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Bank Owner

Bank Holding Company Association Magazine

Spring Seminar Coverage

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Bank Owner

Summer 2023

The Bank Holding Company Association exists to provide education and business connections critical to the vitality of bank holding companies.

Founded in 1981, the BHCA welcomes Members from around the country. Holding companies of all sizes from throughout the Midwest make up a majority of the current membership. Companies that serve bank owners, their holding companies and banks, are welcomed as Associate Members.

The *Bank Owner* magazine is the quarterly publication of the BHCA. The magazine is your best source for BHCA information, including upcoming events. Members receive the magazine in the mail and have access to an online version at theBHCA.org. Managing Director Tom Bengtson serves as editor. Contact him at (952) 835-2248 or email us at Tom@thebhca.org.

ON THE COVER:
Consultant Chris Carlson shares insight into small business lending at the BHCA Spring Seminar.

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BHCA
BANK HOLDING COMPANY ASSOCIATION

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New to BHCA

The Bank Holding Company Association is pleased to welcome a new member:

Physicians First Bancorp, Inc.
Marty Nichols, Vice President and Chief Operating Officer
Tom Chambers, Chief Executive Officer
Des Moines, Iowa

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BHCA Seminar offered ideas and information, in addition to unparalleled networking

By Denise Bunbury
State Bankshares, Inc. (Bell Bank)
Eau Claire, Wis.

I think it is safe to say that industry meetings are back! People seem to want to go to seminars and conferences again, after two years or more of staying away due to constraints related to covid. The Spring Seminar of the Bank Holding Company Association, conducted May 1-2 at the Westin Galleria Edina Hotel, attracted some 230 registrants, which is in line with our pre-pandemic attendance history. As a people-person myself, I am really glad we are past the period of restrictions and can meet with colleagues in person. It was so good to see so many of you at our "Time to Soar" event last month!

While I appreciated all the sessions, I am sure each of us has personal favorites. For me, I really enjoyed the two banker panels on Monday afternoon, and our dinner speaker, Tim Gard, made me laugh so much I almost strained a muscle! In case you missed it, you can read more about the two banker panels elsewhere in this edition of *Bank Owner*. But let me say that I find it inspiring to hear from other bankers who are willing to share their experiences.

The first panel, in which Erik Skovgard of Lincoln Savings Bank in Reinbeck, Iowa and Brian Johnson of Choice Bank in Fargo, N.D., talked about implementing internet banking strategies that dramatically grew their organizations. In addition to the technical considerations, what I found interesting was the work they needed to do at the board level to win support. A lot of this is uncharted territory, and it takes some work and inspiration to map out a course that both makes sense and can win the support of key stakeholders.

The second panel featured bankers with fascinating stories. Dave Hales of Global Innovations Bank of Kiester, Minn., talked about his efforts to build a world-wide fintech company while maintaining a traditional community bank in a town of 500 people. We also heard from bankers who have been successful in the mortgage and credit card spaces. These seminars really demonstrate that while we are all community bankers, there are several ways to succeed in this industry!

By the time we got to the reception and dinner on Monday evening, it was time to relax a little, and visit with other seminar attendees. The social part of these seminars is very important. This is the time to catch up with people we haven't seen in awhile. Sometimes, the conversation builds on some of the points raised by speakers during the day. Other times, we get introduced to someone we have never met. I know I have made many acquaintances at these seminars over the years, and I would consider that to be the most valuable benefit of BHCA membership.

This is part of the beauty of in-person meetings – the opportunity to get to know others. Webinars and Zoom meetings are one way to share information, but they don't compare to events such as BHCA seminars where you get to meet face-to-face with subject matter experts as well as colleagues across the industry. I attend a lot of industry events and I can assure you that BHCA events offer unparalleled networking opportunities that often lead to new relationships and sometimes even important business opportunities.

Let me conclude by thanking you for your membership. Please encourage your colleagues at other institutions to consider joining the BHCA if they are not already members. And, mark your calendar now for our Fall Seminar, which is set for the Westin Galleria Edina hotel on Monday and Tuesday, Oct. 2-3. Fall will be here before you know it, and I look forward to seeing you – in person – at this great event. ■

A look at four issues impacting the banking industry

By Tom Bengtson
BHCA Managing Director

Here are some of the things I am keeping an eye on as we plan for the 2023 Fall Seminar, which is set for Oct. 2-3 at the Westin Galleria Hotel in Edina, Minn:

Everyone is on pins and needles with respect to where the economy is going. The inverted yield curve tells us a recession is coming, or at the very least, that the markets are bearish on the economy's long-term prospects. We are getting mixed signals about the intent of the members of the FOMC – have rates plateaued or will policy-makers continue to increase them? I recently heard one Fed bank president remind us that the inflation rate is still about twice the Fed's 2 percent annual target.

