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BANK HOLDING COMPANY SHEDDING TRANSACTIONS

The authors note recent bank transactions eliminating BHCs, suggesting a trend. They then discuss fiduciary duty considerations, the declining role of traditional BHC advantages, and the benefits of eliminating the FRB and SEC as federal regulators. They address equity and debt offerings by a bank without a BHC and close with a high-level summary of corporate steps required to eliminate a BHC.

By V. Gerard Comizio and Nathan S. Brownback *

Bank holding companies ("BHCs") have been fixtures on the landscape of U.S. banking institutions for more than six decades. Why? Are they still the right choice for every banking institution? And if not, what should a financial institution do about it?

This article discusses the major issues to consider in evaluating the relative merits of undertaking a corporate internal reorganization involving the merger of a BHC into its bank subsidiary, thereby eliminating the BHC structure and all regulation, examination, and oversight by the Federal Reserve Board ("FRB"), as well as eliminating the Securities and Exchange Commission ("SEC") as federal securities regulator in favor of consolidated banking and securities regulation by the Office of the Comptroller of the Currency ("OCC"), if the bank is a national bank, or the Federal Deposit Insurance Corporation, if the bank is a state non-member bank.[1]

This article begins by discussing recent transactions in which banking organizations have eliminated their BHCs, as well as announcements by banking organizations that they intend to or have begun the process of eliminating their BHC structures. It then discusses the fiduciary duty considerations driving BHC elimination transactions at the level of banking organizations' boards. It demonstrates that the "traditional" advantages of BHCs have declined in importance or been eliminated, while regulatory disadvantages to employing a BHC in the structure of a banking organization have substantially increased through increasing levels of BHC regulation, oversight, examination, and supervision. It explains that the OCC has become an advocate for national banks to eliminate their BHC structures in order to reduce "regulatory redundancy." It provides some of the costs and benefits banking organizations should consider when evaluating

[1] A "non-member" bank is one that is not a member of the Federal Reserve System. By contrast, it should be noted that a state member bank, *i.e.*, a bank that is a member of the Federal

footnote continued from previous column…

Reserve System, would retain the FRB as its primary federal bank regulator regardless of whether it employs a BHC structure.

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a BHC elimination transaction, including: (1) how a BHC elimination transaction would substantially reduce and consolidate the number of federal regulators – eliminating both the FRB and the SEC as federal regulators; (2) that a banking organization can continue to undertake common and preferred stock and debt offerings after a BHC has been eliminated; and (3) that a banking organization will generally have the ability to continue to engage in mergers and acquisitions after a BHC has been eliminated. It concludes with a high-level summary of the steps required for a banking organization to undertake a corporate internal reorganization to eliminate a BHC.

BANKING ORGANIZATIONS ARE ELIMINATING BHCS

In exercising their fiduciary duties to enhance shareholder value, boards of directors and management of a number of banking organizations are increasingly considering an innovative strategy: elimination of their BHCs, both for regulatory and strategic reasons.

On April 11, 2017, Bank of the Ozarks, a $19 billion banking organization, citing regulatory burdens and costs, announced it was undertaking an internal corporate reorganization, dissolving its BHC structure, and will no longer be regulated by the FRB. This reorganization was completed on June 26, 2017. Bank of the Ozarks' Chairman and CEO noted that the transaction is "purely an efficiency play," stating that bank holding companies are a "vestige of the past" and are no longer needed. In this regard, he cited the advantages of reducing the BHC regulatory burden – which has increased in recent years – as well as compliance and related costs, and potential ability to close mergers on a shorter timeline.[2]

In addition, Bancorp South, Inc. – a $15 billion company – announced on July 21, 2017 that it is also restructuring to eliminate its BHC. Bancorp South's reorganization was completed on October 31, 2017.

On November 20, 2017, Zions Bancorporation, a systemically important financial institution ("SIFI") with $66 billion in assets, announced its intention to merge its BHC into its national bank subsidiary.[3] It also announced that it intended to request that the Financial Stability Oversight Council ("FSOC") confirm that, after such a transaction, the resulting organization, with a national bank as its top-level entity, would no longer be regulated by the FRB as a SIFI. Zions is engaging in this process with FSOC because the Dodd-Frank Act includes a so-called "Hotel California"[4] provision that prevents BHCs that received financial assistance under the 2008 troubled asset relief program ("TARP") from shedding their SIFI status by "ceasing to be a bank holding company."[5] If an entity ceases to be a BHC – which would presumably include merging a BHC into a bank subsidiary, as Zions contemplates – the Dodd-Frank Act allows an entity to request that the FSOC reconsider the resulting entity's SIFI status.[6] On April 12, 2018,[7] the FSOC considered Zions' potential

[2] Allison Prang, *Why More Banks Could Ditch Their Holding Companies*, American Banker, July 12, 2017.

[3] Zions Bancorporation Announces Plans to Simplify Its Structure By Merging Parent Company Into Its Banking Subsidiary (Nov. 20, 2017), http://www.snl.com/irweblinkx/file.aspx?IID=100501&FID=391166962.

[4] EAGLES, HOTEL CALIFORNIA (Asylum Records 1977) ("You can check out any time you like, but you can never leave!").

