Revisiting The Bank Holding Company Structure: Do Community And Regional Banks Still Need A Bank Holding Company?

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INTRODUCTION

There has been a dramatic rise in the last thirty years toward the adoption of the bank holding company ("BHC") structure by banks. Inherent in this trend is an apparent accepted orthodoxy about the need of such structures from both a business and regulatory perspective. The percentage of U.S. banks owned by BHCs has more than doubled since 1980, from 34.3% to

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approximately 84% today.¹ Notably, though, federal banking agencies ("FBAs") do not require banks to form a BHC.² Thus, the uptick in BHC-owned banks has largely been driven by perceived legal, regulatory, and business advantages. Since 1980, the majority of banks presumably (1) identified significant advantages to forming a BHC that outweighed the increased costs of corporate governance and regulatory compliance and/or (2) saw their peers forming BHCs and generally accepted this industry trend as the orthodoxy of modern banking organization structure.

![Figure 1. Showing the percentage of bank ownership by BHCs from Dec. 1980 to Dec. 2007.](image)

Despite the emergence of BHCs as the "must have" organizational structure for the banking industry, approximately 16% of banks have opted to remain outside of the BHC structure. This statistic suggests at the very least, for certain banks, the perceived advantages of forming a BHC are not compelling. More significantly, the 16% rate of hold-outs suggests that the BHC structure's advantages do not always outweigh the structure's ever-increasing bank regulatory compliance and corporate governance


2. See id. (encouraging organizations to individually consider the advisability of forming a BHC and noting that the Federal Reserve is neutral on their creation).

3. See id. (follow “Bank Ownership by BHCs Dec. 1980 to Dec. 2007" hyperlink) (“The black bars in the chart above represent the number of commercial banks in the U.S. at year-end 1980 and every five years since then and at year-end 2012, while the green bars show the number of banks owned by BHCs during the same time periods. The red line shows the percentage of banks owned by BHCs, which increased sharply in the early 1980s as the movement to form BHCs gained momentum; this movement has continued to increase gradually, but steadily, before declining slightly in recent years.”).
costs, particularly as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Notably, the banks that have avoided forming a BHC are not limited to one particular size or business model. Instead, the hold-out banks range from small community banks with less than $10 billion in total assets,\(^4\) to mid-sized banks with $30 billion in total assets and a number of non-bank subsidiaries engaged in broker-dealer and investment advisory activities,\(^5\) and to large regional banks with total assets exceeding $50 billion.\(^6\) The diversity of these hold-outs calls into question the need for a BHC.

As a general matter, the U.S. banking industry’s BHC structure “is unique” in comparison to the generally BHC-less European banking model, and the U.S. model did not emerge until 1956.\(^7\) The Bank Holding Company Act of 1956 (“BHC Act”) established BHCs and defined the “terms and conditions under which a company can own a bank in the U.S.”\(^8\) While initially BHCs could engage in only a limited range of activities, over time, the BHC Act was amended to significantly expand the

\(^4\) See, e.g., Bank Information – Northwest Bank, FDIC, https://research.fdic.gov/bankfind/detail.html?bank=28178\&name=Northwest\%20Bank \&searchName=Northwest\&searchFdic=&city=&state=&zip=&address=&searchWithin=&activeFlag=&tabld=1 (follow “Financials” hyperlink) (last updated Apr. 6, 2016) (indicating that Northwest Bank has less than $10 billion in total assets); Bank Information – Opus Bank, FDIC, https://research.fdic.gov/bankfind/detail.html?bank=33806\&name=Opus\%20Bank\&searchName=Opus\&searchFdic=&city=&state=&zip=&address=&searchWithin=&activeFlag=&tabld=1 (follow “Financials” hyperlink) (last updated Apr. 6, 2016) (indicating that Opus Bank has less than $10 billion dollars in total assets).

\(^5\) See, e.g., Bank Information of Signature Bank, FDIC, https://research.fdic.gov/bankfind/detail.html?bank=57053\&name=Signature\%20Bank \&searchName=Signature\&searchFdic=&city=&state=&zip=&address=&searchWithin=&activeFlag=&tabld=1 (follow “Financials” hyperlink) (last updated Apr. 6, 2016) (indicating that Signature Bank has a little over $30 billion in total assets); see also About Signature Bank Overview, SIGNATURE BANK, https://www.signatureny.com/about-us/about-signature-bank (last visited Feb. 22, 2016) (stating that a subsidiary of Signature Bank, Signature Securities Group Corporation, is a licensed broker dealer and investment adviser).