I don't know anyone in banking who likes the Consumer Financial Protection Bureau's final rule implementing Section 1071 of the Dodd Frank Act. This is the congressional mandate for banks to collect HMDA-like demographic data on small business loan borrowers. The rule was finalized over the objections of several commentators, including the Small Business Administration and the Conference of State Bank Supervisors, who both stressed the rules would particularly hurt women-owned businesses and minority-owned businesses. Ironically, these are specifically the groups the rules were supposed to help. The CFPB has taken three pages of instructions out of Dodd-Frank and turned them into more than 800 pages of regulations. These rules will be most burdensome at community banks, which make 70 percent of the small business loans in this country. The American Bankers Association and the Texas Bankers Association are suing the CFPB over the final rule.

While M&A has slowed to a trickle in the current market, we are hearing more calls for industry consolidation. This is part of the fall-out of the failures of Silicon Valley Bank, Signature Bank and First Republic Bank. The (faulty) reasoning is that these mid-size regional banks are too small to be "too big to fail" so they should consolidate to gain systemic importance. Apparently, even Treasury Secretary Janet Yellen recently made a comment about the need for more bank consolidation.

Some critics have noted Europe gets by with only a few banks; so why, they ask, does the United States need nearly 5,000 banks? Rob Nichols, president of the American Bankers Association, shared an interesting comment on that recently. Nichols chairs the International Banking Federation, which is made up of the heads of the national banking organizations of the G-20 countries.

"We meet a couple of times per year. Every time the other people tell me 'you have built the best banking sector on the planet; you have a large number of banks.'

"The banking system is the cardiovascular system that allows our economy to do what it does. This is something we should preserve and protect. All these other sovereign jurisdictions, with just one or two banks, don't work all that well. They tell me: 'We are trying to mimic what you have in the United States.'

"There is a really important role for each of these banks along the asset ladder, for community banks in small rural communities, regional markets serving middle-market companies, the largest banks serving the Coca Colas and Boeing, and the 1,700 banks that serve the small rural communities. The idea that we should have three or four banks is certainly misguided and wrong."

Policy-makers are raising questions around deposit insurance rules. Are deposits in accounts with balances higher than $250,000 protected or not? Technically, the current rules say they are not. But it's pretty clear officials at the Treasury and elsewhere are saying deposits in banks large enough to be considered systemically important are protected. This is creating a disparity between the largest banks and the smallest ones, which are unlikely to be considered systemically important. The assumption is that deposits in excess of the insurance limit would not be protected at these banks. This is creating incentives for people with high-balance accounts to move their money to the largest banks.

The FDIC recently suggested three possible tracks for considering changes to the deposit insurance rules. Option One is to keep the rules as they are; Option Two is to insure all deposits; and Option Three is a hybrid in which some deposits in excess of current limits would be protected.

There seems to be a shift in thinking on deposit insurance. Historically, it was for consumers and families. The idea was to make sure "the little guy" had a secure place to safekeep their money. Today, that thinking has expanded to include business owners. In the past, perhaps there was a feeling that small business managers could track the safety of their bank on their own and would take care to make sure their money was appropriately distributed so it wouldn't be vulnerable to a bank failure. But people don't really assume that anymore. Clearly in the case of SVB and Signature, government officials were concerned about business deposits. There is also an understanding that in today's world, even a modest-size business is likely to have an operating account or payroll account with a balance in excess of $250,000. These are some of the depositors most likely to move their money to a larger institution. So it seems the deposit insurance rules need to protect these kinds of accounts. A change in the rules, however, requires Congressional approval which means it will be many months or even more than a year before anything changes. ■

BaaS profitable, requires due diligence, patience

Banking-as-a-Service requires market participants to face more stringent compliance requirements, but it also allows banks to quickly grow their revenue while earning a slice of the rapidly-growing sector.

The industry's challenges and opportunities were highlighted May 1 during a roundtable with Erik Skovgard, president and CEO of Reinbeck, Iowa-based Lincoln Savings Bank; Brian Johnson, CEO of Fargo, N.D.-based Choice Bank; and Brian Love, head of banking and fintech at Travillian. The discussion took place during the Spring Seminar hosted by the Bank Holding Company Association.

The $1.8 billion Lincoln Savings Bank established its BaaS arm LSBX roughly a decade ago as an online savings account provider. LSBX's first partner was Stockholm, Sweden-based personal finance fintech Qapital. As its first sponsor bank, LSBX helped Qapital, a growing fintech company at the time, open a bank account on the back end of its consumer-savings application.

Brian Love

In the coming years, LSBX worked on the beta test for CashApp, a partnership that sparked a massive increase in the number of LSB customers, to 3.1 million from 18,000. LSBX has also worked with financial services platform Square and mobile banking platform MoneyLion.