[5] Dodd-Frank Act § 117(a)-(b). Zions received funds under TARP. *E.g.*, Department of the Treasury, Zions Bancorporation Repays in Full its Remaining $700 Million in TARP Funds, Overall Positive Return on Tarp's [sic] Bank Programs Now Totals More than $21 Billion (Sept. 26, 2012), https://www.treasury.gov/press-center/press-releases/Pages/tg1721.aspx.

[6] Dodd-Frank Act § 117(c).

[7] U.S. Treasury Department Office of Public Affairs, Readout of Financial Stability Oversight Council Meeting (Apr. 12, 2018) ("In addition, the Council discussed a potential application to the Council from a bank holding company or its successor under section 117 of the Dodd-Frank Wall Street Reform and Consumer Protection Act."), https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/April122018_readout.pdf. Though Zions was not named in the press release cited above, it was almost certainly Zions' potential application that FSOC considered.

application but no formal application has yet been considered.[8]

A number of banking industry analysts are now encouraging banking organizations they cover to seriously consider the relative merits of eliminating their BHCs. Notably, approximately 20% of U.S. banks – at least 5% of banks with more than $10 billion in assets – including, for example, First Republic Bank, over $87 billion in assets, and Signature Bank, over $43 billion in assets, just to name a few – are *not* part of a BHC structure.[9] Bank of the Ozarks, First Republic, and Signature are all non-member banks; thus, no FRB regulation would remain at the bank level once a BHC is eliminated.

It is significant to note that the FRB is generally neutral on the question of whether banks should form BHCs, and it does not generally "market" or encourage BHCs. Neither the FRB nor the FDIC made any public objection to the completed BHC shedding transactions of either Bank of the Ozarks or Bancorp South.

FIDUCIARY DUTY CONSIDERATIONS DRIVING BHC ELIMINATION TRANSACTIONS[10]

Each banking organization should periodically assess its corporate strategies, governance, and structure, including an assessment of the need for a BHC structure relative to the disadvantages of a BHC, because the board of directors of every banking organization has a fiduciary duty to enhance shareholder value. This should be an individual determination based on the banking organization's circumstances and needs, business plan, and a full consideration of the relative merits of such a transaction, considering utility and cost, with appropriate consultation with legal and financial advisers.

Certainly, a corporation's primary objective is to conduct its business activities to maximize corporate profit and shareholder gains. The board's responsibilities under its fiduciary duty include informed decision-making regarding corporate policies and strategic goals; among these policies and goals must be the corporate structure of the banking organization:

> From a fiduciary prospective, bank management bears a specific responsibility to periodically review its corporate and governance structure. In addition, the federal banking agencies have emphasized that "financial institutions are encouraged to 'periodically review their policies and procedures related to corporate governance … matters.'" In this context, fiduciary duty requires management to periodically "evaluate which corporate governance policies and procedures are more appropriate [for an institution's] size, operations, and resources."[11]

In this context, to consider eliminating a BHC, the board of directors should assess: (1) regulatory compliance and corporate governance costs; (2) whether there is a strategic need for a BHC in light of current and proposed activities that are impermissible through a bank or its subsidiaries versus regulatory burdens, cost, and expense of BHC structure; (3) the optimal corporate structure to maximize profitability; and (4) appropriate streamlining of regulatory burdens consistent with the company's business plans.[12]

THE DECLINING TRADITIONAL ADVANTAGES OF BHCS

Bank holding companies have been regulated under federal law by the FRB since the adoption of the Bank Holding Company Act of 1956 (the "BHCA").[13] Many banks formed bank holding companies in the 1980s and 1990s, perceiving certain strategic advantages for doing so – largely because BHCs had more expansive powers than banks without a BHC, at least at the time. However, virtually all of the traditional advantages of forming a BHC have either substantially declined in

[8] As yet, no formal application has been announced by Zions or FSOC, and, to our knowledge, no such application has been made.

[9] Partnership for Progress, Bank Holding Companies – Bank Ownership by BHCs December 1980 to December 2012, https://www.fedpartnership.gov/bank-life-cycle/manage-transition/bank-holding-companies.

[10] For more on the fiduciary duties of bank boards regarding the BHC elimination decision, *see* V. Gerard Comizio, *Do Banks Have a Fiduciary Duty to Shed Their BHC?* Harvard Law School Forum on Corporate Governance of Federal Regulation (Aug. 9, 2016), https://corpgov.law.harvard.edu/2016/08/09/do-banks-have-a-fiduciary-duty-to-shed-their-bhc-status/.

[11] *Id*., quoting Am. Bankers Ass'n., The Board's Role in Strategic Planning (2004).

[12] *Id*. *See also* V. Gerard Comizio, *Revisiting the Bank Holding Company Structure: Do Community and Regional Banks Still Need A Holding Company*?, 5 Am. U. Bus. L. Rev. 189 (2016).

[13] 12 U.S.C. § 1841 *et seq*.

importance or been eliminated over the past few decades. These advantages, such that remain, are outweighed in importance – at least for many small- to mid-sized institutions – by the increased disadvantages of significant increased FRB BHC regulation, examination, and oversight.

