

Application considerations for small holding companies

By Mike Scott

The Federal Reserve System considers several factors, including requirements of the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement, in determining whether to approve applications filed by an existing or proposed small holding company. As a result of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, the policy statement now applies to holding companies with consolidated assets of less than \$3 billion (an increase from the previous threshold of \$1 billion), with certain exceptions discussed in the policy statement. This new asset threshold allows many of the roughly 350 holding companies nationwide with total assets between \$1 billion and \$3 billion to take advantage of the policy statement's relative leniency in permitting small HCs to maintain higher debt levels.

We highlight below aspects of the policy statement that most frequently impact applications filed with the Federal Reserve Bank of Minneapolis. These fit broadly into three categories: debt, capital, and expedited/waived processing.

Debt

Reduction in parent company leverage. Most acquisition proposals by Ninth District applicants involve the applicant incurring or assuming some debt to fund the purchase. In order to ensure that small HCs continue to operate in a safe and sound manner despite the policy statement's leniency with respect to debt, the policy statement includes expectations for how small HCs will service their debt. When a small HC files an application in which it proposes to incur debt, it must demonstrate that, without reliance on sustained high levels of dividends or other payments from its banks, it is capable of (i) reducing its debt to equity ratio to 30 percent or less within 12 years of the debt being incurred; and (ii) retiring all debt within 25 years of the debt being incurred. Note that the policy statement contains special rules regarding the treatment of preferred stock (as equity) and the treatment of subordinated debt (as debt) for purposes of debt to equity ratio calculations.

If an applicant's debt will exceed 30 percent of its equity capital, the applicant should provide cash flow projections for each of the next 12 years, along with supporting schedules for each material cash receipt and disbursement. In addition to demonstrating the ability of the applicant to reduce the debt within the timeframes discussed above, these projections must also take into account the schedule of principal reduction required by the parent company's creditor(s). The applicant should include projections of the subsidiary bank(s) asset growth, earnings performance, and dividend paid, as well as capital ratios supported by reasonable assumptions.

Minimum down payment. The policy statement requires a small HC to fund at least 25 percent of each acquisition with sources other than debt. A small HC may not satisfy this requirement by merely demonstrating that it could fund 25 percent of the purchase price without debt. For purposes of this "minimum down payment" requirement, debt incurred by owners of a small HC to finance an acquisition will be attributed to the small HC applicant unless the owners can demonstrate that they can service the debt without relying on the financial resources of the banking organization. This is true even though the debt does not represent an obligation of the bank holding company.

Dividend Restrictions. The policy statement states that a small HC whose debt to equity ratio is greater than 100 percent is not expected to pay corporate dividends, including subchapter S tax distribution payments, until such time as it reduces its debt to equity ratio to 100 percent or less.

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This requirement is in place primarily to preserve the small HC's ability to service its debt. The Board of Governors of the Federal Reserve System's Supervision and Regulation Letter 09-4 provides additional guidance to holding companies regarding the Federal Reserve's supervisory expectations regarding the payment of dividends.

Capital adequacy

Small HCs are not required to meet capital adequacy standards on a consolidated holding company basis. Rather, small HCs are expected to meet the policy statement's debt-related requirements, and each of a small HC's insured depository subsidiaries is expected to be well capitalized. A small HC should demonstrate as part of an acquisition application that its depository institutions (including target institutions) will be well capitalized on a pro forma basis upon consummation of the acquisition. The Federal Reserve is less likely to approve proposals that fail to meet this criteria.

Expedited/waived processing requirements

While other sections of the policy statement apply to small savings and loan holding companies as if they were bank holding companies, this section applies only to small bank holding companies. Specifically, the policy statement addresses requirements for small bank holding companies to qualify for expedited processing of applications or notices under sections 225.14 and 225.23 of Regulation Y, and for small holding companies to qualify for a waiver of the stock redemption filing requirements for well-capitalized bank holding companies contained in section 225.4(b)(6) of Regulation Y. In each case, the policy statement provides for a reduced filing burden for holding companies that have a debt to equity ratio of 100 percent or less, meet the requirements of the policy statement discussed above, and meet other specified criteria contained in section 225.14 or 225.23 of Regulation Y.

Please contact your local Reserve Bank if you are unsure whether your organization is subject to the policy statement or have other questions. The policy statement is contained in Appendix C to Part 225 of Regulation Y at www.federalreserve.gov/supervisionreg/reglisting.htm. ■

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