LSBX earns revenue in three ways, including by having zero deposit rates; sharing interchange fees with fintech partners and core processors; and having a minimum fee structure in the likely event that a partner fintech startup either fails or grows at a slower rate than initially expected. Lincoln Savings Bank only keeps 5 to 10 percent of the deposits it gathers from its fintech partners. The rest is sent to a network from which LSBX generates fee income.

LSBX runs on multiple cores, each of which introduces the bank to a different fintech partner. Skovgard urged bankers entering BaaS not to underestimate the required compliance work and internal controls to scale a nationwide offering. Since 2014, LSBX has added demand deposit accounts, debit cards and a prepaid card program. The consumer-focused fintech is shifting toward commercial services and launching a real-time payments program.

Brian Love (right) asks bankers Brian Johnson (left) and Erik Skovgard to describe their BaaS ventures.

Skovgard noted the bank maintains a community banking presence even as its BaaS arm now includes all 50 states. "We're straddling multiple cultures," he added. "We don't want to lose that, the values of what makes a community bank great."

Erik Skovgard

Choice Financial launched its BaaS offering in 2017, both to ensure the viability of the bank's future and connect with customers who were less likely to visit a physical branch. The bank had recently undergone a core conversion, becoming one of the first FIS banks in the country. The bank has strategically limited its number of partners to allow for more impactful service for the ones they work with. Choice sometimes evaluates potential fintech partners for several years before signing a final agreement.

Choice Financial, which initially partnered with a San Francisco-based health savings fintech, currently works with health care savings fintech Lively, New York City-based fintech Current and business banking fintech Lili. In March, the bank handled the second-most amount of money withdrawn from failed San Francisco-based Silicon Valley Bank through its partnership with California-based fintech Mercury. The bank's BaaS offering, which focuses on the payments and deposits space, employs workers in 22 states outside of Choice's traditional banking footprint in Minnesota and North Dakota.

Johnson said bank boards must realize clean examinations are unlikely initially as regulators don't completely understand BaaS. To be an attractive option for potential employees based in larger cities, Johnson said banks must be willing to invest in BaaS and commit to long-term growth. "If you are willing to invest in them and are committed to the long-term path … they'll come on board with you," Johnson added.

Brian Johnson

The roundtable came as the global BaaS market is projected to grow at a compound annual rate of 16.2 percent through 2030, reaching $74.55 billion, up from $22.49 billion in 2022, according to San Francisco-based market research and consulting company Grand View Research. The research expects that nonbanks will witness the fastest pace of growth over the next seven years. ■

Banks must be proactive to secure small-business customers


Chris Carlson

Bankers looking to establish relationships with small business owners must be proactive and forward-thinking, said Chris Carlson, president of training firm Core Academy. Carlson spoke during the opening session of the Bank Holding Company Association's Spring Seminar on May 1 in Edina, Minn.

Carlson noted small business owners usually fall into two categories, including those who want a more limited business relationship with only one product; and others who openly share their vision and desire a loyal partnership with personal and business accounts. Carlson said bankers spend too much time wooing those in the former category.

Carlson said the top concerns business officers have of their banks include loan officer turnover; bankers who don't understand their business; rare on-site visits other than to deliver bad news; selling non-applicable products; and a lack of consistency in their service.

Carlson said bankers can understand the goals of potential small business customers by:

1) Providing advice on attracting, hiring and retaining employees, implementing artificial intelligence and other value-adds, instead of only explaining the bank's basic offerings.

2) Helping owners set goals for the next three years, understand their financial ratios and how they compare to peer groups. He also advised banks to include a service plan that spans beyond the onboarding process.

3) Launching a small business thought leadership series. Carlson said banks can initially invite targeted prospects into the bank for presentations before backfilling with customers and centers of influence.

4) Starting a cleverly-named podcast with interviews of business owners and other local leaders. Carlson noted the podcast format allows business owners to promote their company by posting the link to social media and newsletters.

"We need to think outside the box," Carlson noted. ■

Banks must be open to change, diligent to survive

Bankers must consistently review their operations and be comfortable with embracing new ways of doing business to survive, said Phillip Smith, chair and CEO of consulting and law firm Gerrish Smith and Tuck.


Phillip Smith

Smith, who doesn't see banks as needing to reach a minimum asset size to remain in business, said survival might instead be predicated on properly scaling operations and finding the next generation of leaders. "The lack of ownership succession is what is killing a lot of community banks, just because they haven't planned for it," he said May 2 during the Bank Holding Company Association Spring Seminar in Edina, Minn.

Smith challenged bankers to avoid falling into familiar routines in running meetings, lending and other operations as strategic planning and M&A planning continue to change. Although closing branches can create the perception that a bank is not doing well, not closing a financially underperforming branch creates problems.

