

Capital Planning for the New Year

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In 2024, a number of banks were taking the overall strategic approach of “Survive till ’25.” As part of that overall philosophy, there became a growing focus on strategically planning for capital needs for banks and holding companies and how capital can be a key resource for both surviving and thriving. As we move into 2025, therefore, it is important for the board to understand some of their options as it relates to capital planning.

As community bankers fully understand, community banks must operate with certain minimum levels of capital to satisfy the regulators. The real issue with capital, however, is what does the future hold, and what does the bank need as it relates to capital? Is there a known need that the bank can currently identify as it relates to capital (i.e., anticipated significant asset growth, an acquisition of a bank, an acquisition of a branch, or another line of business)? Is there an unknown but anticipated need for capital for the future, such as the death of a large shareholder or the buyout of a disgruntled shareholder? Is there a need to streamline or right size for the shareholder base? Is there something similar?

An overarching focus of capital planning for the new year should also be in the context of overall enterprise risk management, which seems to be a new focus for regulators. Part of that analysis begins with a focus on the overall risk profile of the bank and holding company, and that focus necessarily is highlighted by discussing and reviewing the board’s overall risk tolerance. Candidly, it does not matter if you meet the definition of “well capitalized.” If regulators believe your risk profile is too high, they have and will demand more capital. So as organizations contemplate plans for the new year and focus on the need for capital, the long-term thinking also needs to include how best the holding company or bank obtains that capital. During these conversations, the first recommendation is typically to utilize your bank holding company for one of the key benefits that it provides, which is borrowing funds and incurring that debt at the holding company level and down streaming the cash to the bank to increase overall capital ratios. Generally speaking, bank holding companies can typically easily borrow 50% of their capital value, provided they can show a reduction in debt to equity to less than 30% in 12 years.

Many bank holding companies use a borrowing strategy or even the establishment of a line of credit that is drawn on occasionally to maintain the appropriate capital levels at the bank for risk management purposes. Many banks will default to a minimum capital ratio of 8.5% or 9.0% and utilize bank holding company borrowings to maintain that, as both smart capital planning and to keep the regulatory agencies happy. However, if a community bank holding company is going to use leverage

to put capital in the bank, it should leave it there, at least for some period of time, until it is appropriate to term out the holding company debt or something else occurs at the bank level (such as asset shrinkage, substantially increased earnings, etc.) that would no longer make the injection of capital necessary. Capital needs of the community bank

may extend beyond the ability to leverage the holding company or a board may be generally debt averse. In those circumstances, it generally requires the community bank holding company board to contemplate whether some type of stock offering to existing stockholders or to new stockholders may be appropriate. The beginning of the year is often a good time to engage the board to determine if there is more interest from the board or existing stockholders to purchase more shares or whether an offering in the community to new stockholders might be appropriate. These are both ways to raise capital and potentially generate interest in the organization. However, the typical recommendation is to get as much new capital as possible from the fewest number of people to reduce the time and cost of obtaining the new capital. Federal and state security laws and regulations must also be considered when offering shares either internally or externally.

So in 2025 make capital planning part of your organization’s overall strategic planning and consider the wide range of options of everything from a public offering of stock in the bank’s community, to simply utilizing the holding company (or forming a holding company if the bank does not have one) to provide capital injections to the bank to meet the board’s risk tolerance levels and keep the regulators satisfied.



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