Effective October 1, 1998, the FDIC made substantial revisions to Part 303 of the FDIC's Rules and Regulations, which governs the filing and processing of various applications. One of the most significant features of this revised regulation is that of expedited processing that is now available for "eligible depository institutions."

Eligible depository institutions are defined in the regulation as those which meet the following criteria:

- Received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (UFIRS) as a result of its most recent federal or state examination.
- Received a satisfactory or better Community Reinvestment Act (CRA) rating from its primary federal regulator at its most recent examination, if subject to CRA
- Received a compliance rating of 1 or 2 from its primary federal regulator at its most recent examination
- Is well-capitalized as defined in the appropriate capital regulation and guidance of the institution's primary federal regulator; and
- Is not subject to a cease and desist order, consent order, prompt corrective action directive, written agreement, memorandum of understanding, or other administrative agreement with its primary federal regulator or chartering authority.

APPLICATIONS FOR DEPOSIT INSURANCE

Introduction

The granting of deposit insurance confers a valuable status on an applicant institution; its denial, on the other hand, may have seriously adverse competitive consequences, and, in the case of a new institution, may effectively preclude entrance into the banking/thrift business. Obviously, the role of the FDIC, in acting upon such applications, involves important responsibilities and the exercise of sound discretion in the public interest.

Sections 5 and 6 of the Federal Deposit Insurance Act specifically deal with deposit insurance. Under Section 5, the FDIC must determine as a threshold matter that an applicant is a "depository institution which is engaged in the business of receiving deposits other than trust funds. If an institution does not satisfy that threshold requirement as codified under Part 303 of the FDIC Rules and Regulations. Additionally, Section 5 states that before approving an application, consideration shall be given to the factors enumerated in Section 6. Those factors are: the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the risk presented to the insurance fund, the convenience and needs of the community to be served, and whether or not its corporate powers are consistent with the purposes of the Act.

Subpart B of Part 303 of the FDIC's Rules and Regulations implements the basic statutory provisions and governs the administrative processing of applications for deposit insurance. For those filings subject to a public notice requirement, any person may inspect or request a copy of the non-confidential portions of a filing (the public file) until 180 days following the final disposition of the filing.

Rights of Applicants

An applicant has a statutory right to apply for deposit insurance and to obtain full consideration of its application by the FDIC in light of all relevant facts and without prejudice. If all of the seven statutory factors are resolved favorably, the applicant is entitled to receive deposit insurance coverage. In the event an application is disapproved, an applicant has a right to be informed by the FDIC of the reasons for disapproval.

Obligations of the FDIC

Under applicable law, the FDIC is obligated to consider the seven factors enumerated in Section 6 of the FDI Act in connection with every application for deposit insurance. As a measure of protection against unwarranted and unjustified risks, a full and thorough examination or investigation of each application is conducted. The FDIC has formulated certain guidelines for admission, which are designed to ease administrative problems, aid in preventing arbitrary judgment, and assist in assuring uniform and fair treatment to all applicants. These guidelines must, however, be administered in a manner consistent with the spirit of the Act, and the maintenance of a competitive and free enterprise banking/thrift system. Although applicants are largely required to satisfy criteria under each of the seven statutory factors, in a newly organized institution the FDIC views management and capital adequacy as the most important. The FDIC believes active competition between banks, thrifts and other financial institutions, when conducted within applicable law and in a safe and sound manner, is in the public interest.

Examiner's Responsibility

Whether the applicant is a proposed or newly organized institution or an existing institution, a formal application for deposit insurance coverage must be filed with the FDIC. A copy of the formal application will be made available to an examiner for use in the investigation. Although the application contains data on each of the seven factors enumerated under Section 6 of the Act, reports of investigation are not to be limited to material supplied by the applicant. Reports should be factual as to necessary information and represent the independent and unbiased findings of the examiner. The examiner should in no way indicate to an applicant the probable nature of his recommendations or discuss the applicant's chance of gaining admission to the insurance system unless specifically authorized to do so by the Regional Director. Considerable reliance is placed upon impartial reports by examiners in connection with admission procedures.

The report should detail the relevant facts and data pertinent to each of the seven statutory factors, and under a separate topical heading, an opinion as to whether the FDIC's criteria under each of the statutory factors have been met. A negative opinion on one or more of the statutory factors must be fully explained and supported and, where possible, it should be indicated whether and how the situation may be corrected. The report should also include a general recommendation relative to admission and, if appropriate, a list of conditions which should be imposed. As a rule, the FDIC requires applicants to satisfy all criteria under each of the seven statutory factors. In some cases, however, minor deficiencies in certain factors may be excused when they are more than balanced by conspicuous merits in others.

The seven factors enumerated in Section 6 of the FDI Act which are the criteria used by the FDIC to determine eligibility for deposit insurance are discussed below. The FDIC's admission criteria for proposed or newly organized institutions and existing institutions are generally the same; however, pertinent aspects specifically applicable to admission of existing institutions are covered later in this Section.

Statutory Factors, Proposed or Newly Organized Institutions

Financial History and Condition - Proposed and newly organized institutions have no financial history to serve as a basis for determining qualification for deposit insurance. Some consideration may be given to the history of other institutions presently and formerly operating in the area of the applicant, if pertinent. The ability of the proponents to provide financial support to the new institution should be evaluated under this factor. Past institution failures in a community should not be a prominent consideration in acting upon the application of a new institution. New institution applications are to be judged as far as possible upon their own merits relative to capital, management, and the other factors enumerated in Section 6 of the Act.