Bank boards must prepare for the future by considering whether they can afford to buy out their largest stockholder if necessary, or how they would handle an unsolicited offer or enhanced regulatory scrutiny surrounding a key program. Smith suggested banks evaluate whether they want to sell on an annual basis. He noted that in one instance, a 68-year-old community bank owner told him that he was ready to sell, but Smith told the leader that he needed to speak to his family before making the final decision. The banker's son told him that he didn't want him to sell the bank, and that he wanted to be CEO.

"We've always historically said to be independent we've gotta focus on shareholder value," he added. "I no longer think it's enough to focus on just shareholder value. Now we change our thinking. It's gotta be stakeholder value."

Smith said the concept of corporate governance has changed over the years to encompass DEI (diversity, equity and inclusion) and ESG (environmental, social, governance) considerations. Although community banks don't have to consider that regulators will require direct changes to their lending practices, he said, for example, they could closely scrutinize loans to farmers using products deemed harmful to the environment. Banks can burnish their standing by leading a project that reflects the social consciousness of its geographic area.

Smith said he does not support mandatory board member retirement ages but sees having attentive board members as a necessity. To him, too many banks are not effectively utilizing their corporate structure. Bank board meetings should include a consent agenda, and members should be expected to be prepared ahead of time. He noted that the bank boards of today have minimum education hours and residency requirements. Banks also do peer-to-peer evaluations, including asking whether a member should be renominated. Smith said banks are shifting their approach to recruiting as employees gain negotiating power. Some rural banks are relocating corporate offices to metropolitan areas to hire key executives. ■








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Economist: Recession possible in September

A leading economic reading indicates that a recession could begin in September, said Doug Ramsey, chief investment officer at Minneapolis-based market research firm The Leuthold Group. Ramsey was the luncheon speaker on the closing day of the BHCA Spring Seminar.

The yield curve between the three-month Treasury and the 10-year Treasury went inverted in early November, Ramsey said. An inverted yield curve historically has been a reliable predictor of recession. Ramsey sees other indicators of a possible recession, including the near-record 1.58 percent fall in worker productivity in the fourth quarter of last year occurring with full employment. Inflation has been consistently higher than 5 percent for more than a year, he said. Ramsey, who noted the last five high-inflationary periods have only ended after a recession began, expects the Federal Reserve to begin cutting interest rates by the end of this year.

Ramsey said the stock market remains "emphatically-neutral." As of mid-May, the S&P 500 had gained more than 7 percent this year, after losing more than 18 percent last year due to rising inflation and the ongoing Russia-Ukraine war. Ramsey noted that the M2 money supply contracted by at least 4 percent last year for the first time in more than 90 years, even as the economy nominally grew by 7 percent.


Doug Ramsey

Speaking 18 months before the 2024 presidential election, Ramsey said the stock market's results tend to correlate with the election season. He noted that small cap stocks gain an average of 14 percent in the year before a presidential election. Of the previous 14 S&P 500 declines of at least 19 percent, 10 came during an election year. Eight of the 10 occurred between May 1 through Oct. 31. Only one of the 20 recessions recorded since 1914 has begun the year before a presidential election.

"By the time the consensus has come around to the idea of 'we're in a recession,' very often the stock market low has already occurred," Ramsey said. ■

Bankers offer insight into unique business lines

Bankers overseeing niche lending platforms described how their programs have sparked growth for their institutions during a panel discussion presented during the first day of the Spring Seminar of the Bank Holding Company on May 1 conducted at the Westin Galleria Edina Hotel.

Panelists included Chris Vinson, CEO of Sioux Falls, S.D.-based Windsor Mortgage, the mortgage division of Plains Commerce Bank; Alfred Furth, president and CEO of Sioux Falls-based credit card originator Capital Services; and Dave Hales, president and CEO of Kiester, Minn.-based Global Innovations Bank.


Dave Hales

Plains Commerce Bank entered the mortgage business more than a decade ago as it was exiting the card services business, Vinson noted. The bank acquired Sioux Falls-based independent mortgage company Journey Mortgage in 2008, and by 2012 had secured a major share of the Sioux Falls market. Windsor Mortgage was established four years later.

Vinson emphasized the importance of methodically growing unique lending segments. After initially working with a few banks in South Dakota, Iowa and Nebraska as a wholesale mortgage servicer, the bank today has more than 4,000 clients and wholesale mortgage divisions in all 50 states as well as a Sioux Falls-based retail mortgage center. Windsor Mortgage's $5.6 billion in originations over a recent 12-month stretch was nearly six times higher than the bank's asset size of roughly $1 billion.


Chris Vinson

At Capital Services, Furth noted that credit cards are a good complement to the company's strong community bank model. The company has been a key source of growth for the Farrar Banking Organization. During the last five years, Capital Services' 9.2 percent return on assets at its smallest charter, First National Bank of Oldham, was far higher than the core bank's ROA of less than 1 percent. At First National Bank in Pierre, S.D, Capital Services' ROA on credit cards increased the bank's overall ratio to 2.4 from 1.4 percent, providing more income to grow the bank.