Some of the most important of these traditional advantages related to corporate governance, and, in particular, developments in the 1980s and before in Delaware corporate law that conferred new benefits on management, provided increasingly sophisticated methods for corporations to defend themselves from takeovers, or did both.[14] For example, so-called "golden parachutes" – compensation payments made to management or other institution-affiliated parties payable only on their severance or termination from the corporation – provided a means to deter takeovers. A number of banking organizations formed Delaware BHCs in the 1980s and enacted golden parachute provisions that were not available under the corporate laws of other states. Likewise, indemnification payment provisions were enacted that required a corporation, in certain circumstances, to indemnify management from any personal liability for regulatory fines and penalties, such that, if such penalties were applied by a regulator to an executive in her personal capacity, the corporation would reimburse the executive.

Golden parachutes have been limited by law at both the BHC and bank levels. Congress granted the FDIC the power to limit golden parachute and indemnification payments to institution-affiliated parties (which includes directors and executives) of both banks and BHCs.[15] The FDIC promulgated regulations prohibiting such payments in certain circumstances by both banks and BHCs in 1996.[16] Thus, a banking institution has no greater ability to offer golden parachute payments or indemnification payments as a BHC than as a bank.

Further, golden parachutes and other antitakeover provisions, rather than being restricted in the years since their introduction, have been adopted by other jurisdictions, such that they are available to state-chartered banks in many states.

Finally, the OCC has permitted national banks maximum flexibility to elect to follow either: (1) the corporate governance procedures of the state in which the main office of the bank is located; (2) Delaware law; or (3) the Model Business Corporation Act,[17] provided shareholders receive dissenters' appraisal rights comparable to those provided under the National Bank Act.[18] These are similar to those of most state laws, including, for example, Iowa[19] and Virginia.[20] Accordingly, provisions such as limited liability, indemnification, and antitakeover provisions available under Delaware law are available to many, if not most, banking organizations regardless of whether or not they have a BHC.

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[14] A full discussion of the historical development and ultimate effects of antitakeover provisions in Delaware corporate law and elsewhere is beyond the scope of this article, but the topic has been studied in detail in the legal, economics, and finance literature. *See, generally, e.g.*, Michael Klausner, *Empirical Studies of Corporate Law and Governance*, Stanford Law School Olin Program in Law and Economics Working Paper No. 513 (2018); Emiliano Catan & Marcel Kahan, *The Law and Finance of Antitakeover Statutes*, 68 S. L. Rev. 629 (2016); Mark J. Roe, *Delaware's Competition*, 117 Harv. L. Rev. 588 (2003); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice*, 150 U. Penn. L. Rev. 1795 (2002); Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 Va. L. Rev. 111 (2001); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 Fordham L. Rev. 843 (1993); Mark A. Heyl, *Golden Parachutes: Does the Business Judgment Rule Simply Perpetuate the Problem?*, 31 Santa Clara L. Rev. 739 (1991).

[15] Crime Control Act § 2523, Pub. L. No. 101-647 (1990), codified at 12 U.S.C. 1828(k). The Dodd-Frank Act contained additional anti-golden parachute provisions. Dodd-Frank Act § 956. Rules under this section have been proposed but not finalized by the federal banking agencies. *Incentive-Based Compensation Arrangements*, 81 Fed. Reg. 37670 (June 10, 2016). However, in the current regulatory environment under the Trump administration, it is unclear whether such rules remain under agency consideration. *See, e.g.*, Office of Information and Regulatory Affairs, Agency Rule List 2017 – Department of the Treasury, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1500 (OCC does not list Incentive-Based Compensation Arrangements on its most recent regulatory priority list).

[16] *See* 12 C.F.R. Part 359.

[17] *See, e.g.*, OCC Interpretative Letters 891 (April 26, 2000); 879 (November 10, 1999).

[18] *See* 12 U.S.C. §§ 215(b), 215a(b), 215a-2(c).

[19] IOWA CODE §524.1406 (2016).

[20] VA. CODE ANN. §§13.1-730, 6.2-822 (2016).

Another traditional advantage of a BHC not related to corporate governance was the ability to engage through a BHC in a wide range of banking-related activities, such as securities and insurance brokerage; however, due to regulatory developments in recent years widening the powers of banks, these and many other banking-related activities may now be conducted directly through the bank or bank operating subsidiaries.[21] But it should be noted that certain of the nonbanking activities listed in the FRB's Regulation Y[22] may still be conducted more broadly and with fewer restrictions by BHCs than by banks.[23]

In certain areas BHC powers exceed bank powers. Banking organizations with BHCs that are engaged, or are considering engaging, in these activities should carefully weigh the costs and benefits of a BHC shedding transaction. A BHC may make investments of 5% or less in any company (*e.g.*, non-financial investments),[24] and no similar investment authority exists for banks, although national banks and state-chartered banks are generally permitted to make investments in small business investment companies ("SBICs") that are not engaged in financial activities.[25]

Further, securities underwriting of public offerings, merchant banking activities, and insurance underwriting activities are currently permissible only through financial holding companies ("FHCs") *i.e.*, BHCs that elect to become and be regulated as FHCs.[26] However, certain activities that are financial in nature may be conducted by financial subsidiaries of a bank – that is, some financial activities that cannot be conducted in the bank itself may be permissible in a bank subsidiary rather than through the bank's holding company.[27]

THE INCREASING BURDEN OF BHC REGULATION

Prior to the Dodd-Frank Act, banking organizations faced 20 years of increasing regulation, and the levels of regulation only rose further after the Dodd-Frank Act. This ever-increasing level of regulation, oversight, examination, and supervision imposed on banking organizations on a consolidated basis over the last 30 years is causing significant concern about the overall regulatory burden on such organizations.[28] Further, concerns have been expressed that community and regional banking organizations are being subjected to a "one-size-fits-all" regulatory regime, *i.e.*, the same high levels of regulation, examination, oversight, and supervision that are applied to the largest and most complex banking organizations in the United States.

