



Independent Bankers  
Association of Texas

1700 Rio Grande Street,  
Suite 100  
Austin, Texas 78701  
ONLINE: [www.ibat.org](http://www.ibat.org)  
FAX: 512/322-9004  
512/474-6889

J. Pat Hickman  
*IBAT Chairman*  
[jph@happybank.com](mailto:jph@happybank.com)  
Happy State Bank - Happy  
Canyon

Riley C. Peveto  
*IBAT Chairman-Elect*  
[riley@gnbt.com](mailto:riley@gnbt.com)  
GNB Bancshares, Inc.  
Gainesville

James D. Lindsey  
*IBAT Vice Chairman*  
[jlindsey@firststatebank.com](mailto:jlindsey@firststatebank.com)  
First State Bank  
Mesquite

Al Jones  
*IBAT Secretary/Treasurer*  
[abjones@americanbank.com](mailto:abjones@americanbank.com)  
American Bank  
Corpus Christi

Ervan E. Zouzalik  
*Immediate Past Chairman*  
[ervan.zouzalik@statebanktx.com](mailto:ervan.zouzalik@statebanktx.com)  
State Bank  
La Grange

Christopher L. Williston, CAE  
*President & CEO*  
[cwilliston@ibat.org](mailto:cwilliston@ibat.org)

Stephen Y. Scurlock  
*Executive Vice President*  
[sscurlock@ibat.org](mailto:sscurlock@ibat.org)

Karen M. Neeley  
*General Counsel*  
[kneeley@ibat.org](mailto:kneeley@ibat.org)

Mary E. Lange  
*Senior Vice President*  
[mlange@ibat.org](mailto:mlange@ibat.org)

Jane Holstien  
*Senior Vice President*  
[jholstien@ibat.org](mailto:jholstien@ibat.org)

Ursula L. Jimenez  
*Senior Vice President*  
[ujimenez@ibat.org](mailto:ujimenez@ibat.org)

Craig Buford  
*Senior Vice President*  
[cbuford@ibat.org](mailto:cbuford@ibat.org)

July 8, 2004

***Via email: [reg.comments@federalreserve.gov](mailto:reg.comments@federalreserve.gov)***

Ms. Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street & Constitution Avenue, Northwest  
Washington, DC 20551

**RE: Docket No. R-1193**

Dear Ms. Johnson:

The Independent Bankers Association of Texas (“IBAT”) supports the proposal from the Federal Reserve to permit a reasonable level of trust preferred securities to continue to qualify as an element of tier 1 and tier 2 capital. As noted in earlier letters to the Board, IBAT believes that this particular innovative security has proven to be a cost effective, yet safe, method for raising capital and is particularly useful for community banks and their holding companies.

IBAT would also observe that it is past time for the Board to amend the guidelines for “small” bank holding companies to include all bank holding companies with assets of \$500 million or less. However, IBAT would suggest that limiting use of trust preferred securities by these small bank holding companies should be reconsidered with the trust preferred instruments up to 25% considered as equity. Please see attached previous correspondence on this issue.

Thank you for this opportunity to comment. Again, the Independent Bankers Association of Texas is appreciative of this rational approach to dealing with the accounting and capital issues relating to trust preferred securities. The Independent Bankers Association of Texas is a trade association representing approximately 600 independent community banks domiciled in Texas and Oklahoma. A number of our members are currently utilizing trust preferred securities as a component of their capital and would be adversely affected without this rule.

Sincerely,

Karen M. Neeley  
General Counsel

cc: ICBA – Chris Cole  
via fax: 202-659-3604

***“Collectively Creating Value for Community Banking”***

## PREVIOUS CORRESPONDENCE

May 26, 2000

Mr. Richard Spillenkothen  
Director  
Division of Banking Supervision and Regulation  
Board of Governors  
The Federal Reserve System  
Washington, DC 20551

RE: Policy Statement on Assessment of Financial and Managerial Factors for  
Small Bank Holding Companies

Dear Mr. Spillenkothen:

The Board of Directors of the Independent Bankers Association of Texas (“IBAT”) at its March 7, 2000 regular board meeting adopted a resolution urging the Federal Reserve Board of Governors to update the Policy Statement on Assessment of Financial and Managerial Factors for small bank holding companies to adjust the size bracket for inflation. Attached is a copy of that resolution. As Chairman of that board, I would urge your careful consideration of this request, taking into consideration the following discussion and attachments.

