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Are you in Control (Of a Bank)? The FED"s Proposed Framework for Presuming Control Under the Bank and Savings and Loan Holding Company Acts

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On April 23, the Federal Reserve Board (the "FRB") published a Notice of Proposed Rulemaking ("NPR") to "simplify and increase the transparency," while maintaining "consistency" to its determination of whether an entity "controls" a bank or a savings association (collectively, "depository institution"). According to the FRB's announcement, the NPR is a first draft of a "comprehensive regulatory framework for control determinations." FinTech companies seeking to become depository institutions should pay close attention to the NPR as it provides clear guidelines for when its investors would become subject to the Bank Holding Company Act ("BHCA").

Under the BHCA, an investor controls a depository institution if:

1. It directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25% or more of any class of voting securities of the depository institution;
2. Controls in any manner the election of a majority of the directors of the depository institution; or
3. Directly or indirectly exercises a controlling influence over the management or policies of the depository institution.

Entities that control a depository institution are banking or savings association holding companies, which are subject to the rigorous requirements imposed by the Bank Holding Company Act and the Home Owners' Loan Act, and the FRB's implementing regulations as well as the FRB's supervision. Furthermore, you have to get approval from the FRB to acquire "control" of a bank or savings association.

To-date, the FRB determines whether an investor meets the third prong on a case-by-case basis, reviewing the facts and circumstances. The FRB has issued public and private interpretations analyzing the meaning of control, but investors still face substantial uncertainty if and when their investments and business relationships with a depository institution will be deemed controlling. The NPR is designed to clarify when an investor meets the third standard. To that end, the NPR would, according to Randal Quarles, Vice Chair for Supervision, provide greater clarity by "placing substantially all of the [FRB's] [current] control positions into a comprehensive public regulation," one that considers the intersection between the percentage of voting shares the investor owns and the following nine factors:

1. How many directors the investor controls;
2. Whether one of the directors controlled by the investor serves as Chair of the Board;
3. Whether one or more of the directors controlled by the investor serves on a Board committee that has the power to bind the committee;
4. What percentage of the banking organization's revenues or expenses are derived from its relationship with the investor;
5. Whether the business terms of any transactions between the banking organization and the investor are on fair market terms;
6. Whether the banking organization and the investor have interlocking officers or employees;
7. Whether the investor has significant contractual powers over the banking organization;

8. Whether the investor has solicited proxies to replace directors; and
9. The total equity of the banking organization controlled by the investor.

The NPR specifies a presumption of control through a "tiered framework," indicating when the presumption of control is established where an investor owns 5, 10, and 15% of the depository institutions' voting shares. While the NPR would "codify a significant portion of the [FRB's] historical practices," it also makes "targeted adjustments." For instance, the NPR would allow investors to have more director representatives and empower investors to, in many cases, retain 15% of voting stock rather than 10%, when divesting itself of its control of the depository institution. Alternatively, the investor could retain 24.99% of voting ownership, provided it does not exceed that level of ownership for two years. Importantly, the NPR would also codify the FRB's current presumption of non-control: ownership of less than 10% of the depository institutions' voting securities.

Notably, however, once an investor acquires 15% of a depository institution's voting shares, the investor may not, without triggering a presumption of control, have a director representative service as Chair of the Board, may not account for 2% or more of the banking organization's revenues or expenses, may have no interlocking employees or officers, and may only control 24.99% of the depository institution's total equity. Public comments will be due 60 days after the NPR is published in the Federal Register. See here for the FRB's staff memo regarding the NPR.

As FinTech companies consider whether to apply for state and national bank charters, including the Office of the Comptroller of the Currency's special purpose charter, they should weigh how the BHCA and its implementing guidance will impact their relationship with investors and their ability to attract investment. The FRB's NPR provides greater clarity on that impact.

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