Why Investors Prefer Holding Companies

Bank holding companies have played a major role in the financial services industry since the Bank Holding Company Act was passed more than six decades ago. The powers under the act were expanded in 1970 to allow for multibank holding companies, as opposed to one-bank holding companies, and again in the 1990s to broaden their scope of permissible activities. This made holding companies so popular that today they control nearly all U.S. banking assets. Yet, early hints emerged in 2017 suggesting that this trend may be reversing course.

Bank of the Ozarks, a $21 billion bank based in Little Rock, Arkansas, announced in June 2017 that it had completed the merger of its holding company into its subsidiary bank. Explaining the move, Chief Executive Officer George Gleason likened its holding company to a lake house that didn’t get any use, but incurred taxes, insurance and maintenance expenses. The second was BancorpSouth Bank, a $15 billion bank based in Tupelo, Mississippi. “This decision is reflective of our continuing commitment to improve the efficiency of our operations,” said CEO Dan Rollins at the time. A third bank, Zions Bancorp, a $66 billion bank based in Salt Lake City, Utah, announced in November of last year that it would follow suit at some point this year.

It is easy to appreciate why a bank would want to shed its holding company, as doing so can eliminate two layers of regulatory oversight. In the first case, it takes a bank out from under the purview of the Federal Reserve. “As a bank lawyer, the Fed is the larger burden,” says Richard Hils, a partner at Waller Law, a law firm based in Nashville, Tennessee. “A bank holding company is a separate entity that not only is supervised and regulated by the Fed, but the holding company is also required to act as a source of strength if the bank were to get into trouble.” Additionally, there would no longer need to be two sets of directors, officers, corporate records and regulatory examinations for two separate legal entities, Hills continued.

A bank without a holding company would also no longer have to report to the Securities and Exchange Commission. Section 3(a)(2) of the Securities Act of 1933 exempts bank-issued securities from registration under the act. The exemption is based on the principle that banks are already heavily regulated and are thus presumed to provide adequate disclosures to their stakeholders even if not obligated to do so by federal securities laws. As such, “the elimination of the SEC as a regulator creates cost savings in the sense that you can avoid the time and expense associated with registering securities with the SEC,” says Waller Partner Wes Scott.

For any bank thinking about following suit, however, there are also downsides to eliminating the holding company. One of the most important is that a bank’s financial and regulatory filings would no longer be posted on the SEC’s Electronic Data Gathering, Analysis and Retrieval system, or EDGAR. This is the central clearing house for information on publicly traded companies. It is one of the first places, if not the first place, an analyst or investor will go to research current and prospective investments. There are other places to get this information, including the Federal Deposit Insurance Corp.’s website and often a company’s own investor relations webpage, but none of them are as optimized to streamline the process as much as EDGAR.

When Bank of the Ozarks stopped reporting to the SEC last year, for instance, it caught even veteran analysts by surprise. “It’s incumbent on the company to educate the marketplace that it’s three more clicks to get to the company’s investor relations website,” says Scott. It is easy to dismiss this as a trivial inconvenience, but if all other stocks make their information available on EDGAR, then a bank that chooses not to do so could find itself at a disadvantage relative to investment alternatives. It is akin in the logistics context to locating a regional wholesale facility on a country highway as opposed to the interstate. Some customers may tolerate the inconvenience, but others may choose to go elsewhere.

With bank stocks trading at such lofty heights, it is hard to imagine that this would make much of a difference. Industry observers are focused right now on the impact of rising rates and lower taxes on bank profits, neither of which requires much differentiation between banks. But this will change when the credit cycle takes a turn for the worse, at which point the market will be more discerning about the unique credit profiles of individual banks. It is at that point that a bank will benefit more noticeably from having the ability to efficiently communicate with analysts and investors.

In short, given the acute and duplicative nature of bank regulations, the thought of abandoning the holding company structure can seem compelling. But the decision of whether to do so should take into consideration, among other things, the long-term impact of making the research process less convenient for current and prospective shareholders.

John J. Maxfield is a freelance writer and contributor to Bank Director magazine.