prohibit any critically undercapitalized institution from, among other things, entering into any material transaction not in the ordinary course of business, amending its charter or bylaws, or engaging in certain transactions with affiliates. In addition, critically undercapitalized institutions generally will be prohibited from making payments of principal or interest on outstanding subordinated debt. Within 90 days of becoming critically

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<sup>73</sup> 12 C.F.R. § 565.4(b)(5); 12 C.F.R. § 6.4(b)(5).

<sup>74</sup> 12 C.F.R. § 565.6; 12 C.F.R. § 6.6.

<sup>75</sup> 12 C.F.R. § 565.4; 12 C.F.R. § 6.5.

undercapitalized, the primary regulator must appoint a receiver or conservator unless certain findings are made with respect to the prospect for the institution's continued operation.<sup>76</sup>

VI. Change in Control.

a. Banks.

See generally, the discussion of holding company formation contained in Section I *infra* concerning what constitutes control of a bank or bank holding company by a bank holding company for Board purposes. In addition to the rules applicable to bank holding company acquisitions, the Change in Bank Control Act<sup>77</sup> prohibits a person from "acting directly or indirectly or through or in concert with one or more other persons" from acquiring control of any insured depository institution unless the appropriate banking agency is given at least 60 days prior written notice of the proposed acquisition of control. For purposes of the Change in Bank Control Act, a "person" is "an individual or corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, or incorporated organization, or any other form of entity not specifically listed herein."<sup>78</sup>

The Board has promulgated regulations with respect to acquisition of control of bank holding companies by persons.<sup>79</sup> For purposes of Board regulations, a person is deemed to control a bank holding company if, individually or acting in concert with others, the acquiror owns, control, or holds with power to vote 25% or more of any class of voting securities of a

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<sup>76</sup> 12 C.F.R. § 565(a); 12 C.F.R. § 6.6(a).

<sup>77</sup> 12 U.S.C. § 1817(j).

<sup>78</sup> 12 U.S.C. § 1817(j)(8)(A).

<sup>79</sup> See generally, 12 C.F.R. § 225.41 et seq.

holding company or the acquiror, individually or acting in concert with others, owns, control, or holds the power to vote 10% or more of any class of voting securities of a holding company and (i) the company has registered securities under section 12 of the Securities and Exchange Act of 1934 or (ii) no other person will own a greater percentage of that class of voting securities immediately after the transaction.<sup>80</sup> The Change in Bank Control Act, unlike the Bank Holding Company Act, is designed to regulate individuals. Consequently, if the acquiror falls within the definition of "company" for purposes of the Bank Holding Company Act, the group constituting the company will not be required to file under the Change in Bank Control Act.<sup>81</sup>

b. Savings and Loan Associations.

1. Conclusive Control Presumption.

Under the Acquisition of Savings and Loan Control Regulations<sup>82</sup>, a company will conclusively be deemed to control a savings association if the company (i) acquires more than 25 percent of any class of voting stock of a savings association; (ii) acquires irrevocable proxies representing more than 25 percent of any class of voting stock of a savings association; (iii) acquires any combination of voting stock and irrevocable proxies representing more than 25 percent of any class of voting stock of a savings association; or (iv) controls in any manner the election of a majority of the directors of a savings association.<sup>83</sup> In addition to the above

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<sup>80</sup> 12 C.F.R. § 225.41(b).

<sup>81</sup> 12 C.F.R. § 225.42(b).

<sup>82</sup> Hereinafter, "Control Regulations".

<sup>83</sup> 12 C.F.R. § 574.4(a).

described conclusive presumptions of control with respect to savings associations, an acquiror will be conclusive presumed to control a company, including a SLHC if it (i) is a general partner of a company; (ii) has contributed more than 25 percent of the capital of a company; or (iii) is a trustee of a trust.<sup>84</sup> A company shall also be conclusively presumed to control a savings association if the OTS determines after reasonable notice and opportunity for hearing, that a company has the power directly or indirectly, to exercise a controlling influence over the management or policies of a savings association.<sup>85</sup>

2. Rebuttable Presumptions of Control.

i. General

Under the SLHC Control Regulations a rebuttable presumption that a company has gained control of a savings association arises if a company, directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies does the following:

- (a) acquires more than ten percent of any class of voting stock of a savings association and is subject to one or more of the "control factors" listed in paragraph ii, below<sup>86</sup>; or
- (b) acquires more than 25 percent of any class of stock (including nonvoting stock) of a savings association and is subject to one or more of the control

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<sup>84</sup> 12 C.F.R. §574.4(a)(2).