\(^6\) See, e.g., Bank Information of First Republic Bank, FDIC, https://research.fdic.gov/bankfind/detail.html?bank=59017\&name=First%20Republic\%20Bank\&searchName=First\%20Republic\&searchFdic=&city=&state=&zip=&address=&searchWithin=&activeFlag=&tabld=1 (follow “Financials” hyperlink) (last updated Apr. 6, 2016) (indicating that First National Bank has over $30 billion in total assets); see also Company Profile, First Republic, https://www.firstrepublic.com/aboutus/company_profile (last visited Feb. 22, 2016) (listing the different regions where First Republic Bank offers its services).


\(^8\) Id.
range of permissible activities. During the late 1980s and 1990s, a BHC's range of permissible activities dwarfed the scope of activities permissible for a bank without a BHC. During the late 1990s and early 2000s, however, the powers of banks gradually expanded, substantially narrowing this gap.

While the perceived advantages of BHCs over banks have been steadily eroding, the regulatory burdens imposed on BHCs have been significantly increasing, especially following the 2010 enactment of Dodd-Frank. Given the growing regulatory burden on BHCs in conjunction with the expanding range of activities that banks may engage in without them, the BHC structure may no longer be the most advantageous corporate structure for many banks, especially those engaged primarily in banking and certain financial services activities.

This Article explores whether the BHC model remains a compelling organizational structure for the majority of banks in light of the steady erosion of the gap between BHC-permissible activities and bank-permissible activities combined with the ever-mounting BHC regulatory compliance costs. Part II will review an organization's fiduciary duty to consider the optimal corporate structure. Part III will review the evolution of BHC and bank powers. Part IV will evaluate the shrinking advantages of forming a BHC. Part V will assess the mounting regulatory burdens BHCs face in a post-Dodd-Frank regulatory environment. Part VI will review the remaining advantages of BHCs. Part VII will offer some conclusions regarding the merits of the BHC structure for community and regional banks.

II. FIDUCIARY DUTIES REGARDING BHC STRUCTURE

As a general matter, one of a corporation's primary objectives is to conduct its business activities to maximize corporate profit and shareholder

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10. See supra note 9.
gain. Thus, director leadership responsibilities include informed decision-making regarding corporate policies and strategic goals. From a fiduciary perspective, bank management bears a responsibility to periodically review its corporate governance structure. The FBAs have emphasized that “financial institutions are encouraged to periodically review their policies and procedures related to corporate governance and auditing matters.” In addition, fiduciary duty requires management to periodically “evaluate which corporate governance policies and procedures are more appropriate [for an institution’s] size, operations and resources.”

In this context, a corporate governance review should include an assessment of regulatory compliance and corporate governance costs and a consideration of what corporate structure is optimal for the entity to best maximize profitability, streamline regulatory burdens—consistent with the institution’s business plans—and operate safely and soundly. As discussed infra, given the decreasing advantages and mounting compliance costs associated with BHCs, banks should evaluate the relative merits of maintaining a BHC.

III. THE EVOLVING POWERS OF BHCs AND BANKS

In the middle of the Great Depression, the U.S. Congress passed and President Roosevelt signed into law the Banking Act of 1933, commonly referred to as “Glass-Steagall,” which was intended to forever separate commercial and investment banking. After the 1929 stock market crash and resulting Great Depression, Congress worried that commercial banks “were incurring losses from volatile equity markets” and sought to prevent the limited bank credit available from being used for speculation; rather, Congress believed bank credit should be directed toward “more productive


14. See AM. BANKERS ASS’N., CORPORATE GOVERNANCE FOR MUTUALS 2, 8 (2007), https://www.aba.com/Tools/BankType/Mutual/Documents/CorporateGovernanceforMutuals.pdf. (“Proper corporate governance is essential to the fulfillment of directors’ and officers’ fiduciary duties . . . . [I]t is a valuable exercise to reexamine the provisions of the charter and bylaws in order to determine whether these documents provide for structures and procedures, which, in the best judgment of management, facilitate effective corporate governance . . . .”).

15. Id. at 3.

16. Id.

17. See id. at 2, 8.

uses, such as industry, commerce and agriculture.\textsuperscript{19} Upon the enactment of Glass-Steagall, national banks were prohibited from underwriting or dealing in securities, and their activities were generally limited to accepting deposits and making loans.\textsuperscript{20} The companies owning banks, however, could own a wide range of non-bank firms, allowing them to engage in substantially more activities than permitted for banks under Glass-Steagall.\textsuperscript{21}

In 1956, the BHC Act was enacted and imposed conditions and restrictions on the companies owning banks (i.e. BHCs).\textsuperscript{22} Under the BHC Act, BHCs became subject to regulation and supervision by the Board of Governors of the Federal Reserve System (the “Federal Reserve”)\textsuperscript{23} and were restricted from participating, directly or through subsidiaries, in non-traditional banking activities.\textsuperscript{24} Unlike the Glass-Steagall enactment, and the Section 619 of Dodd-Frank (the “Volcker Rule”) enactment\textsuperscript{25}—which has been criticized as restricting activity that not only did not cause the financial crisis but poses relatively little risk to the insurance fund of the Federal Deposit Insurance Corporation (“FDIC”)\textsuperscript{26}—the BHC Act’s enactment stemmed not from any identified abuse in the banking system but rather as “a solution in search of a problem.”\textsuperscript{27}

