LEGAL UPDATES AND NEWS

FEDERAL RESERVE BOARD EXEMPTS BHCS AND SLHCS OF LESS THAN $1 BILLION IN CONSOLIDATED ASSETS FROM CAPITAL REQUIREMENTS

The Federal Reserve Board ("FRB") has adopted a final rule ("Final Rule") that exempts qualifying savings and loan holding companies ("SLHC") and bank holding companies ("BHC") with less than $1 billion in consolidated assets from the FRB's consolidated regulatory capital requirements for holding companies. The Final Rule becomes effective 30 days from publication in the Federal Register, which publication should occur within the next week.

Under the Small Bank Holding Company Policy Statement ("Policy Statement"), adopted by the FRB in 1980, "small bank holding companies" (previously defined as BHCs with less than $500 million in assets) meeting certain criteria have been exempted from the FRB's consolidated capital requirements generally applicable to BHCs. In 2010, Section 171 of the Dodd-Frank Act required the FRB to impose minimum regulatory capital requirements on both BHCs and SLHCs that are no less stringent than those applicable to the insured depository institution subsidiaries themselves. However, Section 171 exempted BHCs that qualify under the Policy Statement, since they had historically not been subject to capital adequacy requirements. The statute did not exempt similarly-situated SLHCs since SLHCs generally had not previously been subject to consolidated capital requirements. In December 2014, the FRB was directed through legislation to adopt regulations extending to SLHCs the Policy Statement and the exemption from the consolidated holding company capital requirements and raising the asset threshold to $1 billion for BHCs and SLHCs that otherwise qualify under the Policy Statement.

In addition to the $1 billion asset threshold, BHCs and SLHCs must meet certain qualitative requirements in order to receive the exemption from the capital regulations through application of the Policy Statement. The Final Rule continues the qualitative requirements previously applicable to BHCs under the Policy Statement. A BHC or an SLHC qualifying for the capital exception under the Policy Statement cannot: (i) engage in "significant" nonbanking activities either directly or through a nonbank subsidiary; (ii) conduct "significant" off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary (but not including the institution itself or its subsidiaries); or (iii) have a "material" amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the SEC (the "SEC securities factor").

The Policy Statement does not define the terms "significant" or "material" with respect to the qualitative requirements. The FRB has previously stated that the ambiguous terminology was intended to provide "supervisory flexibility in determining on, a case-by-case basis," whether a particular holding company should be excluded from the Policy Statement and made

subject to the consolidated capital requirements. Such determinations have generally been made by supervisory staff of the Federal Reserve Banks.

As to the meaning of "significant" nonbanking activities or off-balance sheet activities, the Preamble to the Final Rule (the "Preamble") lists factors that Federal Reserve Bank supervisory staff would consider in making a case-by-case determination. These include the scope of the activities, the nature and level of risk of the activities, and the condition of the holding company and its subsidiary depository institution. The Preamble indicates that the appropriate focus is nonbanking and off-balance sheet activities of the BHC and SLHC and its nonbanking subsidiaries (rather than those of the depository institution and its subsidiaries). The Preamble also emphasizes that few exclusions are expected based upon the "significant" nonbanking or off-balance sheet activities qualitative requirements.

The SEC securities factor is based on the FRB's view that a BHC or SLHC that has a "material" amount of SEC-registered equity or debt securities exhibits a degree of complexity of operations and access to funding sources that warrant exclusion from the Policy Statement and capital exemption. Responding to a comment filed by this law firm, the Preamble makes clear that an SEC-registered equity or debt offering alone would not warrant exclusion. Rather, the Preamble indicates that any exclusion would be a case-by-case determination based on factors such as the number and types of classes and series of stock issued, average trading volume, the particular company's history of issuing securities (including any privately-placed, non-SEC registered issuances), the nature and distribution of ownership, whether the securities are listed on a national exchange, whether the holding company qualifies as a "small reporting company" under SEC rules and interpretations, and the amount, type and terms of any debt securities issued by the company. The Preamble emphasizes that few BHCs have been excluded based on the SEC securities factor. Based on the Preamble and our discussions with FRB staff, we anticipate that case-by-case exclusions based on the SEC securities factor should be rare and based on unusual fact patterns.

Aside from the qualitative requirements, the Final Rule retains general FRB authority to exclude an otherwise qualifying BHC or SLHC at any time for supervisory reasons, and thereby impose the consolidated capital requirements. However, the vast majority of small BHCs and SLHCs should benefit from the FRB's recent action.

* * *

Luse Gorman is one of the leading firms nationally in advising financial institutions on capital-raising, mergers and acquisitions, corporate and securities, regulatory and executive compensation/employee benefits matters. Please contact any of the attorneys listed below if you would like to discuss any information contained in this newsletter.

Eric Luse	■	(202) 274-2002	eluse@luselaw.com
John J. Gorman	■	(202) 274-2001	jgorman@luselaw.com
Joe Daly	■	(202) 274-2034	jdaly@luselaw.com
Lawrence M.F. Spaccasi	■	(202) 274-2037	lspaccasi@luselaw.com
Gary Lax	■	(202) 274-2031	glax@luselaw.com
Kent M. Krudys	■	(202) 274-2019	kkrudys@luselaw.com
Kip Weissman	■	(202) 274-2029	kweissman@luselaw.com