

FED NOTES: Originally published in the Winter 2015 edition of *Bank Owner* magazine.

Federal Reserve permits holding companies to engage in some non-banking activities (part 2)

By Julie Randall

My article in the Summer 2015 issue of *Bank Owner* discussed some of the permissible nonbanking activities in which bank holding companies can engage, directly or indirectly through a subsidiary, without the Federal Reserve's prior approval. In this article, I will discuss nonbanking activities generally requiring prior approval. Regulation Y contains a list of such activities (see 12 CFR 225.28(b)). The more common of these activities include making loans, selling insurance, providing data processing services to other banks, and investing in community development projects. BHCs must submit filings to the Federal Reserve for authority to engage in these activities. Alternatively, they may elect to become financial holding companies. I will note considerations BHC management should keep in mind about the filing process and limitations on activities. I will also briefly discuss FHCs.

Generally, a BHC proposing to commence a permissible nonbanking activity directly or through a subsidiary (i.e., de novo) or acquire a company engaged in the activity must file a notice with the local Reserve Bank for prior approval of the acquisition. However, a BHC proposing to engage de novo in such an activity may be able to provide an after-the-fact notice within 10 business days of starting the activity if the BHC and its subsidiary banks meet certain criteria described in Regulation Y. To qualify for the "post-notice" process, the BHC must be well-capitalized, well-managed and not subject to a formal supervisory action within the preceding 12 months.

The Federal Reserve considers a number of factors when reviewing nonbanking activity proposals, including whether the BHC's performance of the proposed activity will result in public benefits, such as increased competition in the market(s) in which the BHC will conduct the activity. The Federal Reserve also analyzes the financial and managerial resources of the BHC organization and the effect of the proposal on those resources. Another consideration is the size/significance of the nonbank activity relative to the size of the BHC. A small BHC proposing to engage in significant nonbank activities would need to demonstrate compliance with consolidated capital requirements at consummation and on an ongoing basis as part of the application.

Limitations on these activities frequently apply, and BHCs should consult with their appropriate Reserve Bank before submitting a filing if they have questions about whether their nonbanking proposals raise potential permissibility issues. For example, BHCs seeking to sell insurance must comply with limitations pertaining to the types of insurance they can offer (e.g., credit-related life insurance) or, if they intend to offer a wide variety of insurance products, they are limited as to where they can sell the insurance. For example, BHCs intending to offer a wide variety of insurance products are limited to doing so in communities in which their organization has banking offices and which have populations of less than 5,000.

BHCs may also engage in permissible nonbanking activities by electing to become an FHC. FHCs can engage in a broader range of nonbanking activities, and they generally do not have to obtain prior approval before engaging in them. They must report these activities by submitting an FR Y-10 to their appropriate Reserve Bank when they begin conducting them. However, FHCs must comply with requirements to be “well capitalized” and “well managed” on an ongoing basis, at both the parent company and subsidiary depository institution (DI) level, in order to maintain their FHC status.

One example of the broader nonbanking authority FHCs have is that FHCs do not have to observe the limits on the types of insurance they can sell or the size of the communities in which they sell them, unlike BHCs. FHCs in the Ninth District have most commonly used their expanded authority to sell insurance in communities with a population greater than 5,000.

Regardless of how BHCs choose to engage in nonbanking activities, they must reimburse their subsidiary DIs for any expenses that the DIs incur on their behalf in association with the activities. If BHCs sell assets to or purchase assets from their DIs in conducting the activities, they must also ensure that they comply with the provisions of 23A and 23B of the Federal Reserve Act that restrict transactions with affiliates.

The discussion above highlights only a few of the factors BHCs need to consider when planning to engage in nonbanking activities requiring the Federal Reserve’s prior approval. If you have any questions about the permissibility of a nonbanking activity or want more information about submitting a filing to engage in a nonbanking activity or to become an FHC, please contact Reserve Bank staff.

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