BHCs are directly subject to SIFI regulation by the FRB once they reach $50 billion in assets.[29] Further, the FRB begins to push BHCs toward SIFI compliance well in advance of reaching the $50 billion threshold. Banks not in BHC structures, however, *are not* subject to SIFI

[21] OCC, *Activities Permissible for National Banks and Federal Savings Associations, Cumulative* (Oct. 2017), https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-activities-permissible-october-2017.pdf.

[22] 12 C.F.R. § 225.28.

[23] For example, BHCs may engage in data processing services, provided that, along with certain other limitations related to the provision of hardware, the data being processed is financial, banking, or economic in nature; or that the processing of data that is not financial, banking, or economic in nature generates less than 50% of the revenue of the bank subsidiary engaged in the data processing. 12 C.F.R. § 225.28(b)(14). By contrast, a national bank may (1) make a noncontrolling investment through an operating subsidiary in a company that engages in data processing, and, in certain circumstances, "establish an operating subsidiary that engages in payment and information processing services," (2) provide data processing services to affiliates or correspondent banks, (3) sell its excess data processing capacity, and (4) establish an operating subsidiary that sells or licenses data processing software. OCC, *supra* note 21, at 9, 27, 30, 31, 74, 98.

[24] Section 4(c)(6) of the BHCA, 12 U.S.C. § 1843(c)(6).

[25] 15 U.S.C. § 682(b) (statutory authority under the Small Business Investment Act of 1958, as amended). 12 C.F.R. § 248.10(b)(11) (Volcker Rule exclusion from the "covered fund" definition for SBICs).

[26] 12 U.S.C. §§ 1841(p), 1843(l)(1).

[27] 12 U.S.C. § 1831w (statutory authority for state non-member banks' financial subsidiaries), 12 U.S.C. § 24a (analogous statutory authority for national banks), 12 C.F.R. Part 362 Subpart E (regulation for state non-member banks' financial subsidiaries); 12 C.F.R. § 5.39 (analogous regulation for national banks). State member banks have similar powers.

Of course, during the same time period, additional BHC activities have been permitted.

[28] Further, some regulatory concerns focus on the Consumer Financial Protection Bureau ("CFPB"). Once a banking organization's assets reach $10 billion, the CFPB becomes a significant new federal banking regulator. This adds additional impetus and strategic significance to streamlining regulation – and the number of regulators – where possible, even eliminating a BHC will not change the CFPB's powers or jurisdiction with respect to such banking organizations.

[29] Dodd-Frank Act, § 165(a).

regulation when they reach $50 billion in assets, unless designated as SIFIs by the FSOC.[30] Such designation is highly unlikely except for the largest and most complex banking organizations in the United States.[31]

Among the regulatory requirements applicable to SIFIs is the FRB's annual Comprehensive Capital Analysis and Review stress test, commonly known as "CCAR." Banks without BHCs would not be automatically subject to CCAR requirements.[32] However, a national or state bank with assets between $10 and $50 billion would continue to be subject to the Dodd-Frank Act Stress Testing requirements, commonly known as "DFAST," whether or not the bank has a BHC.[33]

The BHC structure is no longer advantageous for issuing hybrid securities to be used for bank or BHC regulatory capital: under the Collins Amendment to the Dodd-Frank Act, since January 1, 2016, banks with $15 billion or greater have no longer been permitted to consider trust preferred or other hybrid securities to be Tier 1 capital.[34]

One countervailing factor to those discussed above – in that it is a factor in favor of employing a BHC structure, if only for the smallest banking organizations – relates to so-called "double leveraging." The FRB has issued a policy statement, applicable to small BHCs (and small savings and loan holding companies) that permits "double leveraging" by eligible banking organizations. For these small banking organizations, proceeds of debt issued at the BHC level may be invested as equity in the subsidiary bank.[35] This is not generally permitted for larger BHCs. Currently, only BHCs with less than $1 billion in assets may rely on the policy statement, though legislation that has passed the U.S. Senate as of the time of this writing would, if enacted, raise the threshold to $3 billion.[36]

While a number of items of legislation has been proposed in recent years to provide varying levels of regulatory relief, including from the Dodd-Frank Act and SIFI regulation, none has been enacted to date,[37] and in any case, none would provide any relief from the basic structure of BHC regulation, examination, or oversight.[38]

The liquidity coverage ratio rule promulgated by the OCC, FRB, and FDIC[39] applies to BHCs with total

[30] *Id.* § 113.

