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Shareholder Agreement Considerations

By Julie Randall

Staff of the Federal Reserve Bank of Minneapolis often encounters agreements among the shareholders of a bank holding company and the BHC that govern the disposition of the BHC's stock. (Similar concerns may arise with savings and loan holding companies.) Shareholder agreements can include restrictions that raise supervisory or control issues. Also, shareholder agreements may be considered a BHC under section 3 of the Bank Holding Company Act of 1956, as amended. Shareholder agreements presenting any of these issues may delay the processing of applications filed with the Federal Reserve or require resolution during supervisory reviews. In this article I will discuss some of the issues we commonly identify in shareholder agreements, although the nature of the issues and their significance will vary.

Shareholder agreements including provisions that impair a BHC's ability to raise or maintain capital will receive supervisory scrutiny. Examples of such provisions include burdensome restrictions on the transfer of shares, particularly to third parties, or requirements that the BHC compensate existing shareholders if shares are sold to new investors at a lower price. BHCs must act as a source of strength to their subsidiary banks so limitations on their ability to grow or maintain capital are a significant safety and soundness concern. This is especially true when the organization is experiencing financial difficulties. Supervision and Regulation Letter 15-15, "Supervisory Concerns Related to Shareholder Protection Arrangements," discusses the types of provisions designed to protect existing shareholders that are of concern. Institutions may be tempted to include these provisions in order to attract investors now, but these provisions can make it difficult to attract new capital in the future. As such, supervisory review may require their elimination.

Shareholder agreements also can present control issues. Agreements that relate to acquisition, voting or transfer of shares generally raise a presumption that all signers are acting in concert to control the organization. This presumption subjects the shareholders to filing requirements under the Change in Bank Control Act. Some examples of situations where the System has found concerted action include certain "right of first refusal" (ROFR) provisions and requirements that all existing and future shareholders sign the agreement. The agreement raises a question of control when the ROFR allows a long period of time to elapse between the selling shareholder's offer to sell and the expiration of all refusal rights. Concerns most frequently arise where there are multiple, consecutive periods for shareholders and the BHC to consider exercising their purchase options (although a single very long period also can be problematic). Similarly, agreements that require subsequent purchasers to sign the agreement, absent a strong business reason, could result in a determination that the shareholders collectively control the BHC because they restrict transfer of shares.

Supervisory concerns also exist when shareholder agreements are structured so they are considered a company under the BHC Act. The Federal Reserve System has determined that shareholder agreements and other buy-sell agreements are generally not considered companies for the purposes of the BHC Act if they meet the following criteria:

• They relate only to the shares of a single BHC or bank,

• They terminate within 25 years, and

• They involve parties who are not participants in any similar or related agreement with respect to any other bank or nonbank business.

The lack of an appropriate termination provision most frequently causes a shareholder agreement to be deemed a company. Filings by shareholder agreements to become a BHC face significant challenges and we strongly discourage them. These entities struggle to demonstrate their ability to serve as a source of strength to their subsidiaries.

A final potential concern arises when a shareholder agreement requires every shareholder to sell their shares when a set number or percentage of shareholders agrees to sell. These are frequently referred to as “drag-along” provisions. In these cases, shareholders who are not natural persons (or testamentary trusts) could be considered to control all shares subject to the agreement. These entities (e.g., LLCs, corporations) would likely be considered BHCs and be required to file under section 3 of the BHC Act.

This article highlights some issues common to BHC shareholder agreements. The determination if a particular shareholder agreement raises supervisory concerns is based on a facts-and-circumstances analysis. If you have questions about shareholder agreements, please contact Reserve Bank staff.

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