Although the BHC Act initially imposed similar activity restrictions on BHCs as Glass-Steagall imposed on banks, subsequent legislation and

\textsuperscript{19.} Id.
\textsuperscript{20.} Id.
\textsuperscript{22.} See Bank Holding Companies and Financial Holding Companies, supra note 1.
\textsuperscript{23.} Id.
\textsuperscript{24.} Avraham et al., supra note 9.
\textsuperscript{26.} Philip Swagel, A Modest Volcker Rule, N.Y. TIMES (Dec. 13, 2013, 12:35 PM), http://economix.blogs.nytimes.com/2013/12/13/a-modest-volcker-rule/?_r=0 (criticizing the Volcker Rule as restricting activity that was not “an especially important factor behind the recent financial crisis” and noting that it generally imposes relatively little risk to the federal government as it involves relatively little FDIC insured funds).
\textsuperscript{27.} See e.g., 101 Cong. Rec. 7957 (1955) (statement of Rep. Harris Ellsworth) (“We did not hear any testimony in our committee to the effect that [the BHC Act] was for the purpose of correcting any present or existing difficulties.”); Mehrsa Baradaran, Reconsidering the Separation of Banking and Commerce, 80 GEO. WASH. L. REV. 385, 395 (2012) (explaining that the BHC Act was enacted as a preventative measure—“to stop the feared expansion of Transamerica into a national banking conglomerate”—rather than as a reaction to identified abuse within the banking system); see also Thomas E. Wilson, Separation Between Banking Commerce Under the Bank Holding Company Act – A Statutory Objective Under Attack, 33 CATH. U. L. REV. 163, 166 (1983).
actions by the FBAs gradually expanded the permissible activities of BHCs throughout the 1970s, 1980s, and 1990s. These expansions offered substantial advantages to banks operating within the BHC structure. During the 1990s and 2000s, however, the powers of banks likewise began to evolve, gradually reducing the number of activities that only BHCs could conduct. This gap was even further narrowed in 2013, when the Volker Rule substantially restricted the ability of BHCs to engage in certain securities and investment activities.

A. The Trajectory of BHC Powers: What Goes up Must Come (Partially) Down

The 1970 amendments to the BHC Act marked the first fissure in the legal barrier between traditional banking and financial activities. Under the 1970 amendments, BHCs obtained authority to own shares of any company engaged in activities “so closely related to banking or managing or controlling banks as to be proper incident thereto.” This new power enabled BHCs to invest in a slightly wider range of financial companies. During the 1980s and 1990s, the FBAs further extended the scope of “closely related to banking” activities to ensure the U.S. banking industry’s continued viability in the “increasingly competitive” financial markets. The Federal Reserve, for example, began interpreting Section 20 of the BHC Act—which prohibited BHCs from owning or controlling more than 50% of a company (or the majority of its directors) that engages principally in the business of issuing, underwriting, selling or otherwise distributing securities—to allow BHCs to develop “significant securities operations

28. See, e.g., Saule T. Omarova & Margaret E. Tahyar, That Which We Call A Bank: Revisiting the History of Bank Holding Company Regulation in the United States, 31 B.U. REV. BANKING & FIN. L. 113, 125–26 n.41 (2012) (citing cases and other authority that suggest that, in 1978, “the Federal Reserve gradually expanded the range of securities activities permissible to BHCs’ non-bank subsidiaries” and that, in 1987, “the Federal Reserve permitted BHCs’ to underwrite and deal in corporate securities through Section 20 subsidiaries, subject to the revenue limitation, which was gradually increased to twenty-five percent of a securities subsidiary’s gross annual revenue”).

29. See OCC, supra note 11.


32. Id. § 103(4), 84 Stat. at 1765.


34. R. Daniel Pace, Limitations on the Business of Banking: An Analysis of
through the establishment of so-called “Section 20” subsidiaries.”

The legislation of the 1970s and the FBAs’ regulatory interpretations of the 1980s and 1990s caused a crack in the BHC Act’s barrier between commercial and investment banking. In 1999, upon the enactment of the Gramm-Leach-Bliley Act (the “GLBA”), this crack became a hole wide enough for BHCs to engage in a range of non-traditional banking activities. Under the GLBA, BHCs had the power to register as financial holding companies, which were allowed to “engage in a broad range of financial activities, including securities underwriting and dealing, insurance underwriting, and merchant banking activities.” Moreover, BHCs could now own securities firms and insurance firms. In the wake of the GLBA, the BHC structure offered substantial advantages to banks. Through the BHC structure, banks could be part of an organization engaged in a far more expansive range of activities than banks could engage in on their own.