### **Background**

Effective in 1979, the Federal Reserve Board of Governors (“Board”) adopted the policy statement by which small bank holding companies’ formation and activities are guided today. The statement applies to bank holding companies with proforma consolidated assets of less than \$150 million that are not engaged in any non-banking activities involving significant leverage and do not have a significant amount of outstanding debt that is held by the general public. That definition of a small bank holding company has not been adjusted. The policy goes on to provide certain criteria for small bank holding company financial adequacy, including debt leverage ratios and restrictions on dividends. Capital adequacy is also addressed with each insured depository subsidiary expected to be well capitalized. Small bank holding companies are not automatically permitted to leverage acquisitions. Rather, they must demonstrate the ability to service acquisition debt without straining the capital of their subsidiaries. In addition, they must show an ability to restore their capital and serve as a source of strength for subsidiaries within a relatively short period of time. In evaluating applications, the Board takes into account a full range of financial and other information about the small bank holding company and its current and proposed subs, including recent trends and stability of earnings, past and prospective growth, asset quality, the ability to meet debt servicing requirements without placing an undue strain on the resources of the banks and their record and competency in management.

The policy states that it is adopted at least in part in the interest of continuing the Board’s policy of facilitating the transfer of ownership in banks without compromising bank safety and soundness. IBAT believes another critical underlying policy is the importance of facilitating structural changes for institutions that are and remain relatively small, posing a small to moderate risk to the safety of the financial system. In addition, we would suggest that facilitating bank holding company acquisitions furthers an additional public policy of maintaining a core of community institutions that are indeed community based both before and after the structural changes.

*“Collectively Creating Value for Community Banking”*

## **Problem**

Over the last 21 years, the \$150 million size no longer is adequate to cover a number of truly small bank holding companies. A list of these, numbering some 281, is enclosed for your perusal. Applying an inflation factor alone would indicate that the bracket should be adjusted to approximately \$344,000.

While many institutions have been acquired by super-regional or interstate banks, there are many more which are not attractive candidates to the larger institutions but which need the potential of being acquired by another community bank in the region in order to remain economically viable. Such mergers take advantage of appropriate levels of economies of scale and efficiencies that could not be accomplished by either institution alone. However, even in these scenarios, acquisitions are based on a price that is greater than the book value with some premium expected in the current market place.

Recent changes to the income tax laws of the United States have also made it possible for the first time for banks with a limited number of shareholders to act as S corporations under the tax laws. This is extremely attractive in terms of capital formation and estate tax planning for many institutions. However, many banks that could benefit from S corporation status have more than the number of shareholders currently permitted under law. Thus, in order to reorganize as an S corporation, the institution finds it necessary to buy back the stock of a certain number of shareholders to bring the total within limitations. Again, both the market place and expectations of shareholders dictate that stock is purchased at a premium in excess of book value. Furthermore, the board of directors and majority shareholders arguably owe a fiduciary duty to the minority stockholders to provide a fair price when such stockholders' interest is acquired, particularly in a squeeze-out situation such a reverse stock split through a bank holding company.

Once the institution is held as an S corporation through the small bank holding company, the institution itself is no longer responsible for paying state and federal income taxes. Rather, the shareholders themselves pay such taxes. The policy statement provides a dividend restriction for entities whose debt-to-equity ratio is greater than 1.0:1. Corporate dividends cannot be paid until the debt is reduced or permission is received from its Federal Reserve Bank. If the institution was not organized as an S corporation, clearly it would be authorized to pay its income tax liability to the federal and state governments. However, once it is reorganized, the ability to pay the taxes indirectly through the shareholders is restricted through this provision in the policy statement.

## **Solution**

IBAT respectfully suggests that after 21 years, it is time for the Board to evaluate the bracket of \$150 million and adjust it for inflation to at least \$300 million. In addition, IBAT suggests that the section restricting dividends should be amended to permit a small bank holding company organized as an S corporation to pay dividends equal to the amount of corporate state and federal income tax which the organization would otherwise be required to pay without further action on the part of the institution or the regulators. In order to have this permission, however, the small bank holding company would be required to maintain in its files, subject to examiner review, a certification from its tax accountant or attorney specifying the amount of corporate tax that would be due if the institution were a C corporation rather than an S corporation.

## **Analysis**

These adjustments, we believe, should not result in any major safety and soundness concerns for the Board. As noted above, formation with debt leverage is not automatic. Rather, critical financial factors must be satisfied related to earnings, management, asset quality, capital, and other factors. This flexibility should provide the

assurance that is necessary to appropriately evaluate these transactions without the further capital limitations imposed on larger institutions.

Furthermore, IBAT believes that this fine-tuning would promote important public policy facilitating the continued existence of community-based financial institutions serving community needs such as small business, agriculture, and agribusiness lending. Certainly, statistics in Texas indicate that these areas are primarily served by the community-based institutions rather than the super-regional or interstate banks. Such were the conclusions of a special interim study committee of the Texas Legislature in 1988 based on call report data obtained through the Department of Banking on all institutions in the state. Retaining and nurturing a vibrant community-based system of banks and small bank holding companies thus is in the best interests of the Board and the general public.

Sincerely,

/s/

Robert A. Hulse  
Chairman

Enclosure

cc: Governor Laurence Meyer  
Board of Governors  
The Federal Reserve System  
Washington, DC 20551

Bob Hankins  
Senior Vice President  
Federal Reserve Bank of Dallas  
P.O. Box 655906  
Dallas, TX 75265-5906