

MEMORANDUM

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FROM: Financial Institutions Group  
Powell, Goldstein, Frazer & Murphy LLP

DATE: December, 2002

RE: Structure Alternatives for a New Bank or Bank Holding Company

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The purpose of this memorandum is to describe the various structure alternatives available to you in organizing a bank or bank holding company. This memorandum will describe each structure and, in general terms, discuss the regulatory applications required and securities law implications.

Whether or not you choose to have a holding company, you will need to determine what type of bank you plan to organize:

- State bank regulated by the applicable state regulator, which this memorandum refers to as the Department of Banking and Finance (“DBF”),
- National bank regulated by the Office of the Comptroller of the Currency (“OCC”), or
- Thrift/savings and loan association regulated by the Office of Thrift Supervision.

There are benefits to each type of charter and your decision will probably be based on your business plan for the bank and, to some extent, on the reception you receive from the regulators. For purposes of this memorandum, we have assumed that you will be organizing a state bank<sup>1</sup>. Additionally, no matter which charter you choose, the FDIC will review the bank’s charter application, which also serves as the bank’s application for federal deposit insurance.

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<sup>1</sup> For national banks, the OCC has adopted the SEC’s rules. As a result, the timeframes under the securities laws are essentially the same.

## **BANK ONLY (NO HOLDING COMPANY)**

In the past, many groups organized a holding company at the same time as they organized the bank because to organize the holding company later entailed significant expense. Recently, we have seen a trend toward organizing a bank without a holding company because it is now significantly less expensive to organize a holding company two or three years later than it used to be. Organizing a holding company at the outset is still the least expensive in up-front costs, but can also increase year-to-year costs without a corresponding benefit.

## **REGULATORY APPLICATIONS**

From a regulatory standpoint, the process of organizing a bank with the DBF will begin with your pre-pre-filing meeting. This meeting will be informative and will give you an understanding of the process going forward. Additionally, the regulators will raise any initial concerns they have about your business plan as it is presented to them.

The next step will be to complete the application for a bank. This is a lengthy application in which you will be asked to provide demographic information regarding your proposed location, projections and biographical information for each of your organizers, directors and officers. A de novo bank and its consultants usually need at least a month to prepare the initial application. While the application is being prepared, the DBF will hold the normal pre-filing meeting, which will be attended by all of the bank's organizers. Once the application is filed, the DBF takes about three months before issuing preliminary charter approval, while the FDIC takes about four months before issuing preliminary deposit insurance approval. During that time, the DBF and FDIC will conduct a field investigation and ask for additional information.

## **SECURITIES ISSUES**

The offering circular (or prospectus) is the vehicle for you to sell the stock of the bank (or bank holding company, as the case may be). The bank will likely focus on preparing the offering circular after all regulatory applications are filed. Please refer to the memorandum regarding "Guidelines for the Release of Information When a Company's Securities are in Registration." Above all, you want to caution your organizers against running afoul of the securities laws.

Bank stock is exempt from registration with the SEC and the state securities regulators, so no filings with securities regulators are required. The DBF, on the other hand, will review the bank's offering circular, which we can have completed in about four weeks after we receive a completed charter application. The FDIC will receive the offering circular, but does not substantively review it. Once the DBF approves the offering circular, the bank may begin to sell its stock.

## TIMELINE SUMMARY

- |   |                              |
|---|------------------------------|
| • Prepare applications to file with DBF and FDIC                  | 4 – 12 weeks                 |
| • Prepare offering circular to file with DBF*                     | 4 weeks                      |
| • DBF review of offering circular                                 | 2 weeks                      |
| • Finalize offering circular, make copies and begin selling stock | 1 – 2 weeks after DBF review |

\* Assuming preparation begins when applications are complete because much of the information in the offering circular is included in the application.

As an aside, we have found that over the past few years, de novo banks have taken as little as 2 and as long as 18 months or more to sell their stock. Once the offering is complete, usually from one to 12 months pass before the bank can open for business. The length of time required usually depends on whether the bank's building is ready to be occupied, whether the bank will open in temporary space, etc. Also, during that time, the regulators conduct a pre-opening exam and review the bank's policies to be sure the bank is ready to begin operations.

## BANK HOLDING COMPANY

A holding company can provide greater flexibility than may exist without a holding company. Some of the benefits of having a holding company are:

- Ability to raise capital by means other than selling stock;
- Ability to assume debt;
- Ability to issue stock more easily;
- Ability to acquire other banks more easily; and
- Ability to organize or acquire nonbank subsidiaries that may not be suitable as bank subsidiaries.

Many of the benefits of having a holding company are not available until the bank becomes cumulatively profitable. A bank may reorganize into a holding company structure at any time (assuming it receives regulatory approval), although we suggest waiting until the bank is cumulatively profitable so that the bank will be able to pay dividends to the holding company, thereby providing it with a source of funding.

The disadvantages associated with establishing a bank holding company at the outset are as follows.