This steady trend of BHC power expansion came to an abrupt halt following the aftermath of the 2008 financial crisis, which former Federal Reserve chairman Ben Bernanke has described as “the worst financial crisis in global history, including the Great Depression.” Enacted in the aftermath of, and in response to, the 2008 financial crisis, Dodd-Frank “represent[ed] a significant shift toward strengthening regulations governing financial service providers and restricting the scope of activities that BHCs may engage in.” The Volcker Rule, in particular, has shrunk the scope of permissible BHC activities, prohibiting all banking entities from engaging in proprietary trading (short term trading of financial instruments on the banking entity’s own account) and investing in or exercising control over certain types of funds (e.g., hedge funds and commodity pools). Moreover, the Federal Reserve has the authority, and


35. See supra note 30 and accompanying text.
36. Avraham et al., supra note 9; see also 12 C.F.R. § 225.84(b)(1) (2013).
37. Avraham et al., supra note 9; see also 12 C.F.R. § 1843(k)(1)(A).
41. Avraham et al., supra note 9.
42. 12 U.S.C. § 1851; 12 C.F.R. §§ 248.3, 248.10 (2015). We note that these restrictions apply to banks as well as to BHCs.
is considering exercising such authority, to further constrain the scope of permissible BHC activities.  

B. The Slow but Steady Expansion of Bank Powers

As the powers of BHCs expanded in the 1970s, 1980s, and 1990s, the scope of activities permissible for banks and their subsidiaries through the late 1990s and 2000s expanded as well. Today, national banks and their operating subsidiaries are permitted to engage in a broad array of financial activities previously reserved for BHCs. The powers of state-chartered banks have likewise expanded as most states enacted “wildcard” statutes, permitting their state chartered banks to engage in the same activities permissible for national banks. Banks can conduct, among other things, certain financial, investment and economic advisory services; provide transactional advice; and engage in various insurance and annuities activities as well as securities activities.

1. Permissible Financial, Investment and Economic Advisory Services

During the late 1990s and early 2000s, the Office of the Comptroller of the Currency (“OCC”) expanded the powers of national banks, and therefore state banks (as a result of state wildcard statutes), to include providing certain financial advisory services to customers. For example, national banks may serve as the advisory company for a mortgage or real estate investment trust, provide consumer financial counseling, furnish economic information and advice (including economic statistical

43. E.g., Wall Street Bank Involvement With Physical Commodities: Hearing Before S. Permanent Subcomm. on Investigations, 113th Cong. 313, 322 (2014) (statement of Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Res. Sys.), http://www.federalreserve.gov/newsevents/testimony/tarullo20141121a.htm (noting that the Federal Reserve issued advance notice of proposed rulemaking in January 2014 requesting public comment regarding imposing further “prudential restrictions or limitations on the ability of financial holding companies to engage in commodities-related activities.” He noted that the Federal Reserve received 184 unique comments and over 16,900 form letters and that, since November 2014, it has been assessing “the potential risk of physical commodities activities to the safety and soundness of the financial holding companies engaged in these activities” and considering what steps to take).

44. See generally OCC, supra note 11 (listing the broad array of activities national banks and their subsidiaries may engage in today).

45. Blair & Kushmeider, supra note 11, at 14.

46. See generally OCC, supra note 11 (listing the different activities).


48. See generally OCC, supra note 11, at 7, 10, 47, 49, 52.
forecasting services), furnish industry studies, engage in financial consulting and advisory services for other financial institutions and the public, offer fiscal planning advice regarding structuring bond issues to municipalities, and provide tax planning and preparation services.\footnote{49} Additionally, national banks may provide employee benefit consulting services to corporations in connection with establishing qualified benefit plans.\footnote{50} Moreover, a national bank's operating subsidiary is authorized to provide benefits counseling to customers (including collecting and disbursing Medicare and Medicaid insurance benefit payments), credit card registration and notification services, and payroll processing services, etc.\footnote{51}

2. Transactional Advice

The OCC has also expanded permissible bank activities to include providing transactional advice.\footnote{52} This expansion of power includes, but is not limited to, the ability to arrange for commercial real estate equity financing, conduct financial feasibility studies, and provide financial and transactional advice in relation to mergers, acquisitions, joint ventures, recapitalizations, leveraged buyouts, and other financial transactions.\footnote{53}

3. Insurance and Annuities Activities

By the mid-1990s, national bank powers further expanded to include authority to engage in certain types of insurance- and annuities-related activities.\footnote{54} Generally, national banks may sell insurance products as agents on a nationwide basis provided they comply with the requirements of 12 U.S.C. § 92.\footnote{55} Furthermore, banks may act as an agent selling a full range of annuities.\footnote{56} In addition to acting as agents, national banks are

