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March 4, 2015

VIA ELECTRONIC MAIL
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Mr. Robert Frierson
Office of the Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave, N.W.
Washington, D.C. 20551

Re: Docket No. R-1508
Docket No. R-1509

Dear Mr. Frierson:

This is a comment on the Federal Reserve Board's ("FRB") interim final rule "Regulatory Capital Ratios: Interim Final Rule to Exempt Savings and Loan Holding Companies from the Regulation Capital Rules," 80 Federal Register 5666 (February 3, 2015) (the "Interim Final Rule") and proposed rule "Small Bank Holding Company Policy Statement; Capital Adequacy of Board-Regulated Institutions; Bank Holding Companies, Savings and Loan Holding Companies; Changes to Reporting Requirements," 80 Federal Register 5694 (February 3, 2015) (the "Proposed Rule"). This law firm represents depository institutions and has numerous bank holding company ("BHC") and savings and loan holding company ("SLHC") clients. It is in that capacity that we are submitting this comment letter.

I. BACKGROUND

A. The Small Bank Holding Company Policy Statement

Both the Interim Final Rule and the Proposed Rule relate to the FRB's "Small Bank Holding Company Policy Statement (12 C.F.R. Part 225 Appendix C) (the "Policy Statement"). The Policy Statement authorizes certain small BHCs to incur debt levels higher than those generally permitted for BHCs, subject to specified requirements.

The Policy Statement was initially issued in 1980 "to facilitate the transfer of ownership of small community-based banks in a manner that is consistent with bank safety and soundness." 71 Federal Register 9898 (February 28, 2006). As explained by the FRB, it generally discourages the use of debt by BHCs to finance the acquisition of banks or other companies because high levels of debt can impair the ability of the BHC to serve as a source of strength to

its subsidiary banks. The FRB recognized, however, that the transfer of ownership of small banks often requires the use of acquisition debt. Accordingly, the FRB adopted the Policy Statement, which was originally applicable to BHCs with consolidated assets of $150 million or less. The Policy Statement contains several conditions and restrictions designed to ensure that small BHCs that operate with permitted higher levels of debt do not present an undue risk to the safety and soundness of their subsidiary banks.

In 2006, the FRB revised the Policy Statement to raise the consolidated assets threshold to $500 million. 71 Federal Register 9897 (February 28, 2006). The FRB deemed the increase in the threshold justified due to "the effects of inflation, industry consolidation and normal asset growth of BHCs" since the Policy Statement was originally adopted in 1980.

The original conditions to applicability of the Policy Statement in 1980 were that the BHC must (i) have consolidated assets of less than $150 million, (ii) not be engaged in any nonbanking activities involving significant leverage, (iii) not be engaged in any significant off-balance sheet activities, and (iv) not have a significant amount of outstanding debt that was held by the general public.

When the FRB increased the consolidated assets threshold to $500 million in 2006, it changed the additional criteria for applicability of the Policy Statement. The Policy Statement currently applies to BHCs with less than $500 million of consolidated assets that (i) are not engaged in "significant" nonbanking activities either directly or indirectly or through a nonbank subsidiary, (ii) do not conduct "significant" off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary (other than in the subsidiary depository institution and its subsidiaries), and (iii) do not have a "material" amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission ("SEC"). (These requirements for application of the Policy Statement will be referred to as the "Qualitative Requirements").

II. Exemption from Capital Guidelines

When the FRB first adopted risk-based Regulatory Capital Guidelines for BHCs in 1989, BHCs of less than $150 million that were subject to the Policy Statement were exempted because the Policy Statement allowed them to operate at a level of leverage that was inconsistent with the capital guidelines. The FRB's Regulation Q, which establishes the current consolidated capital requirements, continues the exemption for small BHCs covered by the Policy Statement. 12 C.F.R. §217.1(c)(1)(ii). (The exemption from consolidated capital requirements for small holding companies will be referred to as the "Small Holding Company Exemption").

III. THE INTERIM FINAL AND PROPOSED RULES

The Interim Final Rule generally extends the applicability of both the Policy Statement and the Small Holding Company Exemption to SLHCs of less than $500 million in consolidated assets, which heretofore have not had the benefit of the Small Holding Company exemption (but

have otherwise generally been exempted from consolidated capital requirements until January 1, 2015). The Small Holding Company Exemption was explicitly preserved in Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") with respect to BHC capital requirements, but the legislation did not specifically refer to SLHCs. The Interim Final Rule corrects this discrepancy. The Proposed Rule would raise the asset threshold for the Policy Statement and Small Holding Company Exemption to cover otherwise qualifying BHC's and SLHCs of less than $1 billion in consolidated assets. Both regulatory actions are a result of recent legislation, Public Law 113-250, which directed the FRB to publish proposed revisions to the Policy Statement that raise the threshold to $1 billion for both BHCs and SLHCs. We understand that the FRB supported the passage of the legislation. See, e.g., Remarks of Governor Jerome H. Powell at the Economic Growth and Regulatory Paperwork Reduction Act Outreach Meeting, Dallas, Texas (February 4, 2015).

