

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-2

January 7, 1980

PROPOSED POLICY STATEMENT
BANK HOLDING COMPANY ACT

(Formations of Small One-Bank Holding Companies)

**TO ALL MEMBER BANKS,
BANK HOLDING COMPANIES,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:**

The Board of Governors of the Federal Reserve System has issued for comments, a proposed policy statement amending the criteria applied when accessing financial factors in the formations of small one-bank holding companies. The Board's order, as submitted to the Federal Register, is enclosed.

Those wishing to make comments on the proposal should do so in writing, and direct all such correspondence to Mr. Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should be received by the Secretary no later than January 31, 1980, and include the docket number R-0265.

Any questions concerning the enclosed document should be referred to Mr. Robert Hankins, Coordinator of Applications, of our Holding Company Supervision Department, Ext. 6120.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE SYSTEM

POLICY STATEMENT
FOR ASSESSING FINANCIAL FACTORS IN
THE FORMATION OF SMALL ONE-BANK HOLDING COMPANIES
PURSUANT TO THE BANK HOLDING COMPANY ACT
[Docket No. R-0265]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed policy statement.

SUMMARY: In the interest of helping to maintain the safety and soundness of the banking system and, in particular, of small community banks, as well as to improve the transferability of ownership of such institutions and facilitate local ownership of these banks, the Federal Reserve Board is proposing for public comment a policy statement for assessing financial factors in the formation of small one-bank holding companies.

DATE: Comments must be received on or before January 31, 1980.

ADDRESS: Theodore E. Allison, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All materials submitted should include the Docket Number R-0265.

FOR FURTHER INFORMATION: James I. Garner, Division of Banking Supervision and Regulation (202-452-2415), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

POLICY STATEMENT
OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
FOR ASSESSING THE FINANCIAL FACTORS IN
THE FORMATION OF SMALL ONE-BANK HOLDING COMPANIES
PURSUANT TO THE BANK HOLDING COMPANY ACT

In acting on applications filed under the Bank Holding Company Act, the Board has adopted, and continues to follow, the cardinal principle that bank holding companies should serve as a source of strength for their subsidiary banks. When bank holding companies incur debt and rely upon the earnings of their subsidiary banks as the means of repaying such debt, a question arises as to the probable effect upon the financial condition of the company and its subsidiary bank or banks. Incurring debt under these circumstances is of particular concern when the debt proceeds are used for acquisitions rather than for internal purposes such as meeting the capital needs of a subsidiary bank.

The Board believes that a high level of acquisition debt impairs the ability of a bank holding company to come to the aid of its subsidiary bank in times of need and in some cases the servicing requirements on such

debt may be a drain on the bank's resources. For these reasons, the Board has not favored the use of acquisition debt in bank holding company formations. Nevertheless, the Board has recognized that the transfer of ownership of small community banks and the maintenance of local ownership in those banks often requires the use of acquisition debt. The Board, therefore, has permitted the formation of small one-bank holding companies with debt levels higher than would be permitted for larger or multi-bank holding companies. Approval of these applications has been given on the condition that the small one-bank holding companies demonstrate the ability to service the acquisition debt without straining the capital of their subsidiary bank and, further, that such companies restore their ability to serve as a source of strength for their subsidiary bank within a relatively short period of time.

The Board continues to subscribe to these principles. In the interest of furthering its policy of encouraging local transfer and ownership of banks in the one-bank holding company format, without diluting bank safety and soundness, the Board has reexamined the analytical framework and the criteria it applies when considering small one-bank holding company formations. To these ends, it proposes certain revisions in its procedures and standards described below.

The proposed criteria shift the focus from debt repayment contained in existing criteria to the relationship between debt and equity at the parent holding company. The holding company would have the option of improving the relationship of debt to equity by either repaying the principal amount of its debt or through the retention of earnings. Under these procedures, newly organized small one-bank holding companies would be expected to reduce the relationship of their debt to equity over a reasonable period of time to a level comparable to that maintained by many large and multi-bank holding companies.

In general, this policy is intended to apply only to one-bank holding companies that do not have significant leveraged nonbank activities and whose subsidiary bank would have total assets of approximately \$100 million or less at the time the application is filed.

The proposed criteria are as follows:

General

In evaluating applications filed pursuant to Section 3(a)(1) of the Bank Holding Company Act, as amended, where the applicant intends to incur debt to finance the acquisition of a small bank, the Board will take into account a full range of financial and other information, including the recent trend and stability of earnings of the bank; the past and prospective growth of the bank; the quality of the bank's assets; the ability of the applicant to meet debt servicing requirements without placing an undue strain on the bank's resources; and the record and competency of management of the applicant and the bank. In addition, the Board will use the following criteria in assessing acquisition debt:

(1) Minimum Down Payment

The amount of acquisition debt should not exceed 75 percent of the purchase price of the bank to be acquired.

(2) Maintenance of Adequate Capital

An applicant proposing to use acquisition debt must demonstrate to the satisfaction of the Board that any debt servicing requirements to which the bank holding company may be subject would not cause the bank's ratio of gross capital to assets to fall below 8.0 percent during the 12-year period following consummation of the acquisition.^{1/} Gross capital is defined as the sum of total stockholders' equity, the allowance for possible loan losses and subordinated capital notes and debentures.

(3) Reduction in Parent Company Leverage

The applicant must demonstrate to the satisfaction of the Board that the holding company's ratio of debt to equity would decline to 30 percent within 12 years after consummation of the acquisition.

The term "debt",^{2/} as used in the ratio of debt to equity, means any borrowed funds (exclusive of short-term borrowings which arise out of current transactions, the proceeds of which have been or are to be used for current transactions), and any securities issued by, or obligations of, the holding company that are the functional equivalent of long-term debt.

The term "equity",^{2/} as used in the ratio of debt to equity, means the total stockholders' equity of the bank holding company adjusted to reflect the periodic amortization of "goodwill" (i.e., the excess of cost of any acquired company over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed) in accordance with generally accepted accounting principles. In determining the total amount of stockholders' equity, the bank holding company should account for its investments in the common stock of subsidiaries by the equity method of accounting.

^{1/} The applicant will be required to submit projected financial statements covering the 12-year period for the bank holding company (parent only) and the bank to be acquired. Such financial statements may be condensed but should identify principal groups of balance sheet and income statement items.

^{2/} Redeemable preferred stock will be treated as equity if, by its terms, it is not redeemable until after the ratio of debt to equity at the holding company is below 30 percent and would remain at 30 percent or less subsequent to the redemption. If the preferred stock is redeemable under other conditions, it will normally be treated as the functional equivalent of debt. Preferred stock that is convertible into common stock of the holding company will be treated as equity.

(4) Dividend Restrictions

The bank holding company is not expected to pay any corporate dividends until such time as its debt to equity ratio is below 30 percent.

Board of Governors of the Federal Reserve System,
December 13, 1979.

Theodore E. Allison
Secretary of the Board