The investigation report should include a pro forma statement of the proposed institution for the first three years of operation. The asset and liability projections and composition should be reasonable in relation to the proposed market. Major assets with which the proposed institution intends to begin business, should be fairly valued and supported with appraisals.

Fixed assets are of primary concern in analyzing the asset condition of a proposed or newly organized financial institution. The applicant’s aggregate direct and indirect fixed asset investment, must be reasonable in relation to its projected earnings capacity, capital and other pertinent matters of consideration. Significant assets should be described in detail. For example, the following elements are pertinent to an adequate description and evaluation of applicant's realty interests: the original cost of the premises at time of construction with a breakdown between land and building, original cost to applicant, date of construction, reasonableness of purchase price, from whom purchased, insurance to be carried, assessed value, prospective or immediate repairs or alterations, estimated useful life of the building as of the beginning of business, outstanding liens, tax status, completeness of title papers, desirability of the location, and prospective annual income and expenses if the building is to be other than a one-purpose structure.

The relationship between the applicant's total investment in fixed assets and capital structure should receive comment.

If the leasing of premises is contemplated either through a real estate subsidiary of the proposed institution or otherwise, the terms of the lease are to be outlined in some detail, including a description and estimated cost of any leasehold improvements. In such cases, the lease agreement should contain a termination clause, acceptable to the FDIC. Lease transactions shall be reported in accordance with Financial Accounting Standards Board Statement 13 (Accounting for Leases). Applicants are cautioned against purchasing any fixed assets or entering into any noncancelable construction contracts, leases, or other binding arrangements related to the proposal unless and until the FDIC approves the application.

Any financial arrangement or transaction involving the applicant, its organizers, directors, officers, 10% or more shareholders, or their associates (insiders) should be avoided. If there are any such arrangements or transactions, it must be determined that they are fair and on substantially the same terms as those prevailing at the time for comparable transactions with noninsiders and must not involve more than normal risk or present unfavorable features. Full disclosure of any arrangements with insiders must be made to all proposed directors and prospective shareholders.

An evaluation and comment should be made as to whether the new institution will provide procedures, security devices, and safeguards which will at least be equivalent to the minimum requirements of the Bank Protection Act of 1968 and Part 326 of the Rules and Regulations of the FDIC. In addition, if the new institution plans to utilize electronic data processing services for some or all of its accounting functions, proponents should be apprised of the need to furnish notification in the form prescribed in Part 304.

In applications anticipating the use of temporary quarters pending construction or renovation of permanent facilities, details should be provided regarding the location of the site in relation to the permanent location, the exact address, the rental arrangement, the leasehold improvements, and estimated nonrecoverable costs upon abandonment.

Considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969 must also be favorably resolved and the applicant is generally requested to submit data in this regard for evaluation.

Applicants often employ professional assistance, such as attorneys, economic researchers, and other specialists to assist in the preparation and filing of an application for deposit insurance coverage. The revised Statement of Policy on "Applications for Deposit Insurance" was adopted by the Board of Directors of the FDIC effective October 1, 1998, requires that legal fees and all other organizational expenses be reasonable and fully supportable. Expenses for professional or other services rendered by insiders will receive special review for any indication of self-dealing to the detriment of the institution and its other shareholders. The FDIC expects full disclosure to all directors and shareholders of any arrangement with an insider. In no case will a deposit insurance application be approved where the payment of a fee, in whole or in part is contingent upon any act or forbearance by the FDIC or by any other state or federal agency.

Adequacy of the Capital Structure – Normally, the initial capital of a proposed depository institution should be sufficient to provide a Tier 1 capital to assets leverage ratio (as defined in the appropriate capital regulation of the institution's primary federal regulator) of not less than 8.0% throughout the first three years of operation. Initial capital should normally be in excess of $2 million net of any pre-opening expenses that will be charged to the institution's capital after it commences business. In addition, the depository institution must maintain an adequate allowance for loan and lease losses.

If the applicant is being established as a wholly owned subsidiary of an eligible holding company (as defined in Part 303), the FDIC will consider the financial resources of the parent organization as a factor in assessing the adequacy of the proposed initial capital injection. In such cases, the appropriate regional director (DOS) may find favorably with respect to the adequacy of capital factor when the initial capital injection is sufficient to provide for a Tier 1 leverage capital ratio of at least 8% at the end of the first year of operation, based on a realistic business plan, or the initial capital injection meets the $2 million minimum capital standard set forth in the FDIC Statement of Policy on Applications for Deposit Insurance, or any minimum standards established by the chartering authority, whichever is greater. The holding company shall also provide a written commitment to maintain the proposed institution's Tier 1 leverage capital ratio at not less than 8% throughout the first three years of operation.

The adequacy of the capital structure of a newly organized financial institution is closely related to its risk appetite, deposit volume, fixed asset investment, and the anticipated future growth in liabilities. Deposit projections made by the applicant must, therefore, be fully supported and documented. Projections should be based on established growth patterns in the specific market, and initial capitalization should be provided accordingly. Special purpose depository institutions (such as credit card banks) should provide projections based on the type of business to be conducted and the potential for growth of that business.

