

## Is financial holding company election right for you?

By Darcey Quist

If a bank holding company is in good condition and would like increased flexibility to engage in nonbanking activities, it may want to elect to be treated as a financial holding company. A financial holding company can engage in a variety of activities beyond those that are permissible for a bank holding company (more on this below). Certain criteria must be met to become a financial holding company at the time of the election and on an ongoing basis, but the process to elect financial holding company status is actually rather simple. The bank holding company must file a written declaration with the following information:

- A statement that the bank holding company elects to be a financial holding company.
- The name and head office address of the bank holding company and of each depository institution controlled by the bank holding company.
- Certification that the bank holding company and all depository institutions it controls are well capitalized as of the date the bank holding company submits its declaration.
- The capital ratios as of the close of the previous quarter for all relevant capital measures for the bank holding company and each depository institution that it controls on the date the company submits its declaration.
- Certification that the bank holding company and each depository institution controlled by the company are well managed as of the date the company submits its declaration.
- A signature of an official or representative with authority to legally bind the bank holding co.

In addition, the election would not be deemed effective if any insured depository institution of the bank holding company does not have a rating of at least Satisfactory under the Community Reinvestment Act.

There is a similar process for a savings and loan holding company that is both filing an application to convert to a bank holding company and electing to be a financial holding company. The request to be a financial holding company is submitted with the bank holding company application and must include the following information.

- A statement that the company seeks to become a financial holding company on consummation of its proposal to become a bank holding company.
- Certification that the company and each depository institution that would be controlled by the company on consummation of its proposal to become a bank holding company will be both well capitalized and well managed as of the date the company consummates the proposal.
- The capital ratios as of the close of the previous quarter for all relevant capital measures for the savings and loan holding company and each depository institution that it controls on the date the company submits its declaration.

Again, the election would not be deemed effective if any depository institution controlled by the bank holding company does not have a rating of at least Satisfactory under the Community Reinvestment Act.

A common question is whether a small bank holding company is required to provide consolidated capital ratios to demonstrate it is well capitalized. Regardless of whether a small holding company ordinarily reports consolidated capital ratios, the company is required to provide these ratios for the

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financial holding company election. After doing so, compliance with the Small Bank and Savings and Loan Holding Company Policy Statement will satisfy the capital-related requirements necessary to maintain its financial holding company status.

The benefits of financial holding company status for a company include the potential for engaging in additional activities and the ease of commencing those activities. While bank holding companies can engage in nonbanking activities that are closely related to banking—such as lending, data processing, or insurance agency activities in small towns—financial holding companies can engage in activities that are defined as financial in nature or incidental to a financial activity. Some of these activities include insurance underwriting, securities dealing, merchant banking, securities underwriting, and investment advisory services. A financial holding company must provide notice to the Federal Reserve each time it engages in a new activity for the first time or acquires control of a nonbanking company. The notice must be filed within 30 calendar days after the commencement of the activity or the acquisition and consists only of the FR Y-10 reporting form. A bank holding company, on the other hand, generally has a more extensive process to obtain authority to engage in nonbanking activities.

There are also nonfinancial or commercial activities that a financial holding company may engage in if the Federal Reserve Board determines that the activities are complementary to financial activities, do not pose a substantial risk to the safety and soundness of depository institutions or the financial system, and results in net benefits to the public. A notice for complementary activities; however, is required 60 days prior to engaging in the complementary activities.

As stated above, a financial holding company is required to comply with the election criteria on an ongoing basis. Noncompliance with the criteria can potentially disrupt a business line engaged in the financial holding company activities. When a financial holding company falls out of compliance with the capital or management requirements, it must either enter into a formal enforcement action or decertify and cease financial holding company activities. Under a formal enforcement action, the company generally must return to compliance within 180 days or the Federal Reserve could require it to limit its activities to those permissible for a bank holding company. It is also important to maintain a satisfactory CRA rating. When a financial holding company falls below the satisfactory CRA rating, the board can prohibit the financial holding company from engaging in its expanded financial activities until it is in compliance.

To decertify, voluntarily or due to noncompliance, a financial holding company would simply write a letter to the Reserve Bank indicating that it no longer wishes to be treated as a financial holding company and note that it has ceased conducting activities permissible only under the financial holding company authority. Any remaining nonbank activities engaged in by the bank holding company must be permissible under section 4(c)(8) of the Bank Holding Company Act.

Financial holding company elections by Ninth District institutions are processed by the Federal Reserve Bank of Minneapolis's Mergers and Acquisitions staff. Please contact us with questions about the process or a specific activity being contemplated for a financial holding company.

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