[31] No banking organizations have been so designated by FSOC. Of the four nonbank financial institutions that have been so designated since the Dodd-Frank Act, only one – Prudential Financial, Inc. – remains a nonbank SIFI. *See* FSOC, Nonbank Financial Company Designations, https://www.treasury.gov/initiatives/fsoc/designations/Pages/ default.aspx; *See also*, e.g., Pete Schroeder, *MetLife, U.S. regulators agree to set aside legal fight*, Reuters (Jan 18, 2018), https://www.reuters.com/article/us-usa-metlife-fsoc/metlife-u-s-regulators-agree-to-set-aside-legal-fight-idUSKBN1F8064.

[32] 12 C.F.R. § 225.8(b).

[33] Dodd-Frank Act § 165(i).

[34] *Id.* § 171(a)(2), (b)(2) (harmonizing BHC and bank tier 1 capital requirements such that trust preferred and hybrid securities are excluded from tier 1 capital for BHCs as well as for banks. *See also, e.g.*, Trust Preferred Securities and the Capital Strength of Banking Organizations, FDIC Supervisory Insights (Winter 2010), https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin10/siwinter10-article1.pdf (discussing the differences between the capital regimes before the Collins amendment).

[35] Small Bank Holding Company and Savings and Loan Holding Company Policy Statement on Assessment of Financial and Managerial Factors, 12 C.F.R. § 225 App. C.

[36] Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155 (as passed by Senate Mar. 14, 2018).

[37] On June 8, 2017 the U.S. House of Representatives passed H.R. 10, the Financial CHOICE Act of 2017, which proposed to amend or repeal various sections of Dodd-Frank. On March 14, 2018, the U.S. Senate passed S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, which would amend Dodd-Frank and other laws governing the financial services industry. It is not yet clear whether the House will take up S. 2155 as passed by the Senate, or whether the two bills will be reconciled in conference.

[38] Executive Order 13772, published February 3, 2017, stated "core principles" for U.S. financial regulations, and tasked the U.S. Treasury Secretary with preparing an initial report within 120 days on the extent to which "existing laws, treatise, regulations, guidance . . . . and other government policies promote the principles." On June 12, 2017, the Treasury Department issued a *Financial System that Creates Economic Opportunities: Banks and Credit Unions*, the first of a series of reports designed to meet the directive of Executive Order 13772. In this document, Treasury reported several recommendations on potential regulatory relief, but did not make specific legislative recommendations.

[39] 12 C.F.R. Part 50 (OCC); 12 C.F.R. Part 249 (FRB's Regulation WW); 12 C.F.R. Part 329 (FDIC); *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*, 79 Fed. Reg. 61440 (Oct. 10, 2014).

consolidated assets greater than $50 billion but less than $250 billion. It does not apply to banks with assets in the same range (provided the bank's on-balance-sheet foreign exposures are less than $10 billion). Of course, banks should still maintain adequate liquidity and appropriate amounts of high-quality liquid assets, even if not subject to the liquidity coverage ratio rule.

Another benefit of operating as a bank without a BHC, outside the context of increasing regulation of BHCs, relates to differences in assessments charged by the FDIC to banks without BHCs versus those with BHCs. In order to fund the depository insurance fund the FDIC uses to insure deposits and resolve failed banks, the FDIC charges assessments to banks and other insured depository institutions. Banks are eligible for a discount of up to 5 basis points on these assessments for deposit insurance on the amount of long-term unsecured debt issued by the bank – but debt with identical features issued by the BHC, not the bank, would not receive reduced deposit insurance assessments.[40]

THE OCC HAS ADVOCATED THAT NATIONAL BANKS ELIMINATE BHC STRUCTURES

In June 2017, Congressional testimony entitled *Opportunities to Promote Economic Growth, Reduce Regulatory Burden*, acting Comptroller of the Currency Keith A. Noreika highlighted, among other things, issues involving reduction of "regulatory redundancy" that resulted in "increased burden and hinders economic growth."[41]

Specifically, he advocated "another approach" to the "problems of multiple regulators" by streamlining and eliminating any and all statutory impediments for banks "that want the choice to operate without a [bank] holding company," by fully modernizing corporate governance requirements for national banks.[42] In so doing, these changes would put banks on the same – or better – footing as BHCs and benefit "banks that wish to operate and access the capital markets without a [bank] holding company."[43]

In the case of an *intrastate* merger transaction, national bank boards are subject to certain meeting, shareholder notification, and vote requirements that are decades-old holdovers from the era when banks' interstate operations were strictly limited.[44] The OCC has recommended that these procedures be harmonized with more streamlined procedures available for *interstate* mergers. However, the bipartisan financial services deregulatory bill passed by the U.S. Senate in March 2018 does not contain provisions addressing these OCC recommendations.[45]

ELIMINATING THE FRB AND SEC AS FEDERAL REGULATORS

Eliminating a BHC would consolidate the number of federal regulators and regulatory functions, eliminate fees, expenses, legal, regulatory compliance, and administrative costs, eliminating not only the FRB but also the SEC as regulators.