In most cases, the first three years of operation is a reasonable time frame for measuring deposit growth in newly organized institutions. Accordingly, in assessing the adequacy of initial capital as related to prospective deposit volume, the examiner should develop a reasonable estimate of the deposit volume a new financial institution may generate in each of the first three years of operation, which may differ considerably from the estimates provided in the proponents' application, feasibility study, or economic survey. It is not unusual to find that the proponents' deposit projections and feasibility study are influenced by the proposed capital structure. The proponents' deposit projections may also be out-of-date or not fully supportable due to lack of adequate information and documentation. The best sources of information to assist in formulating reasonable estimates are local economic indicators, population data, deposit and loan growth in other financial institutions in the area, comments and observations of depository institution managers in the area, the competitive impact of other financial institutions, and the ability of the proponents to generate business in the trade area. In the final analysis, the estimated deposit volume for a new institution's third year of operation is highly significant because it serves the dual purpose of measuring earnings capability as well as capital adequacy after projecting a reasonable operating period.

The number of shares of stock and its par value as of the commencement of business should be scheduled. The per share price of the stock should be stated, and, in cases where an additional amount per share is assessed to cover organizational and preopening expenses, that amount should also be identified. The components of the beginning capital structure can then be allocated to capital stock, surplus, other segregations, and the organizational expense fund. It should be ascertained whether or not the State or Office of Thrift Supervision statutory minimum capital requirements are met and how evidence will be provided to the FDIC that capital funds are fully paid in prior to opening for business. If it appears the proposed capital structure will not meet the FDIC's criteria, the investigation report should reflect fully the extent of and reasons for the inadequacy and recommend to the FDIC an amount which would be acceptable. Should the attitude of the proponents be receptive to a request for supplying additional capital, it should be so indicated.

All stock of a particular class in the initial offering should be sold at the same price, and have the same voting rights. Proposals which allow the insiders to acquire a separate class of stock with greater voting rights are generally unacceptable. Insiders should not be offered stock at a price more favorable than the price for other subscribers. Price disparities provide insiders with a means to gain control disproportionate to their investments.

When securities are sold to the public, the disclosure of all material facts is essential. The FDIC's Statement of Policy regarding use of Offering Circulars in connection with Public Distribution of Bank Securities (dated September 5, 1996) provides additional guidance. A copy of the offering circular prepared by the applicant, the stock solicitation material, and the subscription agreement should be submitted to the FDIC when they become available.

Future Earnings Prospects - Allowing a new institution to commence operations without some indication that it can be operated profitably not only creates a potentially unsatisfactory situation, but could also have a detrimental effect on other competing financial institutions. Usually the operations of a new institution are not profitable for at least the first year. Estimates of operating income and expenses for the first three years of operation should be made using, among other things, the projections of loan and deposit volume made in connection with the "Adequacy of the Capital Structure" factor.

In determining future earnings prospects, the probable income from loans and discounts, bonds and securities, service charges and commissions, and other sources of income must be estimated. Assistance in this task may be obtained from evaluating the applicant's projections, the demand for loans in the area and types thereof, the probable nature of the institution's investment policy, the amount of time and demand deposits likely to be acquired, the probable competitive reaction from existing depository institutions, the economic conditions in the community, the possibility of future development or retrogression in the area, the apparent moneymaking ability of the institution's management, and the FDIC's statistical data for depository institutions operating in the same general area. In addition, estimates must be made for expenses such as salaries and other employee benefits, interest, occupancy and equipment outlays, electronic data processing service costs, and other current operating expenses. Assistance in making these projections may generally be obtained from the same sources used in projecting the various income categories. A review and comparison of original projections and actual data for other recently organized operating financial institutions in the same or comparable areas may be of assistance in projecting earnings and expense data. Applicants need to demonstrate through realistic and supportable estimates that, within a reasonable period (normally three years); the earnings will be sufficient to provide an adequate profit.

The report of investigation should pinpoint any marked divergence between the examiner's findings and those presented in the application and the reasons for such variances. Comment should also be made on the proponents' plans for payment of cash dividends, bonuses, directors' fees, retainer fees, etc, and the accounting system to be used. During the first three years, dividends shall be paid only from net operating income after tax and not until an appropriate allowance for loan and lease losses has been established and overall capital is adequate. In regard to accounting systems, the FDIC requires use of the accrual method from the outset of operations.

As indicated previously, this portion of the investigation report is, by reason of Part 303 of the FDIC's Rules and Regulations, available for public inspection.

General Character of the Management - The quality of an institution's management is vital and perhaps the single most important element in determining the applicant's acceptability for deposit insurance. To satisfy the FDIC's criteria under this factor, the evidence must support a management rating which in an operating institution would be tantamount to a rating of "2" or better. In most instances, the management of a proposed or newly organized institution will not have an operating record as a functioning unit to assist in forming a judgment; therefore, the management rating essentially becomes a question of directly evaluating the individual directors and officers and then making a composite overall rating premised upon the individual analyses.

In general, the individual directors and officers will be evaluated largely on the basis of the following:

- Financial institution and other business experience;
- Duties and responsibilities in the proposed depository institution;
- Personal and professional financial responsibility;
- Reputation for honesty and integrity; and
- Familiarity with the economy, financial needs, and general character of the community in which the depository institution will operate.

The report of investigation should, therefore, contain a schedule giving the name, address, approximate age, total liabilities, and net worth of each director and officer. In addition, for each proposed member of the management team comments should be included that detail present occupation or profession and past banking, thrift, business, farming, or other experience; including observations as to how successful the individuals have been in their present and past activities and whether they have been asked to resign from a position or positions held or have been associated with serious business failures or debt compromises. As a rule of thumb, success of the majority of an applicant's management in their present business endeavors is some evidence of their ability to manage successfully the affairs of the proposed institution.