\footnotesize{\begin{itemize}
\item 49. \textit{Id.} at 7–10.
\item 50. \textit{Id.} at 8.
\item 51. \textit{Id.} at 7–8.
\item 52. \textit{Id.} at 10.
\item 53. \textit{Id.}
\item 54. \textit{Id.} at 47–52.
\item 55. A national bank with a branch location in town with less than 5000 residents may sell insurance as an agent through that office on a national basis. \textit{See id.} at 49. While 12 U.S.C. § 92 provides that a bank with less than 5000 residents may sell insurance, the OCC interpreted that provision to allow such a branch to offer for sale insurance products to customers nationwide in 1986. Furthermore, a national bank need not be headquartered in such small town; it only needs to have a branch in that town through which the insurance is offered. In 1993, over the objection of agents companies, the D.C. Circuit confirmed the OCC's position. \textit{See Independent Insurance Agents of America v. Ludwig}, 997 F.2d 958, 959 (D.C. Cir. 1993); \textit{see also} Letter from Judith A. Walter, Senior Deputy Comptroller, OCC, to Randall R. Kaplan, Caplin & Drysdale (June 13, 1986) (on file with author).
\end{itemize}}
permitted to sell credit life insurance and may underwrite a variety of
insurance products, including credit life, health, disability, and mortgage
life insurance.\footnote{OCC, supra note 11, at 48.} Additionally, a national bank may establish an operating
subsidiary to serve as a captive insurance company to underwrite the
bank’s own operating risks.\footnote{Id.}

4. Securities Activities

Perhaps, most notably, the scope of permissible activities now includes a
wide range of securities activities.\footnote{Id. at 52–65.} Banks may purchase and sell asset-
backed obligations and securitize certain assets, may execute and clear
securities transactions, and may act as a transfer and fiscal agent.\footnote{Id. at 52, 57.} Banks
may also engage in various types of broker-dealer activities such as
transactions for “trust customers, private placements, issuance and sales of
certain asset-backed securities, transactions for certain stock purchase
plans, and transactions in “identified banking products” (including
generally deposit instruments, banker’s acceptances, loan participations
(subject to certain sales restrictions), and derivatives).”\footnote{Id. at 52.} They may even
offer investment advice for and engage in certain derivative activities (e.g.,
swaps, forwards, and options) as a financial intermediary or for risk
reduction purposes.\footnote{Id. at 53.} Moreover, banks can provide full-service securities
brokerage and act as a futures commission merchant.\footnote{Id. at 55.}

The activities listed above represent merely a sampling of the activities
permissible for banks. The gradual expansion of bank powers may have
eroded many banks’ need for a BHC structure.

IV. DIMINISHING ADVANTAGES OF THE BHC MODEL

Although BHCs may still engage in a wider range of activities, the gap
between permissible BHC and permissible bank business has narrowed.
Given the evolution and expansion of bank powers as discussed above,
arguably, many of the advantages of operating within the BHC structure
have eroded.

As discussed infra in Part IV, a BHC-electing financial holding company
status can engage in activities that are “financial in nature” such as
securities underwriting and dealing, insurance activities, and certain
securities activities beyond what was permissible for a bank without a
holding company. However, since the promulgation of the Volcker Rule, the ability of BHCs and their nonbank subsidiaries to engage in many securities and investment activities has been substantially diminished, decreasing one of the major advantages of the BHC structure. Moreover, the OCC now permits bank operating subsidiaries to engage in certain insurance, securities and other activities, further eroding this business advantage.

The waning benefits of the BHC structure are not limited to the reduced gap between authorized BHC and bank activities. Other traditional BHC benefits have also diminished or evaporated. Historically, for example, the BHC structure was the primary means of acquiring and holding multiple bank subsidiaries due to interstate banking prohibitions. However, starting in 1980, national banks could own operating subsidiaries, financial subsidiaries, and bank service companies and maintain certain

64. See Bank Holding Companies and Financial Holding Companies, supra note 1.


66. For example, the OCC permits national bank operating subsidiaries to, among other things, operate as a captive insurance company to underwrite insurance coverages on the operating risks of the parent bank and its affiliates, sell title insurance as an agent, continue to conduct grandfathered title insurance activities, and engage in many types of securities broker-dealer activities, including transactions for trust customers, private placements, issuance and sales of certain asset-backed securities, transactions for certain stock purchase plans, and transactions in “identified banking products.” See OCC, supra note 11, at 48.

67. See Baradaran, supra note 27, at 400 (indicating that, before the Riegle-Neal Interstate Banking Act, interstate bank prohibitions provided BHCs with a competitive advantage as the primary way to engage in banking in multiple states); Carl A. Sax & Marcus H. Sloan III, Legislative Note, The Bank Holding Company Act Amendments of 1970, 39 GEO. WASH. L. REV. 1200, 1208 (1971).