Furth said the groundwork for the company's success was laid even before it was established 25 years ago. The Farrar Banking Organization founder Frank Farrar, played a crucial role by hiring Jeff Agerter, an experienced credit card executive at Citibank and Premier Bankcard. Capital Services has utilized its in-house expertise to test, strategize and optimize returns.


Alfred Furth

"Look for where the need is, and then test it out and have a hypothesis and continue to test out that hypothesis over and over again," Furth advised. "It's all about doing that research, testing the hypothesis and learning with every time that you look at something new." ■

Banks must review capital projections amid economic uncertainty

Financial projections must account for extreme fluctuations in macroeconomic conditions, said Gary Svec, managing director of investment banking at Chicago-based Performance Trust. Svec spoke on May 2, the second day of the BHCA Spring Seminar in Edina, Minn. The event took place at the Westin Galleria Hotel.

Svec urged bankers to offer loan terms that account for the possibility of future expense needs to accommodate cost of funds increases. Balance sheet projections must be reviewed on a consistent basis to account for potential interest rate increases.

He urged bankers to examine their loan pricing strategies. Svec noted that bankers want to earn 3 percent more on a loan than the Treasury rate, meaning they should charge 7.25 percent should rates be around 4.25 percent.

"If you don't get paid for the risk you are taking, don't take the risk," Svec advised. "You've gotta get paid for the loan. And if you don't, find alternatives. There are alternatives out there that have lower credit risk, lower capital strain, much less risk in general, more liquid assets that are better in the market."

Gary Svec

Svec said banking risk management systems have shown signs of error in recent years. One example is the erroneous projection at the end of 2021 that the Federal Funds rate would only be at slightly above 1.00 percent in February 2023. Instead, the rate was at more than 4.00 percent. "We are deathly afraid that your systems are lying to you," Svec said. "We believe that the systems that you have to manage risk in your institution are not telling the truth."

Today, prime borrowers are paying 8 percent interest rates, more than doubling the 3 percent rates they faced 16 months ago. Banks have a major funding advantage, allowing them to put assets on their books with cost of funds at 1.25 percent even as interest rates remain far higher. Svec said those numbers are strong and are harming the fintech industry, which is seeing cost-of-funds increases after it benefitted from having a low cost of funds in 2021. Svec projected that roughly 1,700 banks will lose money if interest rates rise by another 100 basis points.

In 2021, banks were saddled with excess capital and anemic loan demand as they competed with government lending programs offering interest rates of between 0 and 2 percent. Banks that kept a large percentage of their money in cash when rates were near zero in 2021 were the most successful, he added.

Treasury securities are more stable than mortgage-backed securities, Svec said. Silicon Valley Bank was the third-largest buyer of mortgage-backed securities before it failed in March. He contrasted that with Silvergate Bank, which he noted lost 90 percent of its deposits due to crypto fraud but survived because it didn't buy junk assets. ■

Detailed review, customer mapping crucial in loan pricing

Bank leaders must strategically set loan pricing standards and ensure there is sufficient institutional knowledge of existing fee structures, said Wipfli Senior Manager Robert Zondag May 2 during the Bank Holding Company Association's Spring Seminar in Edina, Minn. Zondag presented one of the seminar's three break-out sessions.

During his roughly 40-minute presentation, Zondag said recent turnover at many banks requires executives to not assume employees know where fee income originates. He advised having a written customer journey map to understand how each customer experiences the bank, including client personas/profiles. He also advised banks to closely track fee-producing customer service lines and income-producing business lines.

"If we don't have a map, I don't know how we know where we are going," Zondag added. "I don't know how we can cross-sell additional products, and I don't know how we can certainly spend millions of dollars on fintech solutions if we don't know how they are going to help us with our customer experience."

Banks can capture the opportunities of modern lending by aligning their approach to a broader market strategy and establishing different loan pricing frameworks for separate business lines. Banks must review nonbank loan pricing standards while setting their own policies and commit to risk-adjusted pricing for credit extensions, Zondag noted. Financial institutions can also use multiple pricing metrics to track performance and must identify and quickly correct pricing leakages.

