FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
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ENHANCED SUPERVISORY PROCEDURES FOR NEWLY INSURED FDIC-SUPERVISED DEPOSITORY INSTITUTIONS

Summary: The FDIC is advising the banking industry of supervisory changes for state nonmember institutions insured seven years or less (de novo period). Under current policy, newly insured institutions are subject to higher capital requirements and more frequent examination activities during the first three years of operation. Based on supervisory experience, the FDIC will now extend the de novo period from the current three-year period to seven years for examinations, capital, and other requirements. In addition, material changes in business plans for newly insured institutions will require prior FDIC approval during the first seven years of operation.

Distribution:
FDIC-Supervised Institutions

Suggested Routing:
Chief Executive Officer
Chief Financial Officer
Compliance Officer

Attachment:
None

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Note:
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Highlights:

- Recent experience has demonstrated that newly insured institutions pose an elevated risk to the FDIC Deposit Insurance Fund. Depository institutions insured less than seven years are over represented on the list of institutions that failed during 2008 and 2009, with many of those failures occurring during the fourth through seventh years of operation.
- A number of newly insured institutions have pursued changes in business plans during the first few years of operation that have led to increased risk and financial problems where accompanying controls and risk management practices were inadequate.
- To address the heightened risks presented by newly insured depository institutions, the FDIC is extending the supervisory procedures for the de novo period from three to seven years.
- During the seven-year de novo period, these institutions will remain on a 12-month risk management examination cycle and be subject to enhanced supervision for Compliance examinations and Community Reinvestment Act evaluations.
- Any material change in an institution’s business plan during the de novo period also will require prior FDIC approval.
- These procedures apply to existing newly insured institutions.
- De novo institutions that are subsidiaries of existing “eligible” holding companies generally will be excluded from these procedures.

ENHANCED SUPERVISORY PROCEDURES FOR NEWLY INSURED FDIC-SUPERVISED INSTITUTIONS

Recent experience demonstrates that newly insured institutions pose an elevated risk to the Deposit Insurance Fund, particularly during an economic downturn. Depository institutions insured less than seven years are over represented on the list of institutions that failed during 2008 and 2009, with most of those failures occurring between the fourth and seventh years of operation. A number of newly insured institutions have pursued changes in business plans during the first few years of operation, which, in some cases, have led to increased risk and financial problems where accompanying controls and risk management practices were inadequate.

De Novo Period

Under current policy, newly insured FDIC-supervised institutions are subject to higher capital requirements and more frequent examination activities during the first three years of operation. The FDIC is extending its procedures for these institutions from three to seven years. This change is consistent with the deposit insurance assessment rules, which require newly insured banks generally to pay higher assessments for a period longer than three years of operation (for assessment purposes, the period is five years).

Examinations

The FDIC also is revising the visitation and examination schedules for risk management and Compliance examinations and the Community Reinvestment Act (CRA) evaluations for newly insured FDIC-supervised institutions. Specifically, for risk management, newly insured state nonmember institutions will undergo a limited-scope examination within the first six months of operation and a full-scope examination within the first 12 months of operation. Subsequent to the first examination and through the seventh year of operation, the institution will remain on a 12-month examination cycle. Extended examination intervals (i.e., 18-month intervals) will not be applied during the first seven years of operation.

For Compliance, newly chartered and insured institutions will undergo a full-scope Compliance examination and CRA evaluation within the first 12 months of operation. A visitation will occur in the second year, a Compliance-only examination in the third year, a visitation in the fourth year, and a Compliance examination and CRA evaluation in the fifth year. Thereafter, the institution may be subject to the regular examination schedule.

Business Plans

Some newly organized institutions have pursued changes in approved business plans during the first few years of operation. In certain cases, those changes led to increased risk and financial problems where accompanying controls and risk management practices were inadequate. In all cases, material business plan changes by newly organized institutions warrant more in-depth analysis to adequately assess the potential risk to the institution and the Deposit Insurance Fund.

Troubled or failed de novo institutions have demonstrated these common elements during the first seven years of operation:

- rapid growth
- over-reliance on volatile funding, including brokered deposits
- concentrations without compensatory management controls
- significant deviations from approved business plans
- noncompliance with conditions in the deposit insurance orders
- weak risk management practices
- unseasoned loan portfolios, which masked potential deterioration during an economic downturn
- weak compliance management systems leading to significant consumer protection problems
- involvement in certain third-party relationships with little or no oversight

The FDIC has been requiring de novo institutions to provide written notice of proposed changes to business plans during the first three years of operation. Going forward, deposit insurance orders for state nonmember institutions will require those institutions to obtain prior approval from the FDIC for any proposed material change or deviation in the business plan.

The request for a material change in a business plan should adequately support the business reason for the proposed change. The FDIC will evaluate proposed material changes to business plans to determine if the institution has sufficient capital, management expertise, and internal controls in place to adequately manage the risks. In those instances when an institution has implemented a material change in its business plan without obtaining the FDIC's prior non-objection during the de novo period, the FDIC can consider assessing civil money penalties or other enforcement action.

Before the end of the third year of operation, newly insured FDIC-supervised institutions will be required to submit updated financial statements and business plans for years four through seven. Required submissions will include a strategic plan (highlighting plans for capital maintenance/dividend payments, establishment of branches, determining product offerings and other strategies that may alter the institution's risk profile) and pro forma financial statements. This process will allow the FDIC to more closely monitor the activities and operations of de novo banks for a longer time.

<u>Applicability to Existing Newly Insured Institutions.</u> Newly insured state nonmember institutions that have not yet reached the end of the third year of operation will be required to submit financial projections and updated business plans for years four through seven. All institutions operating within the seven-year de novo period will be subject to the 12-month examination cycle through the end of the seventh year of operation.

Applicability to Existing Holding Companies. De novo institutions that are subsidiaries of existing eligible holding companies as defined in Section 303.22(a) will generally be excluded from the requirements of this Financial Institution Letter (FIL). The FDIC maintains the discretion as to whether some or all of the requirements of this FIL should be extended to such institutions.

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