<sup>85</sup> 12 C.F.R. § 574.4(a)(3).

<sup>86</sup> 12 C.F.R. § 574.4(b)(1)(i).

factors listed in paragraph ii below<sup>87</sup>; or

- (c) holds any combination of voting stock and proxies (revocable or irrevocable), representing more than 25 percent of any class of voting stock of a savings association (excluding proxies held in connection with a solicitation by management of a savings association, or a solicitant in opposition to such solicitation, in connection with any matter other than an election of directors), if the proxies would enable a company to (1) elect one-third or more of the board of directors (including nominees or representatives of a company currently serving on such board), (2) cause savings association stockholders to approve an acquisition or corporate reorganization of a savings association, or (3) exert a continuing influence on a material aspect of savings association's business.<sup>88</sup>

ii. Control Factors.

The control factors specified in the Control Regulations are:

- (a) being one of the two largest holders of any class of voting stock of a savings association;
- (b) holding more than 25 percent of the total stockholders' equity of a savings association;
- (c) holding more than 35 percent of the combined debt securities and stockholders' equity of a savings association;

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<sup>87</sup> 12 C.F.R. § 574.4(b)(1)(ii).

<sup>88</sup> 12 C.F.R. §574.4(b)(2)).

- (d) being party to an agreement pursuant to which an acquiror would (1) possess a material economic stake in a savings association resulting from a profit sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the association; or (2) possess the ability to influence a material aspect of the management or policies of a savings association;
- (e) having the power to direct the votes of more than 25% of a class of association voting stock or to vote more than 25% of a class of association voting stock in the future upon the occurrence of a future event;
- (f) having the ability to direct the disposition of more than 25 percent of a class of a savings association's voting stock in a manner other than a widely dispersed or public offering;
- (g) having more than one member of a savings association's board of directors; and
- (h) having a nominee serve as chairman of the board, chairman of the executive committee, CEO, CFO, or any similar position with policy making authority at a savings association.<sup>89</sup>

iii. Rebuttal of the Presumption of Control.

In order to rebut the presumption of control created in the above referenced circumstances, an acquiror is required to file a submission to the OTS setting forth the facts and

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<sup>89</sup> 12 C.F.R. § 574.4(c).

circumstances that support the acquiror's assertion that no control relationship exists.<sup>90</sup> In addition to the required submission, an acquiror is required to enter into a rebuttal of control agreement with the OTS whereby the acquiror agrees, under penalty of law, not to engage in a laundry list of activities at the savings association without the prior approval of the OTS.<sup>91</sup>

## VII. Mergers and Acquisitions.

The general parameters with respect to changes in control of banks and thrifts have already been outlined in sections I and VI *infra*. The Bank Merger Act<sup>92</sup> applies to any transaction in which an insured state or federal bank or savings association engages in a merger, consolidation, or direct or indirect acquisition of assets or assumption of liabilities of a depository institution. The primary regulatory responsibility for overseeing the transaction lies with the "responsible agency."<sup>93</sup> Each responsible agency has promulgated regulations with respect to financial institution mergers.<sup>94</sup> Nevertheless, depending on the corporate structure of the acquiror in the transaction, a number of federal as well as state thrift or bank regulatory agencies may also require applications.

Each responsible agency requires the acquiror to file an acquisition application on the form prescribed by the agency. The general review process for the agencies requires an

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<sup>90</sup> 12 C.F.R. § 574.4(e).

<sup>91</sup> See generally, 12 C.F.R. § 574.100.