Robert Zondag

Banks must consider whether they are overly reliant on their core processor to provide solutions and fee income, and whether the processor has a long-term plan for how their payment service will evolve. Zondag views non-interest income as a hedge against interest income by independently generating fee and sales income. Banks looking to add income through fintech or banking-as-a-service partnerships must consider the robustness of the potential partner's risk management program. Zondag said banks must also consider who holds liability under the contract or if it involves ACH origination. ■








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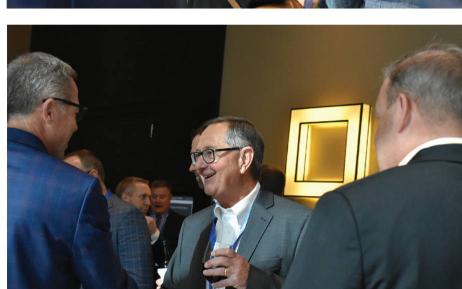


HOLDING COMPANY DIVIDENDS IN AN AOCI LOSS ENVIRONMENT

By Rachel Robison

During the pandemic, community banks experienced a surge in deposits, and some banks invested their deposit growth in longer-dated securities for earnings. Given the recent rising interest rate environment, many banks now have significant unrealized losses in their investment portfolios. These unrealized losses have impacted the banks' tangible common equity ratios. Unrealized losses at the bank level also impact the holding company's parent-level debt-to-equity ratio. This ratio is an important measurement for small bank holding companies, and savings and loan holding companies (i.e., $3 billion or less in consolidated assets) as discussed in the Small Bank Holding Company, and Savings and Loan Holding Company, Policy Statement. The Policy Statement directly says that an HC is not expected to pay dividends until debt-to-equity falls to 1:1 or less. However, we also recognize there are circumstances where a holding company with debt levels exceeding equity may need to pay dividends. In these cases, we expect management to consult with the Federal Reserve Bank of Minneapolis (Reserve Bank) prior to making those capital distributions.

The Federal Reserve Bank of Minneapolis has engaged in many recent conversations on dividends and the implications of the Policy Statement due to a number of our HCs with a debt-to-equity ratio now exceeding 1:1, primarily due to the accumulated other comprehensive income (AOCI) impact on equity at the holding company under GAAP reporting requirements. When these respective HCs consult with us, we review the payments for consistency with the safety and soundness considerations outlined in SR 09-4 (Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases of Bank Holding Companies). We have already worked through several dividend consultations in high debt-to-equity situations, and here are some insights:

- HCs that exceed a 1.0:1 debt-to-equity ratio should provide the Reserve Bank with a consultation letter describing their plans for capital distributions and how such plans will ensure that the holding company continues to act as a source of strength to its insured depository institutions (IDIs). These dividend consultations will typically require 30 days processing time by the Reserve Bank, as our analysis will be more in-depth than dividend requests that qualify for expedited responses.
- Reserve Bank staff will review proposed capital distribution plans for safety and soundness concerns, consult with HCs as needed, discuss the proposed dividend with the IDIs' primary regulators, and respond, as encouraged in SR 09-4. If there are no safety and soundness concerns with an HC's proposal, the Reserve Bank will typically provide a no-objection letter to the HC. When deciding whether there is a safety and soundness concern, supervision will focus on sufficiency of the holding company's cash flow, liquidity, and ability to raise funds to support debt service while maintaining sufficient capital at subsidiary IDIs commensurate with their risk profile.

Rachel Robison is responsible for the HC supervision program, under Manager Linda Anderson. We can be reached at HCrequests@mpls.frb.org for supervision questions and SR 09-4 notifications such as dividend and stock redemption requests. At the Federal Reserve Bank of Minneapolis, all holding companies over $3 billion have a designated Central Point of Contact for supervision matters.

Due to our Reserve Bank's move to electronic correspondence, inspection reports and other supervisory correspondence are now sent by Zix secure email. Registering your holding company's designated contacts in our Supervision Contact System helps us send important holding company correspondence to the right contact.

Rachel Robison is a Senior Examiner with the Federal Reserve Bank of Minneapolis. She is responsible for the Minneapolis Fed's supervision of small shell holding companies and enforcement matters. ■

Is A Bank Holding Company Structure Still Recommended?

By Philip K. Smith

Greater than 80 percent of the commercial banks in the country are in a bank holding company structure. But is it really the best structure for the organization or would operating without a holding company be better? We have looked at this question over the years for a number of different clients as economic cycles ebb and flow and as circumstances changed but, we are yet to find a situation where having a bank holding company is detrimental to your organization. So, we still highly recommend that structure as providing lots of different kinds of benefits, as outlined in this section.

Most of you reading this article are probably already in a bank holding company structure. If you are not and would like more information about how the reorganization process works and what to expect, please drop us a note and we will be happy to talk with you about it or send you some information. For the rest of you, we thought it might be of benefit to the board chair, directors, and senior management to consider the myriad of different ways the holding company can be used to increase overall organizational efficiency and value. We are setting forth below a number of different areas and ways in which your holding company structure can be utilized, perhaps differently than the way you are using it now, to provide further benefit to the organization.