68. 12 C.F.R. § 5.34(d)(2) (defining an operating subsidiary as “a corporation, limited liability company, limited partnership, or similar entity if: (A) The bank has the ability to control the management and operations of the subsidiary, and no other person or entity exercises effective operating control over the subsidiary or has the ability to influence the subsidiary’s operations to an extent equal to or greater than that of the bank; (B) The parent bank owns and controls more than 50 percent of the voting (or similar type of controlling) interest of the operating subsidiary, or the parent bank otherwise controls the operating subsidiary and no other party controls a percentage of the voting (or similar type of controlling) interest of the operating subsidiary greater than the bank’s interest; and (C) The operating subsidiary is consolidated with the bank under generally accepted accounting principles (GAAP)).

69. Id. § 5.39(d)(6) (defining a financial subsidiary as “any company that is controlled by one or more insured depository institutions, other than a subsidiary that: (i) Engages solely in activities that national banks may engage in directly and that are conducted subject to the same terms and conditions that govern the conduct of these activities by national banks; or (ii) A national bank is specifically authorized to control by the express terms of a Federal statute (other than Section 5136A of the Revised Statutes), and not by implication or interpretation, such as by Section 25 of the Federal
other equity investments.\textsuperscript{71}

Moreover, the previously preferential treatment of debt at the BHC level has largely evaporated. Prior to Dodd-Frank, the BHC structure facilitated double leverage where a BHC could engage in trust preferred securities ("TruPS") financing, which could be counted as capital at the BHC level and where the proceeds could be counted as Tier 1 capital at the bank level.\textsuperscript{72} By way of background, TruPS are a type of debt instrument issued generally by a special purpose subsidiary of the BHC (often the bank), and the proceeds generally are loaned to the BHC pursuant to a long-term, subordinated note.\textsuperscript{73} The BHC's loan payments are eventually used to make dividend payments to the TruPS investors;\textsuperscript{74} however, BHCs generally retain generous deferral options regarding repayments.\textsuperscript{75} Beginning in October 1996, the Federal Reserve allowed these kinds of instruments to be treated as Tier 1 capital for BHCs.\textsuperscript{76} TruPS, along with other cumulative preferred stock, were allowed to account for up to 25\% of a BHC's Tier 1 capital, provided that certain conditions were satisfied.\textsuperscript{77} This treatment represented a significant benefit of the BHC structure:

Given the capital treatment[,] ... TruPS presented BHCs with a way to raise capital without diluting existing shareholders. TruPS also provided BHCs with favorable tax treatment in that TruPS dividend payments are tax deductible for the issuers, unlike dividends paid on preferred stock. A final benefit to using TruPS is that the collateralized debt obligations


\textsuperscript{72} Id. § 5.35(d)(1) (defining a bank service company as "a corporation or limited liability company organized to provide services authorized by the Bank Service Company Act, 12 U.S.C. 1861 et seq., all of whose capital stock is owned by one or more insured depository institutions in the case of a corporation, or all of the members of which are one or more insured depository institutions in the case of a limited liability company") (emphasis added); see also 12 U.S.C. § 1863 (indicating that permissible services include performing the following services "check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of checks, statements, notices, and similar items, or any other clerical, bookkeeping, accounting, statistical, or similar functions performed for a depository institution").

\textsuperscript{73} 45 Fed. Reg. 68587 (Oct. 15, 1980); see also 12 C.F.R. § 5.36 (permitting national banks to make various types of equity investments pursuant to 12 U.S.C. § 24(7) and other statutes).

\textsuperscript{74} Id.

\textsuperscript{75} Id.

\textsuperscript{76} Id.

\textsuperscript{77} Id.
(CDOs) could be issued under SEC Rule 144A, which allowed TruPS CDOs to be unregistered when issued to qualified institutional buyers (QIB) through a broker-dealer and permitted CDO issuers and trustees to provide very limited disclosures.78

Post Dodd-Frank, this is no longer the case. The Collins Amendment to Dodd-Frank, along with the related Federal Reserve rules and policies, has largely eliminated TruPS and similar hybrid debt securities from being included in regulatory capital.79

BHCs’ historic director-and-officer-related advantages have likewise deteriorated. BHCs once had an advantage over banks with respect to director and officer liability. While banks were restricted by the corporate governance provisions of the state of their headquarters, BHCs had the flexibility to select their state of incorporation, allowing them to select states with more favorable indemnification and liability laws. But, in 1986, national banks were granted similar flexibility by the OCC,80 which allowed national banks to adopt corporate governance provisions in their bylaws from a number of jurisdictions, e.g., from the home state of the bank, BHC, Delaware, or Model Business Corporation Act.81 Moreover, indemnification by all banks and BHCs is subject to compliance with 12 U.S.C. § 1828(k)82 and the FDIC’s Golden Parachute and Indemnification Rule.83

78. Press Release, Bd. of Governors of the Fed. Res. Sys., Statement Regarding Treatment of Certain Collateralized Debt Obligations Backed by Trust Preferred Securities Under the Rules Implementing Section 619 of the Dodd-Frank Act (Dec. 31, 2013), http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131227al.pdf. In assessing the relative merits of the BHC structure today, the authors note that, to the extent the argument is made that the BHC presents increasing and burdensome regulatory requirement imposed by the Dodd Frank Act, this in no way reflects on a highly professional, knowledgeable and experienced Federal Reserve staff who have more than capably implemented rules and policies required by law.