Pursuant to Section 12(i) of the Exchange Act of 1934, a publicly held bank files all required 1934 Act filings and reports with its primary federal banking regulatory agency; for national banks, the OCC and for state non-member banks, the FDIC. Also, pursuant to Section 3(a)(2) of the Securities Act of 1933, securities issued by a publicly held bank are exempt from registration under the 1933 Act; the OCC has stock offering filing requirements with disclosure requirements similar to the 1933 Act. Insiders and shareholders of a publicly held bank will continue to be subject to the reporting requirements and prohibition on short-swing profits of Section 16 of the 1934 Act.

Therefore, a banking institution will make its SEC filings, to the extent required, with its banking regulator. Similar to the SEC EDGAR system, 1934 Act filings are made with the OCC and the FDIC, and, as with SEC filings, are publicly available information.[46]

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[40] 12 C.F.R. §327.9(d)(1); *Assessments, Large Bank Pricing*, 76 Fed. Reg. 10672, 10680-81 (Feb. 25, 2011).

[41] Testimony of Keith A. Noreika, Acting Comptroller of the Currency, Senate Committee on Banking, Housing, and Urban Affairs (June 22, 2017), https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-71b.pdf. Noreika also recommended that Congress amend the BHCA to "provide that when a depository institution constitutes a substantial portion of its holding company's assets (*e.g.*, 90 percent), the regulator of the depository institution would have sole examination and enforcement authority for both the holding company and the depository institution.

[42] *Id.* at 7.

[43] *Id.*

[44] *See, e.g.*, 12 U.S.C. §§ 214a(a), 215(a), 215a(a)(2).

[45] *Supra* footnote 36.

[46] The filings are available to the public on the OCC and FDIC websites. OCC, Securities Filings Instructions and Content, *available at* https://www.occ.treas.gov/topics/laws-

Most publicly held banking organizations make their 1934 Act reports and filings readily available on their websites and file them with the relevant stock exchanges. This includes publicly held national banks that currently file their 1934 Act reports with the OCC and publicly held state non-member banks that currently file their 1934 Act reports with the FDIC.

EQUITY AND DEBT OFFERINGS AFTER A BHC HAS BEEN ELIMINATED

As discussed above, Section 3(a)(2) of the 1933 Act provides an exemption from registration requirements for all securities, whether debt or equity, issued by a bank, but not a BHC.[47] Also as discussed above, pursuant to Section 12(i) of the 1934 Act, banks – both state-chartered and national banks – filed their 1934 Act reports and filings with relevant stock exchanges, and their consolidated banking and securities regulator. All 1934 Act rules, forms, and SEC interpretations continue to apply. Insiders and stockholders of publicly held banks continue to be subject to reporting requirements and the prohibition on short swing profits of Section 16 of the 1934 Act.[48]

National Banks

Equity and debt offerings by national banks without a BHC are permitted, and governed by the OCC's stock offering rules, 12 C.F.R. Part 16. All stock offerings are required to follow SEC rules, including those for the registration statement, prospectus, offer and sales, use of prospectus, and other disclosure requirements (*e.g.*, the SEC's Guide 3 on statistical disclosure required for BHCs and requirement 7 of Rule 9-03 of the SEC's regulation S-X governing loans).[49]

Offers and sales made privately under the SEC's Regulation D, Rule 144A, or Regulation S are deemed exempt from OCC registration.[50] A specific exemption from OCC registration is also provided for national bank stock sold in connection with a BHC elimination transaction.[51] The OCC, like the SEC, requires filing fees.[52] OCC regulations adopt SEC reporting and disclosure requirements with respect to the parts of the 1934 Act and the Sarbanes-Oxley Act over which section 12(i)(1) of the 1934 Act transfers authority to the OCC.[53]

As previously discussed, a national bank has a broad range of choices to adopt any corporate governance procedures permitted by the state in which its main office is located, Delaware law, or the Model Business Corporation Act. For example, if a banking organization's BHC has its main office in New York, then, post-BHC elimination, the surviving national bank would have the option to adopt Delaware corporate governance procedures, New York corporate governance procedures (because New York is where its main office is located), or the corporate governance procedures of the Model Business Corporation Act – including procedures regarding issuances of equity or debt securities – identical to the current BHC charter and bylaws, to the extent they are otherwise consistent with the OCC's rules.

The OCC provides certain standards for a bank issuing equity and debt securities. A national bank can issue both common and preferred stock under the OCC's rules and pursuant to the OCC's Model Articles of Association for national banks. The common shares must have voting rights (as common shares generally do), and they may either make up a single class (which the OCC's licensing manual suggests is customary), or multiple classes, as long as each of the classes has the same voting rights. Preferred shares can be either

footnote continued from previous page…

regulations/security-filings-instructions-and-content.html; FDIC, Securities Exchange Act Filings, *available at* https://efr.fdic.gov/fcxweb/efr/index.html. Banks generally submit filings and data electronically to the OCC and FDIC through their secure information transmitting sites, BankNet and FDICconnect. OCC and FDIC regulations provide guidance on filing requirements for both electronic filing through these systems and/or paper filing. 12 C.F.R. § 16.17 (OCC); 12 C.F.R. § 335.701(a) (FDIC).

[47] The 1933 Act provides that "the term 'bank' means any national bank, or banking institution organized under the laws of any State, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official." 1933 Act § 3(a)(2), codified at 15 U.S.C § 77c(2).

