

Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework

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Vice Chair for Supervision Randal Quarles' announcement that the Federal Reserve is re-examining its framework for making control determinations under the Bank Holding Company Act is a welcome development. In critiquing the control framework, which has developed piecemeal over decades, Vice Chair Quarles called it "complex and occasionally opaque" and noted that its "practical determinants . . . are now quite a bit more ornate than the basic standards set forth in the statute and in some cases cannot be discovered except through supplication to someone who has spent a long apprenticeship in the art of Fed interpretation." For those in the room, he joked in an ad lib comment that the apprenticeship was like that of a "shaman to novice." The serious point behind the jokes is that the Federal Reserve's control determinations have become unmoored from the statutory language and legislative history.

Control—and in particular the part of the control definition relating to "controlling influence"—subjects the investor to the full glory of the Bank Holding Company Act, including its activities restrictions and compliance norms. Any company considering an investment in a bank or BHC must try to divine whether the Federal Reserve would find it to have a controlling influence over the bank or BHC as a result of the transaction, meaning that the acquirer itself would become a BHC, with all the attendant regulatory consequences. Likewise, when a BHC, including a foreign BHC, seeks to invest in a non-bank company, that company must evaluate whether it runs the risk of being deemed a subsidiary of the BHC by the Federal Reserve, and thus subject to the BHC Act's activities restrictions and other regulatory consequences. In recent years, the controlling influence standards have blocked investment in the banking sector, have been a brake on banking organization investment in financial technology and have complicated compliance with the Volcker Rule, especially in the international context.

To say that the control framework is "ripe for re-examination" is an understatement. Many of the precedents in this area are not public, and a number are unwritten, communicated only in discussions with Federal Reserve staff. This leads to a time-consuming and often unpredictable regulatory review process for proposed investments, particularly when a firm or its counsel does not have experience with this oral tradition. A more efficient, transparent and simple approach to BHC Act control determinations would produce important benefits for banking organizations and investors alike as well as reduce burdens on Federal Reserve staff.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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