Capital Funding

If a bank does not have a bank holding company and needs more capital, it really has a limited number of opportunities, the most likely of which is simply selling more stock. However, selling more stock means that the ownership becomes diluted because their book value may be accretive if you sell stock above book value. A bank holding company can easily take out a line of credit or even a term loan secured by the bank stock and draw against the loan or the line as needed to receive cash which may simply be downstreamed from the holding company to the bank, thereby increasing tier 1 bank capital. In doing so, principal and interest are repaid through dividends from the bank to the holding company to service the debt. Additionally, there is no tax on the distribution from the bank to the holding company.

That type of simple capital funding may be preferential even in times when other groups are pushing for the use of subordinated debt, or the sale of common stock. Debt financing capital is normally cheap and easy to accomplish and can be done relatively quickly.

Improved Management of the Board of Directors

Historically, most banks that had a bank holding company simply had a bank holding company board that was a mirror image of the bank board. In essence, if you were elected to serve on one board you served on both. However, in the more modern era where boards of directors are falling under increased scrutiny, there are more demands for improved corporate governance and there is a greater emphasis on having active and engaged boards that recognize the position is its own job and not merely an honorary position, the holding company can help with those concerns. We are seeing more organizations position their holding company board as separate and distinct from the bank board (although there may be one or more members who overlap both boards). By structuring the boards in this way, the bank holding company board is the "strategic" board that deals with issues such as shareholder distributions, mergers and acquisitions, growth and expansion considerations, etc., while the bank board remains the more operational/tactical board, dealing with day in and day out matters like employee concerns, asset liability management, new technology implementation, etc.

So, you can probably see that these distinct boards may require members who serve in a different type of capacity or have a different skill set. We have also seen banks utilize the bank holding company board to resolve board succession and mandatory retirement issues at the bank level. In essence, you can be "promoted" to serve only at the bank holding company level to handle strategic issues, and you are no longer subject to bank board service dealing with the more technical issues. Similarly, closely-held or family-owned banks might also want to primarily have family members at the holding company level, yet utilize the bank board to recruit more outside directors from the community.

Creation of Liquidity for Stockholders

Anytime your organization is confronted with a stockholder who needs or desires to sell shares, the "purchaser of first resort" in our opinion ought to be the bank holding company. In essence, your corporate entity can negotiate with a stockholder to purchase their shares, can fund the cash purchase price either through debt financing (as described above) or through a dividend of cash from the bank to the holding company, and can provide instant liquidity without any regulatory involvement (in most cases, but not all) and therefore meet the stockholders' needs while providing a benefit to the organization. Unless the holding company pays some extremely high price for the shares that is beyond what a normal price would be, then the stock repurchased by the bank holding company (as opposed to allowing other stockholders to purchase the shares) normally results in many benefits including earnings per share increase, improved return on equity, improved cash flow on a per share basis to remaining stockholders, and the fact that all remaining stockholders will have their ownership percentage increased without spending any of their own money. It really becomes a win/win situation for both the selling stockholder and the stockholders who remain afterward.

Because the benefits of a stock repurchase program are so significant, many organizations choose not to wait until a stockholder approaches the bank holding company about selling shares, but the organization will take the affirmative step of developing and implementing its own stock repurchase program to provide a liquidity opportunity on a voluntary basis for stockholders. Organizations that are not in high growth markets where capital needs to be retained, and where there may be limited in other growth opportunities, may find that the best use of "excess" capital is to fund stock repurchases from existing stockholders who desire to sell.

Anti-Takeover Planning

One of the benefits of the bank holding company structure that often goes overlooked is really the core bedrock change that occurs when you form a holding company. That change is that stockholders become stockholders of a corporation rather than the bank. Therefore, all rights, duties and obligations of stockholders and all relevant legal matters are covered by the corporate statutes rather than the banking statutes. That is important because in most states the corporate law is much more modernized, is corporate friendly, and better from an efficiency of operations standpoint than banking law.

Those benefits are particularly true when thinking about how to avoid unwanted hostile acquisition offers or even in fending off an unsolicited offer. Corporate laws allow for many more protective measures to be implemented through the organization's articles of incorporation and/or bylaws. These steps might include elimination of preemptive rights, removing cumulative voting, increasing voting thresholds for corporate transactions not recommended by the board, making it more difficult for hostile stockholders to call meetings or disrupt meetings, and similar types of corporate protections. Simply put, anti-takeover defenses are generally much stronger through the bank holding company and the corporate code rather than through the banking code.

Growth and Expansion Opportunities

If an organization is thinking of acquiring another entity, having a bank holding company opens up a number of different structuring techniques. For example, you might choose to merge the target's holding company into your holding company but leave the banks separately chartered. If you do not have a holding company, chances are that to get the appropriate tax structure desired, you might have to form a holding company at the time of making the acquisition.

Likewise, if you are looking to add a new line of business or purchase another company you have the alternatives of creating a bank holding company subsidiary versus having to house the new activity at the bank level. There might be a number of reasons you would choose to do that. Again, the bank holding company structure simply provides the most benefit and should be utilized where possible.