In addition, all firms, companies, corporations, and organizations in which a given director or officer is substantially interested should be indicated. If the facts denote that the institution is being organized primarily to finance the businesses or personal interests of certain officers and directors, particularly when the assets related thereto are likely to be of dubious quality, the relevant facts should be fully covered.

Duties and responsibilities as well as the title of each proposed officer and director should be outlined. If the proposed duties and responsibilities are regarded as beyond the capabilities of a particular officer or some other distribution of duties and responsibilities among officers would be more effective than that contemplated, the opinions and reasons therefore should be indicated.

Net worth figures on each director and officer will be available from financial reports filed with the application. In listing net worth figures in the report of investigation, an opinion as to the validity of the figures and any pertinent information relating to sizable liabilities may be made.

Stock holdings of each director and officer are to be indicated. Successful operation of a financial institution requires a real interest in its welfare as well as a willingness to devote a substantial amount of time to its affairs. When directors and officers have a significant financial investment, genuine and continuing interest is more likely.

Section 19 of the FDI Act prohibits, without the prior written consent of the FDIC, a person convicted of criminal offense involving dishonesty, breach of trust, money laundering, or who has entered into a pretrial diversion or similar program in connection with a prosecution for such offense, from becoming or continuing as an institution-affiliated party, owning or controlling, directly or indirectly an insured institution, or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured depository institution. If an employee, officer, or director is involved in a criminal conviction, or fidelity insurance has been denied with respect to any employee, officer, or director, a thorough investigation of the circumstances should be conducted. If the facts of the investigation dictate, the institution may be required to file an application pursuant to Section 19 of the FDI Act.

Length of residence in the community or trade area of the proposed institution and degree of familiarity with the major activities of the locale should be indicated with respect to each director and officer.

The above information should be particularly complete with respect to individuals who are likely to dominate the policies and operations of the institution. In addition, comparable information should be included on any shareholder (other than a proposed director or officer) who is subscribing to 10% or more of the aggregate par value of stock to be issued. Examiners should also include in their report any information that may come to their attention concerning possible changes that may be made in the institution's management after commencement of operations. In addition, the FDIC has found that on occasion, subsequent to approval of an application for deposit insurance and prior to the actual opening of a proposed new institution, changes have occurred in the management or ownership. In order to monitor such changes, the FDIC requires that the prospective incorporators advise the Regional Director in writing if changes in the directorate, active management, or in the ownership of stock of 10% or more of the total are made prior to opening. When conducting investigations, this notification should be stressed in any discussions with the proponents.

Certain other information relative to the sale and purchase of the proposed institution's stock and the exercise of voting rights may also reflect on the general quality and character of management. While these matters may also relate to the "Adequacy of Capital Structure" factor, on balance they are more appropriately treated herein. Stock financing arrangements by proposed officers, directors and 10% shareholders of their investments in stock of the proposed depository institution will be carefully reviewed. Such financing will be considered acceptable only if the party financing the stock can demonstrate the ability to service the debt without reliance on dividends or other forms of compensation from the applicant. When stock financing arrangements are anticipated, information should be submitted with the application demonstrating that adequate alternative independent sources of debt serving are available. Direct or indirect financing by proposed officers, directors and 10% shareholders of more than 75% of the purchase price of the stock subscribed by any individual, or more than 50% of the purchase price of the aggregates stock subscribed by the proposed officers, directors and 10% shareholders as a group, will require supporting justification in the application regarding the reason that the financing arrangements should be considered acceptable. If the proposed financing arrangements are not considered appropriate, the FDIC may find unfavorably on the adequacy of the capital structure.

It should be determined whether any commissions are to be paid in connection with the sale of the stock and confirmed that no loans representing applicant stock purchases will be refinanced by the institution. Any evidence that the institution is being organized on a promotional basis should also be covered. Ownership control by several individuals or groups of shareholders as well as any contemplated or existing buy-sell, voting trust, or proxy agreements between various individuals or other entities, such as holding companies, should also receive comment and copies of any such agreements obtained from the applicant or proponents involved.

Stock Benefit Plans – Stock benefit plans, including stock options, stock warrants and other similar stock based compensation plans will be reviewed by the FDIC and must be fully disclosed to all potential subscribers. Participants in stock benefit plans may include incorporators, directors and officers. A description of any such plans proposed must be included in the application submitted to the appropriate regional director. The structure of stock benefit plans should encourage the continued involvement of the participants and serve as an incentive for the successful operation of the institution. Stock benefit plans should contain no feature that would encourage speculative or high-risk activities or serve as an obstacle to or otherwise impede the sale of additional stock to the general public. The following are the factors to use to evaluate stock benefit plans:

- The duration of rights granted should be limited and in no event should the exercise period exceed ten years;
- Rights granted should encourage the recipient to remain involved in the proposed depository institution
- Rights granted should not be transferable by the participant;
- The exercise price of stock rights shall not be less than the fair market value of the stock at the time that the rights are granted;
- Rights under the plan must be exercised or expire within a reasonable time after termination as an active officer, employee or director; and
- Stock benefit plans should contain a provision allowing the institution's primary federal regulator to direct the institution to require plan participants to exercise or forfeit their stock rights if the institution's capital falls below the minimum requirements, as determined by its state or primary federal regulator.