IV. COMMENT

We applaud the adoption of the Interim Final Rule and urge the FRB to finalize the Proposed Rule as quickly as possible. Certainly, the Policy Statement and Small Holding Company Exemption should be equally available to SLHCs as it is to BHCs. We see no reason to distinguish between the two for this purpose and believe that the failure of the Dodd-Frank Act to refer to SLHCs in the context of the Policy Statement and Small Holding Company Exemption was a mere oversight given that SLHCs were then subject to the jurisdiction of the Office of Thrift Supervision rather than the FRB and were then subject to consolidated capital requirements.

Similarly, increasing the asset size threshold to $1 billion is a positive initiative. The effects of inflation, industry consolidation and normal asset growth motivated the increase in the threshold in 2006 and those factors equally apply nine years later. However, as is explained below, increasing the threshold is sound policy for other reasons as well.

Most BHCs or SLHCs under $1 billion in asset size are simple organizations that do not engage in material business activities separate from those of the subsidiary depository institution (and subsidiaries of the subsidiary depository institution). The overwhelming percentage of the consolidated assets of the organization reside in the institution itself. As such, the application of separate consolidated capital requirements to the holding company is largely duplicative of those applicable to the subsidiary depository institution. Although the Small Holding Company Exemption was originally adopted in the context of small BHC acquisition debt, there was, to our knowledge, never any requirement that a qualifying holding company incur acquisition debt in order to benefit from the Small Holding Company Exemption to the capital guidelines or regulations. The Small Holding Company Exemption was applied as a general exemption for qualifying small BHCs, consistently with the FRB's recognition that doing so within the context of the requirements for applicability of Policy Statement was consistent with safety and soundness. As such, the beneficial policy attributes of the Small Holding Company Exemption go beyond facilitating potential acquisition debt and include eliminating unnecessary regulatory

burden on small holding companies. Increasing the asset threshold facilitates that policy objective.

We do, however, have concerns about an aspect of the existing Qualitative Requirements, specifically the disqualification of an otherwise qualifying holding company from the Policy Statement (and Small Holding Company Exemption) where it has a "material" amount of debt or equity securities outstanding that are registered with the SEC. (This criterion will be referred to as the "SEC Disqualifier.")

The FRB's stated reasoning for adopting the SEC Disqualifier is as follows:

> The revision of the criterion to exclude from the Policy Statement any BHC that has outstanding a material amount of SEC-registered debt or equity securities reflects the fact that SEC registrants typically exhibit a degree of complexity of operations and access to multiple funding sources that warrants excluding them from the Policy Statement and subjecting them to the Capital Guidelines. Moreover, the application of consolidated requirements to these BHCs should not impose significant additional burden, as they are required to have consolidated financial statements for SEC reporting purposes. What constitutes a "significant" amount of nonbanking activities or a "material" amount of SEC-registered debt or equity for a particular BHC depends on the size, activities and condition of the relevant BHC. In the Board's view, differing levels of risk in varying business lines and practices among institutions precludes the use of fixed measurable parameters of significance or materiality across all institutions. For this reason, the rule provides the Federal Reserve with supervisory flexibility in determining, on a case-by-case basis, the significance or materiality of activities or securities outstanding such that the BHC should be excluded from the Policy Statement and subject to the Capital Guidelines.
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> 71 Federal Register 9900 (February 28, 2006)

Initially, we question the continuing validity of the suggestion that having SEC-registered securities implies that a holding company has more complex operations than those that do not have SEC-registered securities. Many holding companies access public funding markets to supplement the capital of their subsidiary institution, not to engage in additional lines of business or complex operations at the holding company. Indeed, in this law firms' general experience counseling SEC-registered securities offerings by depository institutions and their holding companies, most holding companies invest offering proceeds not downstreamed to the institution in investments of the same nature as the subsidiary institution itself.

Also, it must be stressed that there was never any requirement that a holding company incur acquisition debt for the Small Holding Company Exemption to apply. As such, the reduction of regulatory burden purpose of the Small Holding Company Exemption fully applies to otherwise qualifying BHCs and SLHCs that may have issued SEC-registered securities and that purpose is lost where the SEC Disqualifier applies.

