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November 7, 2005

Jennifer J. Johnson, Secretary  
Board of Governors  
Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Re: Regulation Y; Docket No. R-1235; Capital Adequacy Guidelines for Bank Holding Companies; Small Bank Holding Company Policy Statement; Definition of a Qualifying Small Bank Holding Company

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)<sup>1</sup> appreciates the opportunity to comment on a proposal by the Board of Governors of the Federal Reserve System (the "Board") to raise the asset size threshold and revise the other criteria for determining whether a bank holding company ("BHC") qualifies for the Board's Small Bank Holding Company Policy Statement<sup>2</sup> (the "Policy Statement") and an exemption from the Board's risk-based and leverage capital adequacy guidelines for BHCs<sup>3</sup> (the "Capital Guidelines").

### **ICBA's Position**

While ICBA strongly supports the Board's proposal to raise the asset size threshold from \$150 million to \$500 million for determining whether a BHC would qualify for the Policy Statement and an exemption from the Capital Guidelines, we urge

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<sup>1</sup> *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

*With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than \$631 billion in insured deposits, \$778 billion in assets and more than \$493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org)*

<sup>2</sup> Regulation Y, Appendix C

<sup>3</sup> Regulation Y, Appendices A and D)

the Board to raise the threshold further to \$1 billion. We believe it is not until a BHC reaches the \$1 billion asset level that it has the necessary access to equity markets to enable it to finance an acquisition with a lower proportion of debt-to-equity. The ICBA-backed “Community Banks Serving Their Communities First Act” (H.R. 2061) introduced by Rep. Jim Ryun (R-Kansas) provides for raising the asset threshold to \$1 billion.

We also support a longer transition period for the treatment of trust preferred securities and would recommend that the grandfather date for trust preferred securities be moved to the date the final rule is issued. We strongly support the Federal Reserve’s plans to revise the FR Y-9 reports so that qualifying small BHCs can continue filing streamlined regulatory reports.

## **Background**

The Board issued the Policy Statement in 1980 to facilitate the transfer of ownership of small community-based banks in a manner that is consistent with bank safety and soundness. The Board adopted the Policy Statement to permit the formation and expansion of small BHCs with debt levels that are higher than what would be permitted for larger BHCs.

Currently, the Policy Statement applies to BHCs with pro forma consolidated assets of less than \$150 million that (1) are not engaged in any nonbanking activities involving significant leverage; (2) are not engaged in any significant off-balance sheet activities, and (3) do not have a significant amount of outstanding debt that is held by the general public. Under the Policy Statement, qualifying small BHCs may use debt to finance up to 75% of the purchase price of an acquisition (that is, they may have a debt-to-equity ratio of up to 3:1) but are subject to a number of ongoing requirements. The principal ongoing requirements are that a qualifying small BHC (1) reduce its parent company debt in such a manner that all debt is retired within 25 years of being incurred; (2) reduce its debt-to-equity ratio to .30:1 or less within 12 years of the debt being incurred; (3) ensure that each of its subsidiary insured depository institutions is well capitalized; and (4) refrain from paying dividends until such time as it reduces its debt-to-equity ratio to 1.0:1 or less. The Policy Statement also specifically provides that a qualifying small BHC may not use the expedited applications procedures or obtain a waiver of the stock redemption filing requirements applicable to BHCs under the Board’s Regulation Y unless the BHC has a pro forma debt-to-equity ratio of 1.0:1 or less.

## **The Proposal**

The Board proposes to increase the asset size threshold for qualifying small BHCs in the Policy Statement from \$150 million to \$500 million in pro forma consolidated assets. The Board also wants to amend the other qualifying criteria so that a BHC with less than \$500 million in consolidated assets would not qualify for the Policy Statement if the BHC (1) is engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (2) conducts significant off-balance sheet activities, including securitizations or managing or administering assets for third parties, either directly or through a nonbank

subsidiary; or (3) has a material amount of debt or equity securities (other than trust preferred securities) outstanding that are registered with the SEC. The Board believes that only a few BHCs with consolidated assets of less than \$500 million would meet any of these criteria.

Trust Preferred Securities. As for the treatment of subordinated debt associated with trust preferred securities, the Board is proposing that it be considered debt for purposes under the Policy Statement. Specifically, such subordinated debt would be included as debt in determining whether (1) a qualifying small BHC's acquisition debt is 75% or less of the purchase price; or (2) a qualifying small BHC's debt-to-equity ratio is greater than 1.0:1 (the ratio above which a qualifying small BHC is subject to dividend restrictions and is not permitted to use the expedited applications processing procedures or obtain a waiver of stock redemption filing requirements under Regulation Y). However, in order to provide for more equitable treatment between qualifying small BHCs and larger BHCs that are subject to the regular BHC capital guidelines, a qualifying small BHC may exclude from debt an amount of subordinated debt associated with trust preferred securities equaling up to 25% of a small BHC's equity, less parent company goodwill in determining compliance with these requirements.