Stock benefit plans provided to directors and officers will be reviewed as part of the total compensation package offered to such individuals.
Stock benefit plans provided to incorporators will also be closely scrutinized. In reviewing such plans, the FDIC will consider the individual's time, expertise, financial commitment and continuing involvement in the management of the proposed institution. The FDIC will also consider the amount and basis of any cash payments which will be made to the incorporator for services rendered or as a return on funds placed at risk. Plans to compensate incorporators that provide for more than one option or warrant for each share subscribed will generally be considered excessive. It is further expected that incorporators granted options or warrants at or near this level will actively participate in the management of the depository institution as an executive officer or director. On a case-by-case basis, the FDIC may not object to additional options being granted to an incorporator who will also be a senior executive officer.

The FDIC recognizes that there will be limited instances where individuals who substantially contribute to organization of a new depository institution do not intend to serve as an active officer or director after the institution opens for business. The FDIC will generally not object to awarding warrants or options to incorporators who agree to accept shares of stock in lieu of cash payment for funds placed at risk or for professional services rendered. In such instances, the FDIC defines funds placed at risk to include seed money actually paid into the organizational fund and the value of professional services rendered as the market value of legal, accounting and other professional services rendered. Generally, warrants or options for organizers who will not participate in the management of the institution will be considered excessive if the amount of options or warrants to be granted exceeds the number of shares of stock at risk and/or for professional services rendered. The granting of options to incorporators who guarantee loans to finance an institution's organization generally would not be objectionable, but options granted should be limited so that the market value of the stock subject to option does not exceed the amount of the loan guarantees (although guarantees exceeding the amount drawn or expected to be drawn will not be considered.) When continuing service is not contemplated, the FDIC will not require vesting or restrictions on transferability, but will review the duration of the rights, exercise price and exercise or forfeiture clauses in the same manner as discussed above.

In evaluating benefit and compensation plans for insiders, the FDIC will look to the substance of the proposal. Those proposals that are determined to be substantially stock based plans will be evaluated on the above stock benefit plan criteria. Stock appreciation rights and similar plans that include a cash payment to the recipient based directly on the market value of the depository institution's stock are unacceptable.

If the proposal involves the formation of a de novo holding company and a stock benefit plan is being proposed at the holding company level, that stock benefit plan will be reviewed by the FDIC in the same manner as a plan involving stock issued by the proposed depository institution.

Proponents should be made aware of the prohibition against interlocking management relations applicable to depository institutions (banks, savings and loan associations, mutual savings banks, and credit unions) and depository holding companies (banks, and savings and loan holding companies) contained in Title 11 of FIRIRCA and Part 348 of the FDIC's Rules and Regulations. The FDIC adheres to a fixed policy requiring that all applicants provide at least a five-member board of directors, even though the State law may, in some cases, permit a lesser number.

On the basis of the facts and considerations detailed in the report of investigation, examiners should state, and factually support to the greatest extent possible, their conclusions as to the management rating. A notation as to the type and amount of the insurance (fidelity, burglary, robbery, etc.) to be carried by the institution should be included in the report under the management heading. With respect to fidelity coverage, the FDIC's position is that applicants should subscribe to and maintain adequate coverage and have in force at all times a $1 million excess bank employee dishonesty bond, if primary blanket bond coverage is less than $1 million.

Applicants are expected to develop appropriate written investment, loan, funds management and liquidity policies. Establishment of an acceptable audit program is required for proposed depository institutions. Applicants are expected to commit the depository institution to obtain an audit by an independent public accountant for at least the first three years of operation.

An applicant bank or an applicant branch of a foreign bank that expects to operate an international loan department or conduct international lending and investment activities is expected to address country risk and related concentrations of credit with respect to these activities in their written policies. These factors should be segregated from other lending and investment risk criteria and addressed separately in the policies. Policy coverage should not be limited to just loans, but should also encompass securities, deposit balances, acceptances, and other activities that are expected to be included in the bank's or branch's operations. If an applicant does not intend to engage in such activity, they should specifically so state.

Risk Presented to the Insurance Fund - This factor is to be broadly interpreted and may be the most relevant in the unusual circumstance where none of the other factors is clearly identifiable as unfavorable. For example, "risk to the fund" might be resolved unfavorably and the application denied based on the applicant's unsound business plan even though all the other factors might be favorably resolved. The FDIC expects that an applicant will submit a business plan commensurate with the capabilities of its management and the financial commitment of the incorporators. Any significant deviation from the business plan within the first three years of operation must be reported by the insured depository institution to the primary federal regulator before consummation of the change. An applicant's business plan should demonstrate the following:

- Adequate policies, procedures, and management expertise to operate the proposed depository institution in a safe and sound manner;
- Ability to achieve a reasonable market share;
- Reasonable earnings prospects;
- Ability to attract and maintain adequate capital; and

- Responsiveness to community needs.

Operating plans that rely on high risk lending, a special purpose market, significant funding from other sources other than core deposits, or that otherwise diverge from conventional bank related financial services will require specific documentation as to the suitability of the proposed activities for an insured institution. Similarly, additional documentation of plans is required where markets to be entered are intensely competitive or economic conditions are marginal. Like a recommendation based on any other factor, an unfavorable finding based on "risk to the fund" must be clearly articulated.

