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# Financial Reform: Small Bank Holding Company Threshold

Small *bank holding companies* and small *thrift holding companies* (hereafter collectively referred to as small BHCs) face less stringent regulation related to debt financed acquisitions and capital requirements pursuant to the Federal Reserve's Small Bank Holding Company Policy Statement and the "Collins Amendment" to the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203; Dodd-Frank). Currently, a BHC must have less than $1 billion in assets, as well as meet certain qualitative requirements, to qualify. Bills in the 115th Congress would increase this threshold, thus providing regulatory relief to certain BHCs with assets between $1 billion and the proposed higher thresholds.

## Background

Many depositories such as banks and thrifts are owned by a parent holding company. To use this structure, a banking organization must get approval from and is subject to regulation (at the parent level) by the Federal Reserve (the Fed). An organization may choose this structure for a variety of reasons related to its circumstances and business model. Being a BHC may increase access to certain capital markets, allow greater diversification of business activities through the operation of nonbank subsidiaries, and make it easier to merge or acquire other banks.

BHCs vary widely in size and complexity. Some are among the largest financial institutions in the world with thousands of subsidiaries, many of which are not depositories, such as broker-dealers or insurance companies. On the other end of the spectrum, many BHCs are in practice just a legal entity that owns and shares management with a single small bank.

Both the subsidiary depositories and the parent BHCs are subject to prudential regulation intended to ensure the institutions operate in a safe and sound manner. However, the prudential regulations facing depositories and BHCs are not necessarily the same. Under a long-standing regulatory principle, enacted into law by Dodd-Frank, the Fed expects BHCs to act as a "source of strength" (i.e., be able to provide financial assistance) in the event its depositories became distressed. Likewise, distress at nondepository subsidiaries should not threaten the health of the despository subsidiaries. If a BHC has large debts or little capital, it is likely the BHC would be less able to assist its subsidiaries.

## Small BHC Policy Statement

The Federal Reserve's Small BHC Policy Statement (Appendix C to 12 C.F.R. §225) allows BHCs with less than $1 billion in assets to use more debt than would be permitted to larger BHCs to finance the acquisition of another bank, provided the debt does not exceed 75% of the purchase price of the bank acquired. To qualify, the holding company may not (1) be engaged in significant nonbank activities, (2) conduct significant off-balance-sheet activities, and (3) have a "material" amount of outstanding debt or equity securities (except for trust preferred securities) registered with the Securities and Exchange Commission. The Fed has the discretion to exclude any BHC, regardless of asset size, from the policy statement if the Fed determines such action is warranted for supervisory purposes. After an acquisition, the BHC is required to gradually reduce its debt levels over several years, and faces restrictions on paying dividends until the debt level is reduced. This policy is motivated by recognition that small banks typically have less access to equity financing for acquisitions than larger banks.

The policy statement was issued in 1980 with a threshold of $150 million in assets. The Fed subsequently raised the threshold to $500 million in 2006 to address the effects of "inflation, industry consolidation, and normal asset growth of BHCs." More recently, the 113th Congress in P.L. 113-250 (enacted on December 18, 2014) mandated that the threshold increase from $500 million to $1 billion and the policy statement be extended to cover savings and loan (thrift) holding companies. The Fed issued a final rule on April 9, 2015, implementing these statutory changes.

The policy statement is also referenced in other banking statutes and regulations besides those related to acquisition debt. Generally, banks subject to the policy statement are granted exemptions for or relaxed treatment in complying with certain requirements, most of which are reporting requirements. The most significant regulation linked to the statement is the Collins Amendment.

## Collins Amendment

BHCs subject to the Small BHC Policy Statement are exempted from Section 171 of the Dodd-Frank (12 U.S.C. §5371, sometimes called the Collins Amendment), which subjects holding companies to the same capital and leverage requirements as their depository subsidiaries. BHCs subject to the policy statement are also exempted from the rule applying Basel III capital requirements at the holding company level (although their depository subsidiaries are still subject to this rule). The policy of subjecting BHCs to the same capital requirements as depositories is motivated by the goal of having holding companies serve as a source of strength to their depository subsidiaries.

A key issue with the Collins Amendment is the treatment of Trust Preferred Securities (TruPS). Prior to the Collins Amendment, BHCs were allowed to use TruPS to help meet capital requirements even though they had debt-like features, making them less able to absorb losses. However, small banks argue that TruPS are a necessary instrument for their capital needs. Under the Collins Amendment, BHCs could no longer count new TruPS toward capital requirements unless they were subject to the Small BHC Policy Statement. If more BHCs are subject to that statement, more BHCs would be eligible to use TruPS toward capital requirements.