In addition, in order to give qualifying small BHCs time to conform their debt structures to the new rule, the Board is proposing to provide for a five-year transition period during which subordinated debt associated with trust preferred securities issued on or prior to the publication date of the proposal (e.g., September 8, 2005) would not be considered debt under the Policy Statement. However, in the event that a qualifying small BHC issues additional subordinated debt associated with a new issuance of trust preferred securities after September 8, 2005, the temporary non-debt status of all the qualifying small BHC's existing subordinated debt associated with trust preferred securities would be terminated.

Reporting by Small BHCs. Currently, small BHCs that qualify under the Policy Statement can file limited summary parent-only financial data semiannually on form FR Y-9SP with the Federal Reserve in lieu of consolidated quarterly reports on Form FR Y-9C and a parent only annual report on Form FR Y-9LP. The Board is proposing that this be continued for those BHCs that would qualify under the proposed rule and plans to propose for comment revisions to the FR Y-9 series of reports for 2006.

### **ICBA's Position**

**ICBA strongly supports the Board's proposal to raise the asset size threshold from \$150 million to \$500 million for determining whether a BHC would qualify for the Policy Statement and an exemption from the Capital Guidelines.** Over the years, ICBA has consistently supported that position. For instance, we submitted a petition to the Federal Reserve in 1989 and a comment letter in 1996 urging the Board to revise the Policy Statement to define small bank holding companies as those whose assets totaled \$500 million or more, rather than the outdated \$150 million. In addition, we also recommended the debt-to-equity ratio threshold of 1:1 be increased to 3:1.

ICBA agrees with the Board that since 1980 when the Policy Statement was first issued, inflation, industry consolidation, and the normal asset growth of BHCs have caused the \$150 million threshold to lose much of its relevance. **However, in order to truly represent the asset size of a small BHC today, ICBA believes that the exemption should be raised to \$1 billion.** The lack of indexing for the \$150 million over the past 25 years has hindered the ability of small banks to facilitate the transfer of ownership and remain independent, rather than selling out to a larger regional BHC. Increasing the exemption to \$1 billion would improve the ability of small local institutions to sell their stock locally, keeping the financial decisions affecting the community in the local area.

Furthermore, we believe it is not until a BHC reaches the \$1 billion asset level that it has the necessary access to equity markets to enable it to finance an acquisition with a lower proportion of debt-to-equity. BHCs with assets of between \$500 million and \$1 billion are usually not followed closely by securities analysts and have only a limited market for their stock and a limited ability to raise equity in the capital markets. The issuance of trust preferred securities, for instance, is generally their best and sometimes their only method of raising capital. The ICBA-backed “Community Banks Serving Their Communities First Act” (H.R. 2061) introduced by Rep. Jim Ryun (R-Kansas) provides for raising the asset threshold under the Policy Statement to \$1 billion.

With respect to amending the other qualifying criteria, we support the Board’s proposal that if a small BHC is engaged in nonbanking activities involving significant leverage, conducts significant off-balance sheet activities, or has a material amount of debt or equity securities (other than trust preferred securities) outstanding that are registered with the SEC, then it should be disqualified from using the Policy Statement. However, we expect that few BHCs with less than \$500 million in assets will be disqualified.

As for the treatment of trust preferred securities, we agree that the debt associated with the use of trust preferred securities should be considered debt for purposes of the Policy Statement, subject to the exclusion for up to 25% of a small BHC’s equity. **However, we would support a longer transition period than five years for the treatment of debt associated with trust preferred securities. We would urge the Board to have a ten year transition period so that small BHCs would have more time to conform their debt structure to the new rule. We would also suggest that the grandfather date (e.g., the date after which debt associated with trust preferred securities issued after that date would be considered debt for purposes of the Policy Statement) not be September 8, 2005, the date of publication of the proposed rule, but instead be the date that the rule becomes final.**

**We also support the Federal Reserve’s plans to revise the FR Y-9 series of reports so that small BHCs that meet the criteria for using the Policy Statement would be exempt from filing the FR Y-9LP and the FR Y-9C.** One of the significant benefits of the Policy Statement to a BHC is the streamlined regulatory reporting requirements and we would hope that benefit would continue if the new rule is adopted.

Qualifying small BHCs should not have to file consolidated financial data on the FR Y-9C quarterly.

### **Conclusion**

While ICBA strongly supports the Board's proposal to raise the asset size threshold from \$150 million to \$500 million for determining whether a BHC would qualify for the Policy Statement and an exemption from the Capital Guidelines, we urge the Board to raise the threshold further to \$1 billion. We believe that BHCs up to \$1 billion have a limited ability to raise equity in the capital markets and therefore need to be able to finance acquisitions with higher debt levels than larger banks. We also support a longer transition period for the treatment of trust preferred securities and would recommend that the grandfather date for trust preferred securities be moved to the date the final rule is issued. We strongly support the Federal Reserve's plans to revise the FR Y-9 reports so that qualifying small BHCs can continue filing streamlined regulatory reports.

ICBA appreciates the opportunity to comment on the proposal to amend the Small Bank Holding Company Policy Statement. If you have questions or need any additional information, please do not hesitate to contact me at 202-659-8111 or at [Chris.Cole@icba.org](mailto:Chris.Cole@icba.org).

Sincerely,



Christopher Cole  
Regulatory Counsel