Convenience and Needs of the Community to be Served - Generally, there is a presumptive indication of need if the directors or organizers of the applicant are a responsible group of persons willing and able to supply a substantial and adequate amount of money to back up their judgment, and if the management of the proposed institution is competent, honest, and familiar with the problems of the area to be served. However, consideration should be given to the adequacy of existing depository institution facilities in the community and in nearby rival communities, for a financial institution is unlikely to fulfill a need if it is unable to command sufficient volume to maintain profitable operations. In this connection, the Examiner should endeavor to ascertain whether or not the services rendered by existing depository institutions are satisfactory, and whether or not such institutions are meeting the legitimate credit needs of the community.

It should be noted that the provisions of the Community Reinvestment Act are especially relevant in evaluating this statutory factor.

In considering the question of need, it is important that the examiner not adopt the viewpoint of depository institutions located in the community, to the exclusion of other, equally persuasive viewpoints. As in the other lines of business, existing financial institutions may regard any new institutions as unnecessary and a potentially "harmful competitor". An unbiased conclusion in this connection requires impartial consideration of the opinions of the organizers of the applicant as well as those of the management of existing institutions. In addition, it is sometimes necessary to solicit the views of representative business and professional persons in the community, together with those of citizens of more modest means. The results of canvasses and surveys of local individual or business persons should be set forth in the report in order to assist in evaluating support for the proposed institution, the adequacy of present depository institution facilities, whether the legitimate banking needs of the community are being met, whether and to what extent the new facility would be used, and the knowledge these persons have of the proponents. In the final analysis, the value of any information so obtained will depend largely on the examiner's ability to discriminate between those views which proceed from intelligent and rational consideration of the real needs of the community and those which are mainly inspired by a false sense of community pride or selfish personal interest.

A clear definition of the proposed institution's trade area is essential in determining convenience and needs. A brief description of the general area in which the proposed institution is to be situated and its location in relation to other prominent nearby communities, developments, or other important landmarks should be initially presented. The primary trade area as described in the application should then be discussed along with an opinion as to the validity of the applicant's definition of the trade area. In some instances, the applicant may artificially draw its trade area boundaries so as to exclude factors which would be unfavorable to the proposal (nearby depository institutions, depressed areas, etc.) and include others which would increase the attractiveness of the proposed location (significant residential or commercial developments, highly concentrated population area, etc.). Any differences between the examiner's conception of the trade area and that of the proponents should be discussed fully in the report together with a description of the trade area as the examiner perceives it. Once the trade area has been defined, information regarding the following should be set forth.

The principal industrial, trade, or agricultural activity should be described and, if considered relevant, annual values of principal products indicated. The presence and source of large payrolls in the area may also be an important consideration. The number and value of residential and commercial building permits can often be of considerable value in determining the vitality of the area. Figures regarding retail sales from public sources or trade organizations are useful; however, if they are not available, it may be possible to obtain some estimates of volume in the course of conducting a survey of the locale's business establishments. Information regarding medical facilities and other professional services can be a useful indicator of the self- sufficiency of the community or trade area. Statistical information on governmental units such as; assessed valuations, tax levies, bonded indebtedness, and tax delinquencies, and data on the educational environment of the area are also valuable indicators. Reports of investigation should not, however, be filled with pages of statistics unless the figures are relevant.

Demographic figures within the trade area as well as the general surrounding areas are significant determinants in considering convenience and needs. While population as of the date of investigation is important, data which establishes population trends as well as projections for the future should be presented. In some cases it is difficult to obtain accurate population data for a particular trade area, as statistics combine portions of several census tracts. In some instances, data showing the number of household units in the area may be a more appropriate basis for assessing reasonable population estimates.

The examiner should assess the competitive dynamics of the proposed market and how the institution will compete for market share. Officials of area depository institutions should be contacted during the investigation and given an opportunity to express their attitudes on the proposal. Any formal objections to the proposal should be investigated and comments relative to discussions with the objector(s) set forth in the investigation report. The probable competitive effects of a new institution proposal should be fully weighed by the examiner. While the number of depository institutions operating in the city or area to be served is important in determining whether the addition of a new institution may result in an overbanked condition, consideration should also be given to possible procompetitive consequences flowing from the new institution proposal, such as increased customer services and banking options to residents of the area. Therefore, it is necessary to furnish complete factual data with respect to the probable impact of the proposal on existing financial institutions in the community.

The extent of new or proposed residential, commercial, and industrial development and construction is a significant secondary consideration in resolving the convenience and needs factor. Plans for the development of shopping centers, apartment complexes and other residential subdivisions, factories, or other major facilities near the proposed site should, therefore, receive comment. In certain instances, inclusion of maps may be desirable to clarify comments, showing location of competing depository institutions or branches, important buildings, offices, shopping centers, industrial parks, and the like in relation to the office site. As in the case of the "Future Earnings Prospects' factor, this portion of the investigation report is also available for public inspection under Part 303 of the FDIC's Rules and Regulations.

Consistency of Corporate Powers – Generally, the FDIC will presume that a proposed national bank’s or federal savings association’s corporate powers are consistent with the purposes of the Act. Pursuant to section 24 of the Act, no insured state bank may engage as principal in any type of activity that is not permissible for a national bank unless the FDIC has determined that the activity would pose no significant risk to the appropriate deposit insurance fund and the state bank is, and continues to be, in compliance with applicable capital standards prescribed by its primary federal regulator. Similarly, section 28 of the Act provides that a state chartered savings association may not engage in any type of activity that is not permissible for a federal savings association, unless the FDIC has determined that the activity would pose no significant risk to the affected deposit insurance fund and the savings association is and continues to be, in compliance with the capital standards for the association. Since the applicant will have agreed in its application not to exercise nonbanking powers whether granted by charter or statute, the examiner need only refer to this previously obtained agreement. Additional comments may be included if the terms of the agreement are not generally understood by the applicant or if they regard the agreement as being incomplete or amendment to the Articles of Association or Charter is necessary or desirable.