79. Id. (noting that TruPs no longer constitute Tier 1 capital for BHCs with greater than $15 billion in assets).


83. See 12 C.F.R. §§ 359.2, 359.3 (2012); see also Id. § 359.2 ("No insured depository institution or depository institution holding company shall make or agree to make any golden parachute payment, except as provided in this part."). A "golden parachute payment" is a compensation payment, subject to certain enumerated exceptions, by a bank or bank holding company for the benefit of any current or former institution affiliated party—such as a director or officer of the bank or BHC—and is contingent on that person’s employment termination. In such a case, both the person’s termination and scheduled payment must occur closely before or after there is a period of insolvency, appointment of a conservator or receiver of the bank, regulatory notice the bank or BHC is in a troubled condition, assignment of a 4 or 5 composite regulatory


As the benefits of the BHC structure erode, its attractiveness as an organizational model dwindles as well.

V. GROWING BHC REGULATORY REQUIREMENTS AND COSTS

financial regulatory system and ensure that federal regulators actively managed all financial institutions to mitigate risks. Dodd-Frank granted the Federal Reserve sweeping new powers to regulate large financial institutions and directed the Federal Reserve to impose “heightened prudential standards” in a variety of categories, including leverage capital, liquidity, stress testing, and risk management. Dodd-Frank also directed FBAs to issue upwards of 100 new finalized rulemakings. As a result, the regulatory burden on financial institutions is considered to be at an all-time high.

While certain regulations only apply to BHCs with more than $250 billion in assets, Dodd-Frank also directed the Federal Reserve to impose significant new regulatory burdens on all BHCs with consolidated assets over $50 billion. For example, these BHCs must implement new “global risk management frameworks” overseen by a required risk committee and a chief risk officer (“CRO”). BHCs with assets over $50 billion also are now subject, or will eventually be subject, to the new modified liquidity coverage ratio, Comprehensive Capital Analysis and Review (“CCAR”) plans, enhanced liquidity risk management standards, single counterparty credit limits, supervisory run stress tests, and a host of new reporting requirements. The resulting compliance costs are substantial; for instance, in 2015, Citigroup Inc. announced it had spent $180 million in
just a six month period preparing for its annual CCAR. 100

While many of the post Dodd-Frank requirements do not affect BHCs with less than $50 billion in total assets, BHCs with total assets between $10 billion and $50 billion have experienced their own steady increase in regulatory burden. Particularly for many smaller banking entities, the increased compliance costs have been difficult to bear. Publicly-traded BHCs with over $10 billion in assets must adopt a risk committee that is required to meet quarterly.101 The risk committee is charged with establishing a risk management framework, which must incorporate processes for independent evaluation of risk, managerial risk responsibilities, and risk reporting.102 Moreover, all BHCs with more than $10 billion in assets must conduct annual stress tests and disclose these tests to both their regulators and the public.103

The ramped-up regulations imposed on small BHCs have faced considerable criticism, and many argue that the increased regulatory burden greatly outweighs whatever risk small BHCs pose to the national economy.104 This trend toward heightened regulation is especially disconcerting in light of the fact that Dodd-Frank does not require the Federal Reserve to engage in any risk benefit analysis before it imposes additional regulations.105

While BHCs face more regulatory requirements than ever before, many of these heightened prudential standards do not apply to financial institutions without holding companies.106 Many of Dodd-Frank’s most
strenuous requirements were written to exclusively target BHCs with over $50 billion in assets and systematically important financial institutions ("SIFIs") as designated by the Financial Stability Oversight Council ("FSOC"). Notably, banks with less than $50 billion in assets experience regulatory advantages by not having a BHC. While all depository institutions must engage in risk analysis, only BHCs must create a risk management policy, which meets the heightened requirements imposed by the Federal Reserve, and form a separate risk committee. Additionally, only BHCs are required to file quarterly Y-11 reports containing financial statements for their nonbank subsidiaries. 

As the level of BHC regulation rises and the final rulemakings required by Dodd-Frank are drafted and implemented, the regulatory burden on BHCs increasingly reduces their value as an organizational structure. In addition to the growth of BHC regulations as a result of Dodd-Frank, the BHC structure faces another significant disadvantage. While state and national banks generally need only report to one federal regulator, the BHC organizational structure faces the substantial regulatory compliance cost of reporting to two regulators: the Federal Reserve for the BHC and the bank's primary regulator.


