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Bank and thrift shareholders are “different.” Direct or indirect ownership or control of large blocks of stock in a bank or a thrift institution brings with it the need to be cognizant of complex state and federal laws and regulations that may well trigger applications with state and federal regulators to approve the ownership, and/or a proposed transfer of ownership, in advance. In addition, ownership or control of large blocks of stock in banks and thrifts may result in the holding entity being deemed a bank or thrift holding company under federal law, again bringing with it not only the need for prior Federal Reserve approval, but potential ongoing supervision, regulation and limits on activities of the holding entity. Both of the foregoing pertain to shares held directly in banks and thrifts, and also through indirect control of banks and thrifts through stock held in their holding companies (if a holding company is already in place). Applicable law impacts both direct and indirect holdings of bank and thrift stock.

Oftentimes the issue arises in the context of estate planning for closely-held institutions where existing large blocks of shares may come together in an estate plan or may be distributed in an estate plan. On the federal side, the Change in Bank Control Act and the Bank Holding Company Act both impact the concentration of direct and indirect bank ownership and control, and state law impacts the concentration of direct and indirect control of state-chartered banking institutions.

The issue can also arise in the context of a stock offering by an institution and additional subscriptions by existing holders that may take them over the statutory and regulatory trigger thresholds.

The government has a significant interest in making certain that banks and thrifts that take public deposits are not “controlled” by individuals or groups that may abuse the license that such institutions hold. Therefore, the proposed acquisition of direct or indirect “control” of a bank or thrift requires a fairly complex, often lengthy, and detailed application process with the appropriate state and/or federal regulatory agencies prior to completion of the underlying transaction or

distribution. Failure to secure the appropriate prior approvals can result in significant exposure for the holders, including fines and penalties by regulatory agencies.

What are the Triggers?

While far too complicated to go into full detail here, direct or indirect control of over 4.9% of the shares of a financial institution can trigger the need to ascertain prior regulatory approval. The percentage can be less if the ownership is combined with management or board control of the institution, and agencies have a fairly wide latitude to make a determination (subject to appeal) that in fact de facto control exists with smaller holdings.

The most common trigger point occurs with proposed direct or indirect control of more than 9.9% of the voting shares of an institution.

Who is Included in a Control “Group”?

Holdings for individuals can be aggregated in a number of ways, and applicable federal law casts a very wide net over family relationships, aggregating them together for purposes of determining the existence of a “control group.” The same can apply to business partners and other organized groups.

Before aggregate holdings can exceed the relevant thresholds, each of the individuals involved are required to apply to the appropriate agency or agencies for prior approval for the control holdings.

What if the Shares are “Non-Voting”?

Even if shares are classified as “non-voting” shares, those that have convertibility options or even options for the shares to become voting in certain instances, may be deemed “voting shares” for purposes of the control issues. A number of other terms may also trigger a “voting” determination by the agencies. Care must be taken in reviewing the terms of the stock before assuming that non-voting shares qualify for non-voting treatment by the agencies.

What About Holdings by an Entity?

Shares held by business entities, as well as certain types of trusts, can result in the entity or trust becoming a bank or thrift “holding company” under federal law. This situation oftentimes inadvertently occurs when a well-intended shareholder holds shares other than in a personal capacity. Again care must be taken when utilizing business entities or trusts to hold shares of financial institutions or their holding companies.

What is the Application Process?

While too lengthy for complete coverage here, the application process first involves a determination that one or more applications are required and then determining which agency or agencies are involved. The applications themselves can be very intrusive from a personal perspective, and involve extensive personal and financial disclosures and background checks. Many applicants find the process daunting, and some would prefer to not proceed and/or to divest rather than run the gauntlet of the application and approval process. Again the intent of the law is to keep bad actors from “control” of financial institutions, and the

regulators treat the process very seriously.

Importantly, the application and pre-approval process is required before the “control” is acquired. In the case of estate planning, care must be taken to recognize the potential impact of control issues on the estate plan. In the case of estate administration, care must be taken to review and analyze the proposed stock distributions in light of the control issues and secure any regulatory approvals in advance thereof.

Whose Responsibility is it to Apply?

The responsibility lies with the individual or individuals who seek to directly or indirectly control an institution, and not with the institution itself. The institution is not required to monitor holdings to determine whether there may be an individual or group that exceeds the share ownership triggers, however holdings are reviewed by examiners. If such a situation exists or is anticipated by the institution it can be helpful to point it out prior to an inadvertent control issue arising.

What if I Just Ignore This Issue?

Don't. Bad things can happen to the holder and the institution, including a forced divestiture that adversely impacts not only share value but may also result in an undesirable shareholder securing a large portion of the institution's shares.

What Should I Do?

Institutional and estate strategic planning is critical to avoid inadvertent regulatory issues and violations of applicable law. Estate plans that include substantial holdings in financial institutions need to take into account the complex and nuanced requirements of the referenced federal and state laws and regulations in structuring ownership and ownership transfers. Reviewing and understanding these matters in advance is critical.

That planning and monitoring should be ongoing in light of potential transactions in shares, share repurchases by the institution, share offerings by the institution, and a variety of other matters that can impact the control analysis.

This is a very fact-specific analysis for each holder and each institution, and requires understanding of the underlying ownership structure of the institution and those individuals and organizations that may in fact be aggregated in the control analysis under applicable law.

Conclusions

Understanding the nuances of the impact of state and federal financial institutions control issues is important for individuals and groups holding and/or transferring significant portions of institution stock. Unfortunately, the issues are not well known outside of banking circles, and mistakes can be costly.

Individuals, families and related persons and entities holding financial institution stock must be aware of the requirements and implications of applicable state and federal law and regulation on those holdings in order to avoid inadvertently upsetting institutional strategic planning as well as individual estate and tax

planning goals.