Miscellaneous - The existence of any conflicting applications to establish depository facilities in the immediate area should be indicated and receive appropriate comment in the examiner's report of investigation. If operation of a trust department is contemplated, applicant must also file with the FDIC the appropriate form covering "Application for Consent to Exercise Trust Powers". This form will provide much of the information necessary for the completion of the report of investigation with respect to this phase of the applicant's operations. If the proposed trust functions will materially affect the examiner's findings in making a recommendation on anyone of the seven factors contained in Section 6 of the Federal Deposit Insurance Act, it may be advisable to analyze the prospects for the operation of the commercial and trust departments under separate subheadings for any factor so affected.

If any of the documents essential for full consideration of the application have not been submitted to the FDIC, the proponents should be instructed to transmit such documents at the earliest practical date and a notation to that effect included in the report.

Statutory Factors, Existing Institutions

As indicated previously, the FDIC's admission criteria for proposed or newly organized institutions and for existing institutions are generally the same. Consequently, principles previously discussed in this section of the Manual are not repeated herein. Prior to processing applications for existing institutions for deposit insurance coverage, examiners should familiarize themselves not only with the following provisions but also those set forth under "Statutory Factors, Proposed or Newly Organized Institutions". In the case of an existing institution, the FDIC will conduct an examination of the ongoing institution or its predecessor institution and a report prepared on the regular printed FDIC form, with appropriate notation on the cover indicating the special purpose of the examination. Under Examiner's Comments and Conclusions of the Supervisory Section of the Report of Examination, the examiner is required to discuss separately each of the seven statutory factors.

Financial History and Condition - While the financial history of an operating institution is usually reflected in its present condition, the basic cause or causes for an institution's condition, whether satisfactory or unsatisfactory, should be analyzed and the reasons therefor ascertained. Accordingly, where the financial history of an operating institution has not been successful or is questionable, the FDIC generally requires reasonable assurance that the cause or causes of any past difficulties of a serious nature have in large measure either been overcome or ceased to exist.

Date of primary organization should be indicated. Another important feature in the financial history of an existing institution is its past attitude on the prompt recognition and current charge-off of losses and the administration of dividend policies. In addition, mergers, consolidations, recapitalizations, reorganizations, liability assumptions, deposit waivers, deposit deferments, and similar events, which are not recent, should be covered in the Report of Examination, but in less detail.

With respect to an operating institution's financial condition, the FDIC customarily requires that the general quality of its net assets be satisfactory and on a par with that of peer institutions. In appraising the value and quality of an applicant operating institution's assets, the same appraisal and classification procedures and criteria are to be followed as in regular FDIC examinations. The "Items Subject to Adverse Classification" as well as the "Items Listed for Special Mention" pages in the Report of Examination as well as the "Summary Analysis of Examination Report" (SAER) should include data on the quality of an institution's net assets. This information should be summarized in the "Examination Conclusions and Findings" under an appropriate caption. General comments on asset condition and problems should also be included, as well as a summary of "Violations of Laws and Regulations", contingent liabilities, existing litigation against the institution, dividend and remuneration policies, and other matters which could affect the institution's condition.

Adequacy of the Capital Structure - An existing institution applying for deposit insurance should have sufficient capital to support the volume, type, and character of its business, provide for losses, and meet the reasonable credit needs of the community which it serves. The process of determining the adequacy of an institution's existing capital as well as that after three years of operation (considering estimated deposit growth) begins with a qualitative evaluation of critical variables that directly bear on the institution's overall financial condition. These variables as well as all the principles set forth in the FDIC Statement of Policy on Capital (Appendix B to Part 325), are applicable here. The Statement, setting forth various levels for adjusted equity capital, only provides a benchmark for evaluating capital adequacy. Although it establishes uniform standards for capital levels among depository institutions regardless of size, the ratios set forth therein are, however, only starting points since such ratios are not in themselves determinative and must be integrated with all other relevant factors such as character of management, quality of assets, and so on. In the final analysis, each case must be judged on its own merits. It should be recognized that various State banking departments may impose more stringent capital requirements than those set forth in the FDIC Statement of Policy on Capital.

The Report of Examination should include some of the data necessary for determining whether the applicant's capital is adequate. The data should also be summarized and augmented in the Examiner's Conclusions and Recommendations of the Supervisory Section under the caption "Adequacy of Capital Structure". If for any reason a substantial increase in deposits is anticipated, or any plans of the applicant with respect to the institution's capital structure are contemplated, or if the proponents appear receptive to a request for supplying additional capital, it should be so indicated in the Report of Examination. It is desirable to include under this caption, or as a supplemental page to the Report of Examination, a complete or reasonably complete list of all shareholders, their holdings, and related interests.

Future Earnings Prospects - The earnings capability of an existing institution is reflected in its earnings record. Ordinarily, an operating institution's earnings record should indicate ability to pay all operating expenses with a safe margin for the absorption of losses and for the payment of reasonable dividends. For comparative purposes, current earnings ratios may be obtained from various data prepared by the FDIC. If earnings have not been sufficient, areas where income may be improved or expenses reduced should be noted. The principles described in the Earnings Section of this Manual are applicable here. The income and expense figures reflected in the Report of Examination are book figures. If the examiner regards these figures as incorrect or misleading because of improper accounting for unearned discounts, failure to charge off losses, failure to properly depreciate fixed assets, or similar deviations from accepted practices, the matter should be fully discussed in the presentation of earnings data in the Supervisory Section. The examiner should also comment on the effect deposit insurance coverage might have on the institution's income and expenses in the future.