108. A particularly notable example is the United Services Automobile Association ("USAA"), which has assets of approximately $134 billion. See USAA, WE THE MEMBERS 2014 REPORT TO MEMBERS (2014), https://content.usaa.com/mcontent/static_assets/Media/report-to-member-2014.pdf?cacheid=1896096673. USAA has not been designated as a SIFI, and as such, it has escaped many of the additional regulatory costs imposed since Dodd-Frank. Wack, supra note 100. With the exception of company-run stress tests, the Federal Reserve has not applied any of the enhanced prudential standards created pursuant to savings and loan holding companies through Dodd-Frank.


111. See also DAVIS POLK, supra note 92 (indicating that there are over twenty-five remaining rulemakings requirements by Dodd-Frank that have not yet been implemented).

to eliminate this inefficiency, Dodd-Frank instead reinforced this double-reporting system.

VI. CERTAIN BHC ADVANTAGES REMAIN STANDING

Notwithstanding the erosion of advantages and mounting regulatory burdens of the BHC structure, BHCs continue to offer certain key advantages. For one, unlike a bank, a BHC may own up to 5% of the voting shares of any other company without prior regulatory approval. This additional authority makes BHCs far more efficient for investment and initial business expansion purposes. Additionally, the BHC structure facilitates international banking activities as a BHC has significantly greater flexibility to engage in foreign nonbanking activities than many banks, which generally are restricted to establishing foreign branches or investing in entities “principally engaged” in banking. International activities conducted by a BHC are exempt from § 4 of BHC Act’s “closely related to banking” requirement. Unlike its bank counterpart, a BHC may acquire “shares of or activities conducted by, any company which does no business in the United States except as incident to its international or foreign business, if the Board by regulation or order determines . . . . the exemption would not be substantially at variance with the purposes of the Act.”

Furthermore, BHCs that qualify as financial holding companies (“FHCs”) enjoy additional advantages, for FHCs may engage in activities that are “financial in nature” beyond what is allowable for banks. Only BHCs, not banks, can qualify for FHC status, which allows them to engage in securities underwriting and dealing, insurance underwriting, insurance agency activities, and merchant banking. Although banks may affiliate with an insurance underwriter and insurance sales and brokerage firm, only FHCs may engage in virtually any insurance activity. Moreover, FHCs

115. This applies to U.S. bank holding companies and U.S. banks and not necessarily to foreign banking organizations. See, e.g., id. § 1841(h)(2); 12 C.F.R. § 211.23.
117. Id. § 1843(c)(13).
118. Id.
119. See generally id. § 1843.
120. Id. § 1843(k)(4).
121. See id. § 1843(k)(4)(B) (providing that an FHC may engage in any of the following: “insuring, guaranteeing, or indemnifying against loss, harm, damage, illness,
may use their merchant banking authority to acquire any ownership interest—even 100% ownership—in any type of entity, including a nonfinancial entity.\textsuperscript{122}

BHCs also benefit from greater flexibility in raising capital than banks, which generally can only raise capital by issuing stock.\textsuperscript{123} In addition to an increased ability to raise capital, a banking structure helmed by a BHC facilitates better separation of a troublesome subsidiary from the bank to preserve the bank’s supervisory and credit ratings.\textsuperscript{124} More generally, the BHC structure can more effectively shield banks from potential veil-piercing liability for the acts of its subsidiaries, including from environmental regulatory risk.\textsuperscript{125} Depending on a banking entity’s activities and liability risks, these advantages may continue to outweigh the enhanced regulatory burdens of the BHC structure.

CONCLUSION

While maintaining a BHC remains necessary for most very large financial institutions that engage in financial activities only permitted for FHCs, a large number of community and regional banks conduct activities that do not require a BHC. Many of the advantages that previously encouraged banks to adopt the BHC model no longer exist, and those advantages that remain may well be outweighed by the onerous and ever-increasing regulatory burden imposed on BHCs. As the regulatory framework has changed, the incentives to form a BHC have disappeared. Currently, many banks appear to subject themselves to inefficient and unnecessary costs by failing to evaluate whether forming or maintaining a BHC is still advantageous. A bank should not simply assume a BHC is necessary or advisable regardless of their particular business model, but rather, it should make an informed assessment and decision as to the need for a BHC in light of its operating plans.

\textsuperscript{122} \textit{Id.} § 1843(k)(4)(H) (indicating that an FHC may engage in merchant banking and that it remains allowable despite that the Volker Rule limiting this type of investment).

\textsuperscript{123} \textit{Bank Holding Companies and Financial Holding Companies, supra} note 1.


\textsuperscript{125} \textit{Bank Holding Companies and Financial Holding Companies, supra} note 1.