[48] Section 12(i) of the 1934 Act, codified at 15 U.S.C. § 78l(i). Section 12(i) transfers administration and enforcement authority for certain enumerated sections of the 1934 Act and the Sarbanes-Oxley Act of 2002 from the SEC to the OCC, FDIC, and FRB, with respect to banks. Section 12(i)(1)-(3).

[49] 12 C.F.R. § 16.8(b).

[50] 12 C.F.R. §§ 16.5, 16.7.

[51] 12 C.F.R. § 16.9.

[52] 12 C.F.R. § 16.33; *see* 12 C.F.R. § 8.8 for a fee schedule.

[53] 12 C.F.R. Part 11.

perpetual or non-perpetual, carrying a maturity date, pursuant to the OCC's Model Articles of Association.

Generally, only the provision of notice to the OCC is required for a national bank to permanently *increase* its capital, by issuing either common or preferred stock, but a more extensive and lengthy application and approval process is necessary for a national bank to *reduce* permanent capital.[54]

In a sale of preferred stock (but not of common stock), the OCC requires certain documentation about the bank's power to issue such stock, including: "provisions in the articles of association concerning preferred stock dividends, voting and conversion rights, retirement of the stock, and rights to exercise control over management…"[55]

Under OCC rules, once a BHC is eliminated, a publicly held national bank can continue to issue debt, including subordinated debt. Procedures for issuing subordinated debt, and for counting such debt as Tier 2 capital, are found in 12 C.F.R. § 5.47 of the OCC's regulations. Such debt must be unsecured and subordinated, must be ineligible to be used as collateral for a loan by the issuing national bank, must not be a deposit, and must have a minimum term of at least five years, among other requirements. Issuance of debt, subordinated or otherwise, does not require shareholder approval.

State-Chartered Banks

State banking laws impose certain requirements on state-chartered banks, including requirements regarding stock and debt issuance. In New York, Article XV, Title V of the New York Banking Law governs corporate finance requirements for certain types of New York corporations, including banks. Among many provisions of Title V is a provision permitting banks to issue common and preferred shares; as with the OCC's rules, each can include multiple series or classes.[56] New York banks may, in some circumstances, issue preferred shares that are convertible at the option of the shareholder; likewise, in certain circumstances, issuance of convertible notes or debentures is permitted.[57] Some states provide banks with only more limited powers; for example, in Alabama "[n]o bank shall issue capital notes or capital debentures except with the prior written approval of the [S]uperintendent [of Banks of Alabama]."[58] As usual, state requirements and practices vary.

With respect to state-chartered banks and their regulation under the securities laws rather than state banking laws, the 1933 Act exempts bank-issued securities – including securities issued by state banks – from registration, as discussed above. The 1933 Act also includes such securities in its definition of "covered securities," which are exempt from state Blue Sky laws.[59] As discussed above, § 12(i) of the 1934 Act requires banks to follow certain requirements of the 1934 Act (and the Sarbanes-Oxley Act) under the regulations of their consolidated federal banking regulator.

The FDIC and the FRB have regulations promulgated under the 1934 Act governing securities issued by state nonmember and state member banks and related disclosures.[60] Unlike the OCC (or, for that matter, the SEC), neither the FDIC nor the FRB requires filing fees.[61] The FDIC regulations adopt a number of SEC requirements by cross references, including requirements regarding proxy solicitations, tender offers, and reports of beneficial ownership.[62] The FDIC has also adopted a policy statement requiring certain legends and disclosures in offering circulars for bank-issued securities.[63] FRB regulations include a section on reporting requirements for state member banks subject to

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[54] 12 C.F.R. § 5.46(b). National banks are generally prohibited from reducing their capital through a dividend, 12 U.S.C. § 56, but the prohibition does not apply to preferred stock. Reducing capital through a preferred stock dividend would still require OCC approval, however. 12 C.F.R. § 5.63(b).

[55] 12 C.F.R. § 5.46 (g)(2). The OCC will deem the proposed sale approved within 15 days of receipt unless it provides notice of disapproval.

[56] N.Y. BANKING LAW § 5001-5002.

[57] *Id.* § 5016.

[58] ALA. CODE § 5-5A-16.

[59] 1933 Act § 18b(4)(E), codified at 15 U.S.C. § 77r(b)(4)(E).

[60] 12 C.F.R. Part 335 (FDIC) and Subpart C of the FRB's Regulation H, 12 C.F.R. § 208.30-208.37.

[61] 12 C.F.R. § 335.801(a) (FDIC); § 208.36(c)(2) of Regulation H (FRB).

[62] 12 C.F.R. §§ 335.401, 335.501, 335.611-613. These FDIC regulations adopt SEC requirements with respect to the parts of the 1934 Act and the Sarbanes-Oxley Act over which § 12(i)(3) of the 1934 Act transfers authority to the FDIC.

