

## Publications

### Stock Buybacks for Banks and Bank Holding Companies

#### Related Industries

Financial Institutions

**AUTHORED ARTICLE** | Winter 2019

By **Jeffery E. Smith**

(Published in the Winter 2019 issue of *The Bankers' Statement*)

Recent changes in stock prices, capital levels and loan demand for some institutions have created an increased interest in stock buybacks. Using excess capital or borrowings to repurchase outstanding shares can provide an outlet for shares under pressure and help address shareholder concerns in appropriate instances.

According to published statistics, buyback programs in 2018 substantially surpassed those in 2017 and appear to remain on the rise indicating confidence by institutions that the long-term prospects for their shares are solid, and a willingness to take advantage of depressed prices to refill their stock coffers. Timing, price and volume are critical.

For community banking institutions concerned about an aging shareholder base and local ownership of stock, buybacks can provide a method to help avoid shares falling into unfriendly hands.

Buybacks seem simple as a concept, but can and do trigger a number of regulatory and securities laws issues. What should boards consider when looking at potential buyback programs?

#### Pricing and Terms

In all situations, the paramount consideration is the best interests of the organization and its constituencies. Sometimes short- and long-term considerations make for conflicting and complex considerations, and in all instances boards should receive input from disinterested and objective financial professionals when pricing the buyback program. Price considerations can vary significantly based on a number of factors, and pricing for the repurchase of a large block of shares can differ from that of small lots. Also, as in other situations, the board will want to carefully document their considerations in minutes of the meetings where the repurchase considerations take place and where professional presentations are provided. There is a particular challenge for non-SEC companies in establishing pricing terms, and those

considerations can be difficult in light of shareholder expectations of value.

Board considerations include establishing the number of shares to be repurchased, funding sources, securities law implications, “manipulation” issues and other legal issues such as tender offer considerations, the length of time the program will be in place, accounting treatment, any outstanding contractual commitments that might be impacted, and, of course, pricing. There are a number of very specific requirements for SEC reporting companies undertaking a buyback program.

### Securities and Insider Trading Considerations

Another important consideration is the presence of material non-public insider information concerning the issuer. Institutions, and especially non-SEC reporting companies, can have significant challenges that arise from the presence, at the issuer level, of information that is not part of the public record. This information includes potential pending regulatory and credit issues, management changes, and a host of other potentially material matters that can impact the ability of the institution to actually undertake a buyback program. A buyback program followed by an acquisition of the issuer at a higher price than was offered, even if completely unexpected, will be problematic. Likewise, a public or non-public regulatory restriction imposed on the issuer such as termination or prior approval of dividends, a significant credit issue, and a plethora of other potential matters that can adversely impact value may have remaining shareholders questioning the price paid for the repurchased shares. Board-established trading windows may likewise impact the ability of the institution to repurchase shares.

There are certain complex safe harbor opportunities for buybacks that fall within the purview of federal securities laws as well as certain exchange-based requirements. Tender offer issues may arise, as well as “going private” issues. Repurchased shares, whether held in treasury or as authorized but unissued shares, require registration or an exception from registration if they are resold or reissued. Resales of repurchased shares are treated as new issuances by the issuing institution.

Institutions considering buybacks should consider consulting with legal counsel regarding securities laws as well as other implications of buyback activities.

### Bank Stock Buybacks

Bank stock buybacks can be a complicated process. Stock redemptions are considered reductions in capital by the OCC, and as a result national banks are required to secure the approval of the OCC as well as two-thirds of their shareholders prior to commencing a buyback program, and that approval is only good for a period of one year.

State banking laws and regulations may also apply to buybacks by state-chartered banks, and may impose similar requirements. Ohio requires compliance with general Ohio corporate law in regard to buybacks, as well as prior written approval of the Superintendent of Financial Institutions and compliance with whatever restrictions the Superintendent may impose. State banks will also need to consult with the Federal Reserve or the FDIC depending on whether they are state member or non-member institutions.

## Holding Company Buybacks

Holding company buybacks can be somewhat less complex from a bank regulatory perspective, provided the holding company meets certain criteria. Holding company stock redemptions require compliance with applicable state and federal corporate and securities laws and regulations (and listing exchange rules for public issuers), but only involve regulatory approvals in certain instances. Under the “source of strength” doctrine in Federal Reserve Regulatory Y (12 CFR 225.4(b)), holding companies are permitted to repurchase shares without prior FRB approval when the holding company is “well-capitalized” both before and after the proposed redemption, well-managed, and not the subject of any unresolved supervisory issues. If the institution does not meet these criteria, it is required to provide prior written notice to the FRB if the gross consideration (when aggregated with the net consideration paid for all repurchases and redemptions during the preceding 12 months) is equal to 10 percent or more of the company’s consolidated net worth.

Stock redemptions by holding companies are also governed by Federal Reserve SR 09-4, which was issued in 2009 primarily to address capital instruments issued by holding companies under government investment programs arising from the issues created by the recession at that time. It provides, among other things, that holding companies should consult with applicable Federal Reserve personnel before repurchasing shares when the holding company is experiencing financial weaknesses or when the repurchase would result in a net reduction as of the end of the quarter in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption occurred.

Bottom line: given the technical nature of the FRB regulations, with any proposed stock repurchase by a holding company, it is strongly recommended that the holding company discuss the proposal with its Federal Reserve representative.

## Ancillary Issues

A number of ancillary issues arise requiring consideration in a proposed redemption program. Those include a reduction in loan limits as a result of reduced capital in bank stock redemptions, and potential “change in control” issues arising from a reduction in shares outstanding when calculating “control” percentage ownership for both banks and holding companies. Governance documents must permit share repurchases, as well as the laws of the state of incorporation, and care must be taken that repurchases do not trigger issues under other contracts that may contain share repurchase restrictions. Tax ramifications should be reviewed with tax counsel. Careful consideration of all potential issues, direct and indirect, and the relative risks and rewards is appropriate before proceeding with any such program.

## Conclusions

Stock redemptions involve a number of issues for institutions, requiring careful review and consideration prior to proceeding. Regulators should be consulted early in the process, and prior regulatory approval may be required in certain situations. In all instances, involvement of a number of parties is critical and should be undertaken very early as part of the planning process in order to address relevant issues in advance. Handled incorrectly, share redemptions can result in significant potential financial, regulatory, business and reputation risk to the institution.