BALCH & BINGHAM LLP

B&B REVIEW

Financial Services and Transactions

WHEN RAISING CAPITAL, KEEP IN MIND THE RULES ON 'CONTROL' OF A BANK

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INTRODUCTION

There is increasing interest in private equity (PE) investments in banks. The FDIC recently proposed new restrictions on PE acquisitions of failed banks, which were criticized by many as too stringent. A less onerous version may be forthcoming.

However, the FDIC also recently approved the acquisition of a family of failing banks in Georgia that avoided the proposal's restrictions, demonstrating some flexibility on the agency's part.

Many banks not in danger of failing are also under some pressure, internal and external, to raise capital.

With all this interest in raising new capital, it is important to keep in mind the rules regarding "control" of banks. There are several federal laws designed to ensure that banking supervisors know and approve of exactly who does control or could control banks. Knowing the rules in advance could help avoid misunderstandings with regulators and investors alike.

BANK HOLDING COMPANY STATUS

Under the Bank Holding Company Act (BHCA), a "company" cannot own more than 25% of any class of *voting* securities without becoming a regulated "bank holding company". Therefore, the first rule to observe when raising capital from a "company" is the 25% threshold for becoming a bank holding company arising from voting stock ownership.

The BHCA does not, however, impose a limit on ownership of *nonvoting* equity. The Federal Reserve Board has permitted a company to acquire up to one-third of the total equity of an organization without becoming a bank holding company, so long as the shares were a combination of voting and nonvoting shares and had not in fact acquired a controlling influence over management or policies of the bank.

CHANGE IN BANK CONTROL ACT

Separately from the BHCA, the Change in Bank Control Act (CBCA) requires that any party (whether or not a "company") seeking to acquire 25% or more of a class of voting securities of a bank must give notice to the appropriate federal banking regulator at least 60 days prior to the acquisition.

In addition, the CBCA provides that "persons" (again, not just "companies") seeking to acquire the power to vote 10% or more of a class of voting securities are *presumed* to have acquired control in certain circumstances and unless the presumption can be rebutted will be subject to various restrictions. In certain cases, the CBCA requires the acquiring party to file a change in control advance notice with banking regulators or to rebut the presumption of control.

In particular, control issues can arise when two or more persons simultaneously acquire equal percentages of 10% or more of a bank's voting securities, whether or not they are otherwise related. Moreover, persons who are deemed to be "acting in concert" will have their interests in a bank aggregated so that they can be regulated under the CBCA as controlling a bank.

Compliance with the CBCA requires considerable work and communication with investors, so banks raising capital should be aware of its presumptions as to control and the methods of rebutting those presumptions.

Moreover, the CBCA might also require that notices be given in advance of a proposed acquisition of voting stock for purposes of providing the regulators the opportunity to

approve or disapprove of the proposed investment. Negotiations with potential investors should take such notice requirements into account.

ACTING IN CONCERT

If a group of "persons" (individuals and legal entities) knowingly participate in a joint transaction with a common goal of acquiring control of a bank, then they are considered to be acting in concert and subject to the CBCA's restrictions. No express agreement is required.

Banks often raise capital from unrelated investors at the same time. When this occurs, the banking regulators will evaluate the facts and circumstances and determine whether those persons are in fact acting in concert. Therefore, if potential acquirers simultaneously purchasing shares of a bank or bank holding company do not intend to act in concert, they should make a complete showing in a notice of the specific facts and thoroughly explain why they are not acting in concert. An acquiring party seeking to establish that no concerted action is occurring may also be asked to provide an affidavit supporting this position.

MEMBERS OF AN IMMEDIATE FAMILY

There are special concerns when capital is raised from members of the same family, including where shares are acquired at different times. Members of an "immediate family" are presumed to act in concert.

"Immediate family" includes a person's father, mother, stepfather, stepmother, brother, sister, stepbrother, stepsister, son, daughter, stepson, stepdaughter, grandparent, grandson, granddaughter, father-in- law, mother-in-law, brother-in-law, sister-in-law, son-in-law, daughter- in-law, the spouse of any of the foregoing, and the person's spouse.

Many times individuals may be related to one another closely enough to be considered "immediate family" under the above definition, but in reality have no intention to be "acting in concert". If family members do not believe they are acting in concert, they should be prepared to show that individual family members have the legal capacity and funds to make independent investments and that family members are not engaged in a knowing participation or joint activity towards a common goal of exercising control of the bank in question.

CONCLUSION

As much as banking regulators might be urging that banks raise new capital, they must do so within the confines of existing rules on control of banks. Failure to follow these rules could result in fact-finding among extended family members at a minimum and onerous compliance issues and regulatory sanctions as well.

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