## Policy Discussion

The effectiveness of the Fed's Small BHC Policy Statement arguably depends on the degree to which holding companies subject to the policy statement have the ability to complete mergers and acquisitions without incurring relatively large amounts of debt. If they lack that ability, then the policy statement may afford a means of relaxing regulations that restrict BHCs from growing and responding to economic and business conditions through acquisitions. If they have that ability, however, the policy statement may needlessly encourage BHCs to take on relatively risky liabilities, and thus reduce their own safety and ability to act as a source of strength for their depositories.

As noted above, some banks adopt a holding company structure with their assets and activities predominantly in banking subsidiaries, whereas other holding companies have significant activities in nonbank subsidiaries. The effectiveness of the Collins Amendment arguably depends on whether a holding company has meaningful activities outside of its depository subsidiaries. If it does not, then there would be few nonbank subsidiary assets that the Collins Amendment would require BHCs to hold capital against. In this case, the bank may not face regulatory burden from the requirement to hold additional capital (although it may face a compliance burden in calculating and reporting the necessary capital measures).

In general, smaller BHCs derive less income from nonbank subsidiaries than larger BHCs, as shown by the means in **Table 1**. In addition, the medians show that most BHCs do not have significant nonbank income. However, as the final column illustrates, certain small BHC do have relatively high nonbank income. Thus, the higher the threshold is raised, the more institutions with meaningful activities outside of banking subsidiaries could potentially be exempt from the Collins Amendment. These exemptions could be curtailed to some degree depending on how many of these institutions do not meet the qualitative criteria of the policy statement and how often the Fed would exercise its discretion to exclude certain BHCs.

**Table 1. Nonbank Subsidiary Operating Income**

Percentage of Total Operating Income, as of 3rd quarter 2017

| Assets | Mean | Median | Top Decile |
|---|---|---|---|
| $1 billion-$3 billion | 1.9% | 0.0% | 16.2% |
| $3 billion-$10 billion | 2.3% | 0.3% | 12.5% |
| $10 billion + | 11.0% | 0.6% | 61.6% |

**Source:** Federal Reserve BHC Performance Report.

In general, proponents of bills that would raise the threshold view the legislation as providing well-targeted regulatory relief to banks with between $1 billion in assets and the new threshold. Opponents may object on the grounds that it may weaken the ability of holding companies to act as a source of strength for affected banks, or that providing relief based on size creates inefficient distortions in the allocation of credit or bank funding. The possibility of the former would be mitigated if the Fed prudently exercises its discretion to exempt potentially riskier institutions from the policy statement.

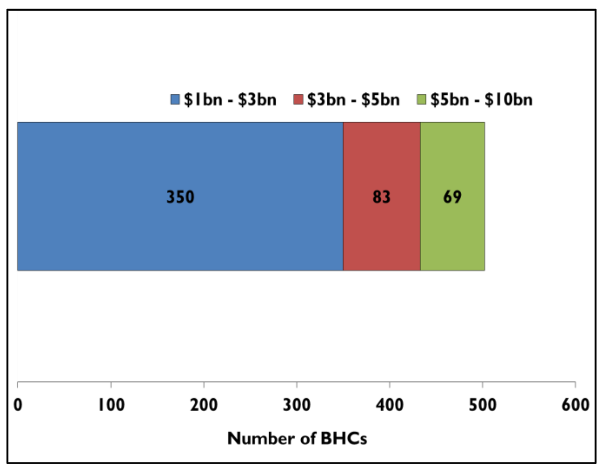
## Legislation in the 115th Congress

A number of bills in the 115th Congress would change the asset threshold criterion, provided the BHC meets the other three criteria found in the statement. In addition, these bills would not disturb the qualitative requirements or the Fed's discretion "to exclude any bank holding company, regardless of asset size, ...if it determines that such action is warranted for supervisory purposes." However, the proposed thresholds differ. For example,

- Section 207 of S. 2155, as reported, and H.R. 4771, as passed by the House, would raise the policy statement threshold to $3 billion;
- S. 1284 would raise the existing exemption to $5 billion; and
- Section 526 of H.R. 10 as passed by the House would raise the existing exemption to $10 billion.

Determining how many BHCs are currently subject to the policy statement and how many would be under the proposed thresholds is difficult due to the qualitative nonasset-sized-based criteria. According to 2015 Fed testimony, 89% of bank holding companies and 81% of thrift holding companies were covered by the policy statement. Approximating how many BHCs would meet the size-based criteria is possible, however. As of June 30, 2017, approximately 3,922 BHCs had less than $1 billion in assets. **Figure 1** illustrates how many additional holdings companies fall under each ascending threshold.

**Figure 1. Additional BHCs Meeting Proposed Asset Thresholds**




**Source:** CRS calculations, Federal Reserve form Y9-C data.

**Note:** Based on total assets reported as of June 30, 2017.

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