<sup>92</sup> 12 U.S.C. § 1828(c).

<sup>93</sup> 12 U.S.C. § 1828(c)(2).

<sup>94</sup> Office of the Comptroller of the Currency, 12 C.F.R. § 5.1 et seq.; Federal Deposit Insurance Corporation, 12 C.F.R. § 303.3 et seq.; OTS, 12 C.F.R. § 563.22 et seq.; Board, 12 C.F.R. § 208 et seq.

announcement of the proposed acquisition to be published for a specific time period (not less than 30 days); however, the period or method of time calculation may vary by agency.<sup>95</sup> The responsible agency is required to request reports on the anticompetitive effects of the transaction from the Department of Justice and the other federal banking agencies.<sup>96</sup> The specific filing requirements, review periods, automatic approvals and delegated authority for each agency is prescribed by the specific agency regulations.<sup>97</sup> Once the application has been approved or deemed approved, there is a 30 day waiting period before the transaction may be consummated.<sup>98</sup>

a. Antitrust Considerations.

Acquisitions subject to the Bank Merger Act or Bank Holding Company Act require the responsible agency to consider the effect on competition of the merger. Transactions are also subject to review by the U.S. Department of Justice. The general approach used by the responsible agency is to consider the effect of the merger within the affected geographical market. However, the Board continues to use a product market analysis that "clusters" the services and products provided by commercial banks in the relevant product market. The cluster approach places weights on services such as deposits, generally allocating a 50% weight to

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<sup>95</sup> Id.

<sup>96</sup> Id.

<sup>97</sup> Id.

<sup>98</sup> Id.

thrifts in the region.<sup>99</sup>

The Department of Justice also conducts an anti-trust review of mergers, focusing on discrete lines of business, such as lending to small or medium sized businesses, trust services etc. As a result of this approach, geographic markets may differ significantly from the Board's approach. Consequently, even smaller bank or thrift mergers may result in Department of Justice objections.<sup>100</sup>

b. Community Reinvestment Act Considerations.

In addition to an anti-trust review of mergers, the responsible agency is required to consider the Community Reinvestment Act<sup>101</sup> rating of the institutions involved in the merger. The CRA requires financial institutions to meet the needs of their local communities, including minority communities and low and moderate income individuals. The evaluation of the merger must be reviewed in light of the convenience to the local community, and merger applications must address these concerns. Additionally, members of the affected community are entitled to object to the merger based on CRA concerns.<sup>102</sup>

In a joint rule making proposal, the federal banking regulatory agencies are considering a re-write of the CRA.<sup>103</sup> The revised proposal would require an assessment of (i)

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<sup>99</sup> See generally, Fluckiger, Heyward and Cuda, Bank Mergers, Acquisitions, Anti-Trust Provisions and the CRA, presented to the Texas Association of Bank Counsel Conference, March 18 - 19, 1994, Austin, Texas.

<sup>100</sup> Id.

<sup>101</sup> Hereinafter, "CRA".

<sup>102</sup> Id.

<sup>103</sup> 59 Fed. Reg. 51232 (October 7, 1994).

demographic data about the community; (ii) information about the community characteristics and needs; (iii) information about the financial institution's capacity and constraints, product offerings and business strategies; and (iv) data on the institution's performance and the performance of similarly situated institutions.<sup>104</sup> The primary criteria for CRA evaluation would be based on a three part test assessing the institution's lending, service and investments. The new CRA is also expected to create additional reporting burdens related to information on the race and gender of small business and farm borrowers.<sup>105</sup>

#### VIII. Conclusion.

The area of financial institution holding company regulation consists of a complex web of inter-related statutes and regulations. These regulations vary by agency and are revised by agencies on a regular basis. When considering any significant regulatory action, it is strongly advised that specialized legal advice be sought and if possible, consultation with the responsible regulatory agency. In this way, surprises and problems, such as agency objections, may be avoided.

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<sup>104</sup> Id.

<sup>105</sup> Id.

## Current Federal Regulation and Supervision of Banks and Thrifts and their Holding Companies

