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Advantages and Disadvantages of Bank Holding Company Structure

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Over the years many banks, particularly community banks, have formed bank holding companies to take advantage of certain additional permitted activities and other practical benefits. More recently, certain community banks, including Bank of the Ozarks, have determined to terminate the bank holding company structure in order to achieve certain efficiencies and other practical benefits. Set forth below is a list of certain advantages and disadvantages of a bank holding company structure.

Advantages of a Bank Holding Company Structure

- ***Greater Flexibility with Regulatory Capital*** – Greater flexibility includes the ability to repurchase capital without regulatory approval within certain limits and operating conditions (Federal Reserve Reg. Y permits stock redemptions of up to 10% of holding company consolidated net worth in the preceding 12 months without prior approval, assuming the company and subsidiary bank will be well managed, well capitalized, and have no other significant supervisory issues both before and after the stock repurchase), and the ability to issue trust preferred securities and hold grandfathered trust preferred securities assumed in an acquisition. In addition, a holding company may issue debt securities and contribute the proceeds as equity capital to the subsidiary bank, and the interest paid on these debt securities is tax deductible for the holding company.

- ***Greater Flexibility for Restricted Stock Awards*** – A bank holding company has more flexibility than a bank in providing employee-friendly tax withholding provisions in restricted stock awards. Federal banking regulations limit the ability of banks to reduce permanent capital without prior approval. A holding company may issue equity awards, including restricted stock awards, without impacting the permanent capital of a subsidiary bank. Accordingly, holding companies may permit employees to satisfy tax withholding triggered by vesting events by returning or surrendering shares of holding company stock to the company rather than by paying cash. For national banks and banks chartered in states that do not recognize the corporate concept of treasury shares (including Virginia), returning or surrendering shares of bank stock in this manner is treated as a repurchase that reduces the bank's permanent capital. Absent prior regulatory approval, which would likely be difficult to obtain, returning or surrendering shares to satisfy tax withholding obligations is impermissible, and these banks must explore other methods to help employees manage the tax consequences of vesting in a restricted stock award.

- ***Better Investor Relations*** – Bank holding companies with securities registered under federal securities laws file SEC reports on the SEC's EDGAR System, providing greater transparency and disclosure of financial and other significant corporate information; whereas banks without holding companies with securities registered

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under the federal securities laws file similar reports on the FDICconnect system, which is not as visible to the public. However, banks without holding companies can make voluntary filings with the SEC and self-publish reports on their public websites to maintain investor and analyst visibility.

- ***Greater Flexibility Regarding Activities*** – A bank holding company may engage in certain additional permissible activities not possible for a bank, such as holding certain problem assets purchased from a subsidiary bank and owning up to 5% of any class of voting securities of any entity without prior regulatory approval. In addition, eligible bank holding companies may elect financial holding company status, which permits certain non-bank activities that are incidental to banking and/or financial in nature, including securities underwriting, insurance underwriting, and merchant banking.

- ***Structural Flexibility with M&A*** – A bank holding company structure provides organizational flexibility when merging or integrating an acquired bank with an existing subsidiary bank. If a holding company acquires another bank, it can merge the subsidiary banks at any time after the acquisition, while in a bank-to-bank merger banks must be fully integrated on day one of the acquisition, which may create timing problems with core processor conversion, increase integration risks, and increase costs.

- ***Flexibility for Small Bank Holding Companies*** – Bank holding companies with less than $3 billion in assets may take advantage of the Federal Reserve's Small Bank Holding Company and Savings & Loan Holding Company Policy Statement. Traditionally, the Federal Reserve has disfavored the use of debt in bank mergers and acquisitions. However, the Federal Reserve recognizes that the transfer of ownership of small banks often requires the use of acquisition debt and, thus, permits the formation and expansion of small bank holding companies with debt levels higher than would be permitted for larger bank holding companies.

Disadvantages of a Bank Holding Company Structure

- ***Enhanced Regulatory Burden*** – A bank holding company is regulated by the Federal Reserve and State regulatory authorities. For a national bank or a state non-member bank, this creates an additional set of regulators. In addition, a bank holding company is subject to periodic examination by the Federal Reserve and is required to be a source of financial strength for its insured subsidiary bank.

- ***SEC Costs*** – A bank holding company with securities registered under federal securities laws typically incurs higher costs for SEC reporting and pays registration fees for non-exempt issuances of new securities.

- ***No Federal Registration Requirement for State Bank Securities Offerings*** – Without a holding company, the public offering of bank stock by a state bank is exempt from registration under the Securities Act of 1933, allowing the use of an offering circular that is shorter than a public company registration statement/prospectus. This not only saves in registration fees, but also other costs associated with securities registration and offering document preparation. A national bank without a holding company, while exempt from SEC registration for securities offerings, is subject to comparable registration requirements imposed by the OCC.

- ***Multiple Governance and Organizational Structures for Both the Holding Company and the Bank*** – A

bank with a holding company will have separate sets of articles, bylaws, policies, procedures, and risk management guidelines. It will also have two boards of directors with certain actions required to be approved by the holding company board and certain actions required to be approved by the bank board. This burden may be eased by having the same individuals serve on the holding company board and the bank board.

- ***More Financial Reporting*** – Financial reporting is at the holding company and bank level, requiring the need to maintain separate books for the bank and holding company, including with regard to filing Call Reports, making SEC filings, and related activities.

- ***Affiliate Transaction Considerations*** – Sections 23A and 23B of the Federal Reserve Act (and Federal Reserve Reg. W) impose quantitative and market-terms restrictions on a bank's loans to, purchases of assets from, and certain other transactions with, affiliates, including its bank holding company. By contrast, these provisions are largely inapplicable to transactions between banks without holding companies and their direct subsidiaries (although loan-to-one borrower rules and restrictions on the transfer of low-quality assets remain applicable).

Conclusion

While there are certain advantages to a bank holding company structure, there are certain disadvantages as well. Because each bank and bank holding company structure is unique, as are their business plans, executives and boards addressing this issue should carefully analyze their unique circumstances. We are pleased to assist executives and boards explore structural alternatives.

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