Permitted Activities for Bank Holding Companies

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PRESENTER NOTES ...

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Banking Powers – General Principles

• BHCs, SLHCs and their non-bank subsidiaries may not engage in any business or activity that is not expressly permitted by statute, regulation or regulatory order.

• Holding companies are deemed to be engaged in all activities that their direct and indirect non-bank subsidiaries engage in.
Commercial Activities Prohibited

• Glass-Steagall Act – BHCs, SLHCs and their non-bank subsidiaries may not engage in commercial activities
• General Motors and Walmart may not own a commercial bank
• But what about:
  – John Deere Financial, FSB
  – Target Bank, a Utah industrial loan company
Grandfathered Commercial Activities

• Prior to 1999, a unitary SLHC that owned only one federal savings bank (and no commercial bank) could also engage in any financial or commercial activity if the bank was a “qualified thrift lender”
  – John Deere could manufacture tractors and own a federal savings bank
  – Gramm Leach Bliley Act grandfathered existing unitary SLHCs, but prohibited new commercial affiliations
• Commercial companies may own special-purpose depository institutes which have more limited powers than commercial banks
  – Industrial banks, credit card banks and trust companies
  – Target may own an industrial bank
BHC Permitted Activities

- Owning and controlling national banks and state-chartered commercial banks
- Activities “so closely related to banking as to be properly incident thereto” (“4(c) Activities”)
- Owning 5% or less of the outstanding shares of any class of voting securities of a company (including commercial companies)
Approved 4(c) Activities include:

- consumer finance, credit card and mortgage lending
- commercial finance operations
- operating nonbank depository institutions, such as trust companies and industrial loan companies
- financial counseling services
- leasing companies
- investment in community development corporations;
- financial data processing services
- management consulting for other financial institutions
Approved 4(c) Activities (continued)

Approved 4(c) Activities include:
• bank-related courier services
• credit life insurance
• money transmittal
• collection agency services
• tax preparation services
• consumer credit bureau services
• consumer financial counseling
• securities brokerage services for customer investments
• government securities underwriting
• printing and selling checks
Activities Not Deemed Closely Related to Banking

• Real estate brokerage activities
• Land development activities
• Real estate syndication activities
• Property management activities
SLHC Permitted Activities

- Owning and controlling federal savings banks and state-chartered savings associations
- Section 10 Exempt activities, such as:
  - holding, managing or liquidating assets owned or acquired from a subsidiary savings association
  - performing management services for a savings association subsidiary
- Section 4(c) Activities (same as BHCs)
- 1987 Activities – certain services and activities that were permissible for SLHCs and their subsidiaries by regulation in 1987
  - broader than 4(c) activities
  - include some real estate activities
1987 Activities

SLHCs are authorized to engage in activities that multiple SLHCs were authorized, by regulation, to engage in on March 5, 1987:

- Originating, purchasing, selling and servicing loans
- Accounting and internal audit services for affiliates
- Preparing tax returns
- Purchasing and selling gold coins
- Insurance underwriting (credit life and health only) in connection with credit extensions by savings association subsidiaries
- Data processing, research, advertising and other services for affiliates

Including certain real estate activities:

- Acquisition of unimproved real estate for prompt development (e.g. residential subdivisions)
- Acquisition of real estate and mobile homes for rental
- Development and construction of homes on such real estate
- Remodeling, maintenance and management of improved real estate
A BHC or SLHC may elect to become a FHC and engage in expanding 4(k) activities

- written statement of intent and certifications given to Federal Reserve electing to become an FHC
- not an application (no approval required)

Requirements:

- holding company and all its subsidiary banks must be well capitalized
- holding company and all its subsidiary banks must be well managed
- all subsidiary banks must have satisfactory or high CRA rating

AND must continuously maintain such ratings
FHC 4(k) Activities

• Activities financial in nature or incident thereto
• Activities complimentary to a financial activity, that do not pose safety and soundness risks
• May be conducted by the FHC itself or by a direct or indirect non-bank subsidiary
• May continue to engage in all 4(c) Activities (closely related to banking)
Activities Financial in Nature

• Acting as agent, broker or underwriter of life, health, property or casualty insurance and annuities
• Acting as a securities broker-dealer, underwriter and market maker
• Organizing, sponsoring, managing and advising a mutual fund;
• merchant banking activities (venture capital investments)
• Issuing or selling asset back securities (“ABS”) that are permitted bank investments
Activities Financial in Nature (cont’d)

• Providing financial, investment and economic advisory services (including a requested investment admission)
• Providing management consulting services
• Lending, exchanging and investing for third parties
• Making and managing portfolio investments for insurance company affiliates
• Operating a travel agency
• Acting as a “finder” (business broker)
Activities Complimentary to a Financial Activity