So, we hope you can see there many beneficial uses, including others we have not even talked about, like selling troubled assets out of the bank up to the holding company during times of declining asset values or problem loan situations. Hopefully we will not need that in the current environment, but if we do, it is better to have the holding company. So, if you do not have a holding company, now is the time to form one. If you need more information about the mechanics of the process, we would be happy to share that with you or provide you information. By the way, those of you who might be mutual institutions also may form a holding company and receive many of these same benefits. Forming a holding company for a mutual is not necessarily a step toward loss of mutuality, but can be used as a protection against losing mutuality. So the bottom line for the board chair and for the board is to have a holding company and use it strategically for the benefits it provides.

Originally published by Philip K. Smith, Gerrish Smith Tuck Consultants and Attorneys in the Board Chair Forum Newsletter. *Reprinted with permission. Mr. Smith was a presenter at the BHCA Spring Seminar in May. He may be contacted at gerrishsmithtuck@gerrish.com* ■

Holding Company Transaction Report

Here are selected recent bank holding company filings with the Federal Reserve Banks of Chicago, Minneapolis, Kansas City and St. Louis

▷ David Oren, Somerville, Tenn., filed to acquire shares of A.M. Saylor, Inc., and thereby control First Hampton Bank, both of Hampton, Iowa.

▷ Notice filed by The First National Bank in Sioux Falls, S.D., as trustee of the Kehl Family 2009 Trust, and others, to join the Kehl Family Control Group to acquire shares of Savanna-Thomson Investment, Inc., Savanna, Ill., and thereby acquire shares of Savanna-Thomson Bank, Thomas, Ill.

▷ Notice filed by Stavros Papastavrou and others to acquire control of ServBanc Holdco, Inc., Phoenix, and thereby acquire control of Allied First Bank, Oswego, Ill.

▷ Lake Central Financial, Inc., Annandale, Minn., filed to acquire State Bank of Danvers, Benson, Minn.

▷ Vista Holding Company, St. Louis, filed to become a bank holding company through the acquisition of Mohler Bancshares, Inc., and thereby acquire First National Bank of Harveyville, both of Harveyville, Kan.

▷ Stockgrowers State Bank ESOP, Ashland, Kan., filed to acquire additional shares up to 39 percent of Stockgrowers Banc Corp, Ashland, and thereby acquire additional shares of Stockgrowers State Bank, Ashland; and Peoples Bank, Coldwater, Kan.

▷ The Gary W. Paulson and Lyla G. Paulson Revocable Living Trust filed to acquire shares of First Holding Company of Park River, Inc. and thereby acquire First United Bank, all of Park River, N.D.

▷ Grinnell Bancshares, Inc., Grinnell, Iowa, filed to acquire The Colorado Bank & Trust Company of La Junta, Colo.

▷ Multi-Bank Services, Ltd., Southfield, Mich., filed to become a bank holding company by acquiring shares of Florence Bancorporation, Inc., Florence, Wis., and thereby acquire Great North Bank, Florence.

▷ Alexandra G. Solanki, Wauwatosa, Wis., filed to become the largest individual shareholder by becoming co-trustee of the Horicon Bank Profit Sharing & ESOP and thereby acquiring shares of Sword Financial Corporation, Horicon, Wis., and acquiring shares of Horicon Bank, and Cornerstone Community Bank, Grafton, Wis.

▷ 1905 Nekota Bankcorp, Inc., filed to become a bank holding company through the acquisition of Lewellen National Corp., and thereby acquire Bank of Lewellen, all of Lewellen, Neb.

▷ First Mid Bancshares Inc., Mattoon, Ill., filed to acquire Blackhawk Bancorp Inc., and thereby acquire Blackhawk Bank, both of Beloit, Wis. In addition, Eagle Sub, LLC, Mattoon, Ill., an interim subsidiary, to merge with Blackhawk Bancorp Inc., whereby Eagle Sub LLC will be the surviving entity and a wholly-owned subsidiary of First Mid Bancshares, Inc., for a moment in time. Following the interim holding company merger, Eagle Sub LLC will be merged with and into First Mid Bancshares, Inc., with First Mid Bancshares, Inc. being the surviving entity.

▷ First Financial Corporation, Arthur, N.D., filed to merge with HSB Financial Corporation, and thereby indirectly acquire Harwood State Bank, both of Harwood, N.D.

▷ Notice by Dierk Halverson, Coon Rapids, Iowa, John Chrystal, Aspen, Colo., and Steven Spotts, Sac City, Iowa to retain and to acquire voting shares; and together with Timothy O. Lee, Coon Rapids, Iowa, who was previously approved, to form a group acting in concert to control Sac City Limited and thereby indirectly control Iowa State Bank both of Sac City, Iowa. ■

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