- There are additional regulatory applications and compliance.
- There are additional set-up costs compared to not having a holding company (but these costs are somewhat less compared to forming a holding company later).
- A minimum of \$100,000 to \$500,000 of additional capital will need to be raised in the offering so that the bank can be capitalized with the required amount while maintaining a little capital at the holding company level. This is necessary because the holding company will have expenses that the bank cannot pay, and the bank will not be able to pay dividends to the holding company until the bank is cumulatively profitable.
- The holding company will need to file reports (annual report on Y-6, semiannual report on Y-9, etc.) with the Federal Reserve in addition to the call reports the bank will file with the FDIC. There is a cost associated with these reports, but it should be relatively small.
- If the number of shareholders will be 300 or more, the bank holding company will be required to file reports with the SEC. Normally these reports are not required until the holding company has 500 or more shareholders. (See “Securities Issues” below.)

## **REGULATORY APPLICATIONS**

In addition to filing the charter application with the DBF and the FDIC as discussed above, when forming a holding company, the organizers file a holding company application with the Federal Reserve, with a copy to the DBF. The Federal Reserve does not begin its review of the application until the bank regulators have issued preliminary approval. The Federal Reserve’s approval is usually issued 30 days thereafter. Thereafter, an additional 15 days has to pass (the Department of Justice waiting period) before the holding company can acquire the bank.

## **SECURITIES ISSUES**

A holding company intending to sell its stock will be required to register with the SEC unless it qualifies for an exemption from registration.

Regulation D Offering. A Regulation D offering may be available as a way to avoid SEC registration. Regulation D is not actually an exemption from registration, but allows companies to sell stock to an unlimited number of “accredited investors” and up to 35 unaccredited investors. An “accredited investor” is an individual with an income level in excess of \$200,000 for the two most recent years and reasonably expects that income level in the current year (or joint income with spouse in excess of \$300,000) or net worth exceeding \$1 million. Directors and executive officers of the holding company are also considered accredited investors. A Regulation D offering (also known as a private

placement) requires a filing of a Form D with the SEC, which is a short form giving general information about the offering. The offering circular is not reviewed by the SEC. We would also need to make filings with the states in which you intend to sell securities (with some exceptions if small amounts are issued in a particular state).

Stock issued in a Regulation D offering is restricted stock. The stock will need to be held for at least one year before it can be sold to anyone. (Stock sold pursuant to an offering registered with the SEC may be freely sold at any time, except for stock held by insiders which is subject to restrictions.)

Intrastate Offering. The holding company's sale of stock would also be exempt from registration with the SEC if the holding company sold its stock only to residents of its home state. This exemption is called an "intrastate" exemption. In an intrastate offering, the company will be required to register the offering with the state's securities commission. Stock sold in an intrastate offering may be sold only to resident of the applicable state for nine months after escrow is broken. Thereafter, the stock would be freely tradable.

Registration with the SEC. If you organize a holding company and do not qualify for an exemption from registration, you will have to register the offering with the SEC. Registration with the SEC requires a registration statement that includes the offering circular as well as additional information. The SEC will review the registration statement and will provide comments approximately 30 days after receipt of the registration statement. Once the company has responded to the comments to the SEC's satisfaction, the SEC will declare the registration statement "effective" and the company can begin selling stock.

The company may begin to market its stock once it has filed its registration statement with the SEC. This means that company may send out a preliminary prospectus or red herring to prospective investors but cannot accept any subscription funds. Once the SEC declares the registration statement effective, the company may begin selling its shares and accepting subscription funds. To do so, the company will need to send a final prospectus to each investor who wishes to purchase shares. We generally recommend that the company not market its stock using a preliminary prospectus because of the duplicative printing costs. In some instances, however, being able to market the stock 45-60 days earlier in the process can be important.

If the company has more than 300 shareholders, there are significant ongoing filing requirements for a company that registers with the SEC. The company is required to file quarterly and annual reports (10-Q and 10-K) and may have greater reporting requirements depending on its size and number of shareholders. Additionally, the SEC requires these reports to be filed on an electronic system called "EDGAR." The company would need to hire a financial printer to "edgarize" the reports or purchase software that would allow it to edgarize the documents in-house. A company may, however, deregister after its initial public offering if it has been reporting for one year and has fewer than 300 shareholders.

If you choose to form a holding company, we would be able to file the registration statement before receiving preliminary approvals from the regulatory agencies so that their timeframes would run concurrently.

## TIMELINE SUMMARY (ASSUMES SEC REGISTRATION)

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|---|---|
| • Prepare application to file with DBF and FDIC                                 | 4 – 12 weeks  |
| • Prepare offering circular and registration statement to file with SEC         | 4 weeks   |
| • Prepare bank holding company application to file with Federal Reserve and DBF | 4 weeks   |
| • SEC review and comment on registration statement                              | 4 weeks   |
| • Respond to SEC comments and amend registration statement                      | 2 – 4 weeks   |
| • Finalize offering circular, make copies and begin selling stock               | 1 – 2 weeks after the SEC declares the registration statement effective |

## CONCLUSION

We think that the structure you choose depends on a number of factors. Some of the factors that will be important to consider are:

- What are the future plans for the bank?
- How quickly do you want to begin the offering process?
- How many shareholders do you expect to have?

We will be happy to discuss these issues in greater detail with you at your convenience.

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