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Abstract: This paper is the first to show that financial institutions may be effectively undercapitalized as a result of incomplete consolidation of minority ownership. Using two approaches – consolidating the minority-owned affiliates with the parent or deducting equity investments in minority ownership from the parent's capital – we find that the effective capitalization ratios of small US bank holding companies (BHCs) are substantially lower than the reported ratios. Empirical evidence suggests that the effectively lower capitalization ratios are associated with higher riskiness at the BHC level. Capital adjustments following pro forma consolidation better capture the additional risks than capital adjustments in the form of equity deductions for investments in minority-owned affiliates. These findings have important implications for the regulation of bank capital.