These points are emphasized by the application of the Policy Statement and Small Holding Company Exemption to SLHCs. Mutual savings associations and mutual savings banks (or their mutual holding company parent, if in that structure) have the opportunity to raise capital through conversion to stock form (or a minority offering by a mutual holding company). Most of these institutions are typical community institutions. The legal restrictions on various types of lending by federal savings associations and the application of the Qualified Thrift Lender Test to savings associations, and state savings banks that opt for the SLHC structure, require that the portfolios of such institutions be heavily weighted in residential mortgage-related investments. The mere fact that such an institution converts to stock form by issuing SEC-registered securities rarely results in an increase in the complexity of the company's business; such SLHCs and their depository subsidiaries typically remain community banking organizations with non-complex operations.

Additionally, while it is certainly true that BHCs and SLHCs with SEC-registered securities must have consolidated financial statements, the effect of the SEC Disqualifier goes well beyond reporting requirements to actually limit a particular holding company's operating flexibility. This is particularly so since, as required by Section 171 of the Dodd-Frank Act, the FRB's Regulation Q now imposes equally rigorous capital requirements at the holding company level as are applicable to the subsidiary depository institutions. This was not the case when the SEC Disqualifier was adopted in 2006, when holding company capital requirements were less stringent than those applicable to the institutions. This makes even more pronounced the adverse effect of the SEC Disqualifier on companies disqualified for that reason.

Also, placing generally similarly-situated holding companies under differing sets of regulatory capital requirements may create unintended competitive disparities. A BHC that has issued a "material" amount of SEC-registered securities is subject to more stringent regulatory capital requirements than a privately held BHC of similar size in the same market that qualifies for the Small Holding Company Exemption. We do not believe any such competitive disadvantage is justified by the presence of an SEC-registered offering.

Both the Policy Statement and the Small Holding Company Exemption provide the FRB with authority to eliminate applicability of the Policy Statement and apply the capital requirements to a BHC or SLHC of any size if deemed necessary. In addition, the Qualitative Requirements concerning nonbanking and off-balance sheet activities adequately cover BHCs and SLHCs that may meet the size threshold but have unusually

complex activities at the holding company level. We are therefore unsure what purpose the SEC Disqualifier continues to serve. While we recognize that the definition of a "material" amount of SEC-registered securities may have been intentionally left open to interpretation by the FRB and by a Federal Reserve Bank supervisory staff, that still leaves the possibility that a narrow or mechanical interpretation may result in BHCs and SLHCs losing the benefit of the Small Holding Company Exemption in situations where there is no sound policy basis for that result. In addition, we believe that the vagueness of the "materiality" language causes considerable confusion among holding companies that meet the size threshold but have SEC-registered securities outstanding as to whether or not they may rely on the Small Holding Company Exemption. Consequently, we urge the FRB to rescind the SEC Disqualifier as unnecessary in light of subsequent developments since its adoption.[1]

If the FRB determines that it is inadvisable to rescind the SEC Disqualifier at this time, the FRB should issue a much needed clarification. One means of providing clarification would be for the Policy Statement to confirm that BHCs and SLHCs that meet the asset size threshold and would otherwise qualify under the Policy Statement and Small Holding Company Exemption may rely upon both, even if they have issued SEC-registered securities, unless and until instructed otherwise by the FRB or by a Federal Reserve Bank. In the alternative, the Policy Statement could rely on existing SEC rules for determining what is a material amount of securities registered for purposes of providing regulatory relief to smaller companies, and provide for a regulatory presumption that a holding company that qualifies as a "smaller reporting company" (generally, a company that has less than $75 million in public float measured as of the end of the second quarter of the company's fiscal year) does not have a "material" amount of securities registered with the SEC and therefore qualifies for the Small Holding Company Exemption, unless the FRB determines otherwise for supervisory reasons. Every company that has securities registered with the SEC self designates whether it qualifies as a "smaller reporting company" for SEC registration purposes (the cover page of the annual report on Form 10-K requires the company to check a box to indicate if it is a smaller reporting company), which would allow a standard mechanism for indicating qualification for the Small Holding Company Exemption. The SEC has determined that registered companies with public float of less than $75 million are small businesses and should have available to them a streamlined disclosure framework that is designed reduce compliance costs and improve the ability of small businesses to obtain financing through the public capital markets, which purposes are consistent with those underlying the Policy Statement.

[1] Public Law113-250 mentions the SEC Disqualifier in directing the FRB to adopt regulations increasing the threshold for applicability of the Policy Statement to $1 billion. However, nothing in the statute constrains the authority of the FRB to modify or interpret the Qualitative Requirements as deemed necessary.

The regulated clarification could be made in the final rule that results from the Proposed Rule, or in the preamble to that final rule. This approach would alleviate the confusion as to the applicability of the Small Holding Company Exemption, which is likely to be compounded by the expansion of the Small Holding Company Exemption to include SLHCs and larger BHCs more likely to have issued SEC-registered securities.

Thank you for the opportunity to submit these comments.

Very truly yours,

Luse Gorman

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