• mail order pharmacy activities, complimentary to underwriting health insurance
• physical commodity trading in energy-related commodities
• energy management services, complimentary to commodity derivatives trading
BHC – Prior Notice or Approval Requirements

• BHCs must obtain prior approval of Federal Reserve before commencing a new 4(c) Activity
  – includes de novo activities and acquisition (in whole or in part) of a business or entity
  – includes new activities and acquisitions by non-bank subsidiaries

• However, no BHC prior notice is required (must notify Board within 10 business days of commencing activity) if:
  – No BHC depository sub has received 1 of the 2 lowest composite ratings at recent examinations
  – Before and after transaction the BHC and sub depository institution are well capitalized
  – Before and after transaction the BHC and sub depository institution are well managed
  – No outstanding regulatory orders or other impositions of Fed
  – Book value of total assets acquired does not exceed 10% of Bank Risk-Weighted Assets

(Does not apply to activities and acquisition of a subsidiary of a subsidiary bank)
SLHC: Prior Notice and Approval Requirements

- Most SLHCs must obtain prior approval of Federal Reserve before commencing (de novo or by acquisition) a new 4(c) Activity directly or through a non-bank subsidiary
  - Grandfathered unitary SLHCs are exempt
  - Only notice is required if SLHC
    - has a composite rating of “1” or “2”
    - is not in troubled condition
    - activity is not commenced through an acquisition
- A SLHC that has elected to be a FHC may engage in any activity that has been determined to be financial in nature without prior approval
- A SLHC that has elected to be a FHC must obtain prior approval to engage in activity that is complimentary to a financial activity
- A SLHC must obtain prior approval to engage in any 1987 activity
FHC: Prior Notice and Approval Requirements

- BHC must provide written statement of intent electing to become a FHC
- But a FHC may engage in any activity that has already been determined to be financial in nature without prior notice or approval
  - this applies to 4(c) Activities because they are included in activities that are financial in nature
  - also applies to acquisition of entities engaged in such activities
  - Exception: prior approval is required if acquiring an entity with $10 billion of assets
- FHC must obtain prior approval to engage de novo or by acquisition in an activity that is complimentary to a financial activity
Permissible BHC Activities and Affiliations

Bank Holding Company ("BHC")

National Banks
- Underwriting bank eligible securities
- Limited insurance agency activities
- Limited securities brokerage

State Banks
- State authorized activities subject to FDIC limitations

Securities Activities (Limited)
- Brokerage for customer accounts
- Underwriting bank eligible securities

Section 4(c) Activities
- Activities closely related to banking
  - No insurance underwriting
  - No merchant banking

Operating Subsidiaries
- All activities authorized for national banks

Operating Subsidiaries
- State authorized activities (broader than federal) subject to FDIC limitations

Prohibited Activities
- Insurance Underwriting
- Securities Activities (Unrestricted)
- Financial Activities Not Closely Related to Banking
- Commercial Activities
Permissible SLHC Activities and Affiliations

Savings and Loan Holding Company
(“SLHC”)

Federal Savings Banks
- federally authorized activities
- limited insurance agency activities

Section 10 Exempt Activities
- ownership and management of savings associations and their assets
- insurance agency

Section 4(c) Activities
- activities closely related to banking
  - (no insurance underwriting)
  - (no merchant banking)

1987 Activities
- activities which multiple SLHCs were authorized, by regulation, to engage in on March 5, 1987

Operating Subsidiaries
- all activities authorized for federal savings banks

Service Corporation Subsidiaries
- activities authorized for service corporations

Prohibited Activities
- Insurance Underwriting
- Securities Activities (Unrestricted)
- Financial Activities Not Closely Related to Banking
- Commercial Activities

Not Closely Related to Banking
- Securities Activities
- Insurance Underwriting
Permissible FHC Activities and Affiliations

**Financial Holding Company ("FHC")**

- must be:
  - well capitalized
  - well managed
  - satisfactory CRA rating

**National Banks**
- must be:
  - well capitalized
  - well managed
  - satisfactory CRA rating

**State Banks**
- must be:
  - well capitalized
  - well managed
  - satisfactory CRA rating

**Securities Companies**
- securities underwriting (without limitations)
- securities brokerage
- mutual funds
- merchant banking (i.e. venture capital)

**Insurance Companies**
- insurance underwriting (without limitations)
- insurance brokerage
- merchant banking (i.e. venture capital)

**Financial Affiliates**
- activities financial in nature or incidental thereto
- activities complimentary to financial activities

**Section 4(c) Activities**
- activities closely related to banking

**Operating Subsidiaries**
- all activities authorized for national banks

**Operating Subsidiaries**
- state authorized activities (subject to FDIC limitations)
- grandfathered activities

**Prohibited Activities**
- Commercial Activities