[63] Statement of Policy Regarding Use of Offering Circulars in Connection with Public Distribution of Bank Securities, 61 Fed. Reg. 46808 (Sept. 5, 1996).

the 1934 Act; the section adopts by cross reference requirements of many sections of the 1934 Act and all rules and regulations promulgated under the referenced sections.[64]

A BANK CAN CONTINUE TO ENGAGE IN M&A AFTER ELIMINATING ITS BHC

Once a BHC is eliminated, a publicly held bank can continue to actively engage in strategic bank mergers and acquisitions. There is no need to hold an acquired bank, either permanently or temporarily, under a BHC. That is, banks can acquire other banks and merge them into the acquiring bank, hold the target bank as a wholly-owned bank subsidiary, or as a department of the acquiring bank. Where additional time may be needed post-closing to convert systems of the target bank, the target bank can be held as a subsidiary of the acquiring bank until conversion is complete, and then can be merged into the acquiring bank. It is important for a banking organization conducting the transaction to be aware that, during any time period in which the target bank is held as a subsidiary of the acquiring bank, the acquiring bank would itself be regulated as a BHC (in addition to being regulated as a bank) until the merger is complete.[65] Any plan for the acquiring bank to hold the target bank temporarily post-closing would be considered by the relevant regulator or regulators approving the merger as part of the bank merger application.

The merger itself can be accomplished through either a forward or reverse triangular merger, and as with BHCs, a number of forms of consideration can all be used, including cash, stock-for-stock exchanges, or stock and cash.

Further, regulatory timeframes for merger approvals may be streamlined by eliminating the FRB as a regulator. The BHCA requires the FRB to review mergers of BHCs, and the Bank Merger Act requires a responsible federal regulator (the FRB, FDIC, or OCC, as applicable) to review mergers of banks.[66] When the FRB's approval is required for a merger involving a BHC, the FRB requires BHC applications and filings, and conducts a regulatory review process, which generally includes public notice and FRB review of resulting public comments. Approval timeframes vary, but can be lengthy, partially due to the number of FRB offices that review the merger and the number of approvals required within the FRB. If the merger does not involve a BHC and thus does not require the FRB's approval, then the approval process with a single regulator, either the FDIC or the OCC, is likely to be quicker and less burdensome than the approval process with two regulators would be.

HOW TO UNDERTAKE A CORPORATE INTERNAL REORGANIZATION TO ELIMINATE A BHC

As discussed above, and for the reasons discussed above, a national bank or state non-member bank may eliminate its BHC structure through a corporate internal reorganization whereby it undertakes a merger of the BHC into its bank subsidiary. Such a transaction would generally constitute a tax-free reorganization. While there are costs and expenses associated with a corporate internal reorganization, boards of banking organizations should consider whether the regulatory streamlining that could result from shedding a BHC could outweigh such costs and expenses.

In eliminating a BHC, the following is a list of major steps that are required:

- review any tax issues; confirm tax free reorganization treatment; take steps to discontinue consolidated returns;
- resolve BHC trust preferred and other debt securities issues through redemption or exchange for bank debt;
- address and resolve any affiliated transactions issues under Regulation W related to consolidation of BHC assets and liabilities with any bank subsidiaries;
- review relevant state law merger rules:
  - shareholder approval will generally be required;
  - in some states, a merger may trigger dissenters' rights of appraisal; and

[64] § 208.36(a)(1)(i) of Regulation H. These FRB regulations adopt SEC requirements with respect to the parts of the 1934 Act and the Sarbanes-Oxley Act over which § 12(i)(2) of the 1934 Act transfers authority to the FRB.

[65] The BHCA defines "bank holding company" to include any company that "has control over any bank," and there is no exception from the BHC definition for a bank itself. 12 U.S.C. § 1841(a)(1).

[66] 12 U.S.C. § 1842(a) (BHCA); 12 U.S.C. § 1823(c) (Bank Merger Act). Similar substantive review is required under both statutes.

— review change-of-control issues under debt instruments, contracts, and benefit plans and arrangements;

- prepare and execute merger agreement; merger agreement should include form of proposed charter and bylaws of the bank that will take effect at the time of the merger;
- publicly announce proposed merger of BHC into bank sub;
- obtain shareholder approval for exchange of BHC stock for bank stock;
- prepare proxy materials for an annual or special shareholder meeting to obtain shareholder approval for exchange of BHC stock for bank stock; proxy includes a plan of merger of the BHC into the Bank, and management's reasons for undertaking the transaction;
- shape shareholder perception of the proposed transaction through press release announcing the transaction and disclosure in proxy materials;
- consolidate "mirror" management contracts at BHC and bank level;
- consolidate boards of directors and standing committees;
- consolidate benefit plans such as employee stock option plans and other stock option plans to address compensation and benefits issues;
- make appropriate filings with the FRB to deregister as a BHC; and
- register bank's common stock under the 1934 Act with the OCC or FDIC and relevant stock exchange(s).

Finally, it is important to understand that eliminating the BHC does not have to be permanent. A new BHC could be formed in the future if doing so would be beneficial or necessary; for instance, if a banking institution became small enough and would benefit from relying on the FRB's small BHC policy statement, discussed above.[67] Forming a BHC could be beneficial if a banking institution became large and complex enough to want to be able to engage in activities reserved for FHCs. There are no barriers to doing so just because a bank has previously eliminated a BHC, and there is a streamlined regulatory process for an internal corporate reorganization by a bank into a BHC. ■

[67] *Supra* footnote 35.