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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Small Bank Holding Company Policy Statement

The Federal Reserve Board has raised the asset size threshold for determining the applicability of its Small Bank Holding Company Policy Statement to $1 billion from $500 million and to expand the scope of the Policy State to include savings and loan holding companies that also meet its Policy Statement. For purposes of the Policy Statement, the board treats subsidiary savings associations of savings and loan companies as if they were banks. The Board last raised the asset limit in 2006 when it increased it from $150 million to $500 million. The board recognizes that small bank holding companies have less access to equity financing than larger bank holding companies, and that the transfer of ownership of small banks often requires the use of acquisition debt. Accordingly, the Board adopted the Policy Statement to permit the formation and expansion of small bank holding companies with debt levels that are higher than typically permitted for larger bank holding companies.

The Policy Statement applies to bank holding companies with pro forma consolidated assets of less than $1 billion that (i) are not engaged in significant nonbanking activities either directly 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, and (iii) do not have a material amount of debt or equity securities outstanding, other than trust preferred, that are registered with the Securities and Exchange Commission (the foregoing three items are referred to by the Board as the "Qualitative Requirements").

Under the Policy Statement, bank holding companies that meet the Qualitative Requirements may use debt to finance up to 75 percent of the purchase price of an acquisition, but are subject to certain ongoing requirements. The principal ongoing requirements are that a qualifying small bank holding company (i) reduce its parent company debt in such a manner that all debt is retired within 25 years of being incurred, (ii) reduce its debt-to-equity ratio to .30:1 or less within 12 years of the debt being incurred, (iii) ensure that each of its subsidiary insured depository institutions is well capitalized, and (iv) refrain from paying dividends until such time as it reduces its debt-to-equity ratio to 1.0:1 or less.

Under the Policy Statement, small bank holding companies and savings and loan holding companies would no longer be required to file quarterly reports but would file parent only financial statements (the FR Y-9SP) reflecting a significant reduction in regulatory burden.

For small bank holding companies and savings and loan holding companies that meet the requirements of the Policy Statement, this will be a significant advantage since they will only be tested for regulatory capital at the subsidiary bank level and not on a consolidated basis. The Policy Statement is scheduled to become effective March 31, 2015.

Due Diligence

In the financial sector, due diligence is a term that has been used and defined in many ways, but the best meaning of it is the level of judgment, care, prudence, determination, and activity that a person would reasonably be expected to do under particular circumstances. Due diligence involves exercising the degree of care in investigating a matter by verifying facts in order to eliminate unknown risks.

The origin of the term due diligence came about following the passage of the Federal Securities Act of 1933 which afforded a defense to persons selling securities when accursed of inadequate disclosure of material information to investors. As a result, persons selling securities to the general public, such as broker/dealers, instituted a standard practice of conducting due diligence investigations into the company having a stock offering in order to protect themselves from nondisclosure of material information. Although the term was originally limited to public offerings of stock, it has now become associated with all types of investigations.

The purpose of exercising due diligence is to cut down the risk to a manageably small level. A considerable measure of judgment is involved, not only in deciding what to do, but in determining the level of investigation into a particular matter.

Due diligence investigations frequently arise in a number of different contexts. These include (i) acquiring a company, (ii) loaning monies to a company, and (iii) marketing a new product. For instance, in the acquisition of a company, a careful analysis of the target company would involve an analysis of financial statements, environmental reports on real estate, existing contracts, pending litigation and regulatory proceedings and a review of contingent liabilities not reflected on the financial statements.

In loaning money to a company, due diligence would involve reviewing the business plan of the company, analysis of financial statements, possible environmental issues if real estate is involved, and making sure that the lender is the first lienholder on any collateral for the loan.

Due diligence in marketing a new product may involve such things as whether the product would infringe upon the rights of other similar products and whether a patent or trade mark is available for the new product.

In connection with the issuance of stock by a company, due diligence is a requirement on the part of the company as the issuer to insure that the offering does not misstate or omit material information to a prospective purchaser of its securities. To some degree, due diligence is involved in the day-to-day activities of everyone as they relate to a purchase of a car or home such as obtaining an appraisal, inspections and making sure that everything works.

In more complicated transactions, the due diligence will take place between the time of the signing of an agreement outlining the terms of the transaction, sometimes referred to as a letter of intent, and the execution of a definitive agreement which sets forth, among other things, the representations and warranties of the parties to the transaction. Due diligence reduces the risks by ensuring the creditability and accuracy of information.