

Dodd-Frank Act Significantly Changes Bank Holding Company Capital Requirements

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The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) will have significant effects on the capital requirements for bank holding companies.

The Dodd-Frank Act, signed by President Obama on July 21, 2010, will bring wide-ranging changes to U.S. financial regulations. Under one important provision, the so-called “Collins Amendment” to the Dodd-Frank Act, U.S. bank holding companies, including U.S. intermediate holding companies of foreign banking organizations, thrift holding companies and systemically important nonbank financial companies, will face increased capital requirements and will no longer be permitted to treat trust preferred securities as an element of Tier 1 capital. The Dodd-Frank Act will also result in new capital requirements intended to address systemically risky activities applicable to all insured depository institutions, depository institution holding companies and systemically important nonbank financial companies. Implementing regulations must be issued no later than January 21, 2012.

Establishment of Minimum Leverage and Risk-based Capital Requirements

The Collins Amendment directs federal banking regulators to establish minimum leverage and risk-based capital requirements to apply to insured depository institutions, bank and thrift holding companies and systemically important nonbank financial companies. These capital requirements must not be:

- less than the generally applicable risk-based capital requirements and the generally applicable leverage capital requirements; and
- quantitatively lower than the above requirements that were in effect for insured depository institutions as of July 21, 2010.

The Collins Amendment defines “generally applicable risk-based capital requirements” and “generally applicable leverage capital requirements” to mean the risk-based capital requirements and minimum ratios of Tier 1 capital to average total assets, respectively, established by the appropriate federal banking agencies to apply to insured depository institutions under the prompt corrective action provisions of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure. Consequently, the Collins Amendment applies to bank and thrift holding companies and to systemically important

nonbank financial companies the risk-based capital requirements and leverage capital requirements that currently apply to insured depository institutions.

Exclusion of Trust Preferred Securities from Regulatory Capital

Another key consequence of the Collins Amendment is to exclude trust preferred securities from the regulatory capital of bank holding companies with assets of \$500 million or more. Many bank holding companies utilize this type of capital at the holding company level, so the exclusion of trust preferred securities from regulatory capital will likely require many bank holding companies to seek replacement capital. To mitigate the effect of the new measure, the elimination of trust preferred securities from regulatory capital will have a transition period; for bank holding companies and systemically important nonbank financial companies, any "regulatory capital deductions", which presumably includes trust preferred securities, for debt or equity issued before May 19, 2010 will be phased in from January 1, 2013 to January 1, 2016. Trust preferred securities issued before May 19, 2010 by bank holding companies with assets of less than \$15 billion as of year-end 2009 may be included for purposes of calculating regulatory capital.

While many institutions have trust preferred securities with maturity dates which extend beyond the phase-in dates, loss of Tier 1 capital treatment is a common event which generally triggers early redemption rights at the option of the issuing institution. Issuers of trust preferred securities would be well advised to immediately review the terms of the trust agreement and other issuing documents to determine whether early redemption rights are triggered. Institutions which have issued securities under the Troubled Asset Relief Program (TARP) should note that TARP-preferred securities are exempt from the Collins Amendment.

Ramifications for Intermediate U.S. Holding Companies of Foreign Banks

A common organizational structure of foreign-owned banks in the U.S. is for a foreign parent banking organization to own its domestic U.S. banks through an intermediate bank holding company (IHBC). Domestic IHBC subsidiaries of foreign banking organizations have in the past been able to rely on the exemption from the Federal Reserve's capital adequacy guidelines under Supervision and Regulation Letter SR-01-1 (January 5, 2001) where the group had attained the status of a "financial holding company." By requiring that bank holding companies hold the same amount and same type of leverage and risk-based capital that is required of an insured depository institution, the Dodd-Frank Act ends the ability of an IHBC to rely on this exemption. For foreign-owned IHBCs, the U.S. risk-based capital and leverage capital requirements and the other requirements of the Collins Amendment for debt or equity issued before May 19, 2010 will take effect in July 2015. These capital requirements are not applicable to the foreign parents of the IHBC.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

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