General Character of Management - In the case of an existing institution, management may be evaluated both from the standpoint of the institution's condition and the vantage point of management's past performance as reflected in the books and records of the institution, previous Reports of Examination and correspondence from other regulators, and internal records, such as committee and board of directors' minutes. A management rating of "2" or better is necessary to satisfy the requirements of this statutory factor. The rating of management is discussed in the Management Supervision, Administration and Control Section of this Manual.

Complete information on management will be included in the report. In addition, a summary discussion of important aspects of this information, together with information on director and officer indebtedness to the institution, should be included under this caption in the "Examiner's Conclusions and Recommendations" of the Supervisory Section. If management is not regarded as warranting a rating of "2" or better, it should be indicated what changes are believed essential to warrant such a rating. Fidelity insurance on active officers and employees and other indemnity protection should receive comment to the extent necessary under this captioned statutory factor.

Risk Presented to the Insurance Fund - Analysis of this factor is the same as previously described for proposed new institutions.

Convenience and Needs of the Community - The FDIC's criteria under this statutory factor are closely related to those outlined with respect to the "Future Earnings Prospects" factor. A going institution which is being successfully and profitably operated, and which has a recognized place and established customer relationships in its community, is for self-evident reasons convenient to and fulfilling the needs of the community it serves. An institution may, however, have had inferior earnings in the past and nevertheless qualify under this statutory factor. Any pertinent information with respect to local economic conditions, population trends, or unusual circumstances which have affected or may affect the community and the applicant should be commented on under this caption. It should be noted that the provisions of the Community Reinvestment Act are relevant in evaluating this statutory factor.

Consistency of Corporate Powers - Nonbanking powers and certain saving associations activities, other than trust powers, are regarded by the FDIC as inconsistent with the purposes of the Act. In some states, institutions have been granted the right under their charters or by statute to engage in certain nonbanking activities. Section 24 of the Act limits the powers of insured state banks and section 28 of the Act limits the powers of state chartered savings associations. If the institution is exercising any powers not authorized under the applicable statute, the application should contain an agreement and plan for eliminating the activity as soon as possible, or a separate application should be submitted seeking the FDIC’s consent to continue the activity.

Miscellaneous - If the applicant operates a trust department, an examination will be conducted and a Report of Examination compiled. The examiner should consider the condition and the prospects of the trust department in developing the conclusion for each factor enumerated under Section 6 of the Act. Should trust department operations be of sufficient influence in the final determination of the examiner's findings on any of the factors, it may be advisable to analyze the commercial and the trust operations under appropriate subheadings. The examiner should indicate the number of tellers' windows at which insured deposits will be received. If any of the documents essential for full consideration of the application have not been submitted to the FDIC, the proponents should be instructed to transmit such documents at the earliest practical date and a notation to that effect included in the report.

Examiners should indicate in their reports the sources of information on significant points covered in their comments. During the examination, the examiner should review reports of examination of other supervisory authorities and correspondence from these authorities.

Deposit Insurance Applications from Proposed Publicly Owned Depository Institutions

An application for deposit insurance from a depository institution which would be owned or controlled by a domestic governmental entity (such as, for example, a state, county or a municipality) will be reviewed very closely. The FDIC is of the opinion that due to their public ownership, such depository institutions present unique supervisory concerns that do not exist with privately owned depository institutions. For example, because of the ultimate control by the political process, such institutions could raise special concerns relating to management stability, their business purpose, and their ability and willingness to raise capital. On the other hand, such institutions may be particularly likely to meet the convenience and need of their local community, particularly if the local community is currently un- or under- served by depository institutions.

APPLICATIONS TO ESTABLISH A BRANCH OR TO MOVE MAIN OFFICE OR BRANCH

Provisions of Law

Under the provisions of Section 18(d) of the Federal Deposit Insurance Act (the "Act"), no State nonmember insured bank may establish and operate any new branch, or change the location of any existing branch, or move its main office, unless it obtains the prior written consent of the FDIC. The factors to be considered in granting or withholding such consent are those enumerated in Section 6 of the Act. Also included in Section 18(d) of the Act, no state nonmember insured bank shall establish or operate any foreign branch, except with the prior written consent of the FDIC. There are further restrictions detailed below concerning either establishment or relocation of branches in states other than the applicant's home state. Subpart C of Part 303 of the FDIC's Rules and Regulations governs the administrative handling of applications to establish a branch or to relocate an office.

Filing Procedures for Branch Applications

In applying to establish a branch or to relocate an existing office, State nonmember insured banks must file an application in letter form with the FDIC. A complete letter application shall include:
(1) a statement of intent to establish a branch or to relocate the main office or a branch;
(2) the exact location of the proposed site including the street address; and
(3) details concerning any involvement in the proposal by an insider of the bank;
(4) a statement on the impact of the proposal on the human environment, including information on compliance with the provisions of the NEPA (National Environmental Protection Act);
(5) a statement as to whether or not the site is eligible for inclusion in the National Register of Historic Places for purposes of complying with the applicable portions of NHPA (National Historic Preservation Act);
(6) comments on any changes in services to be offered, the community to be served, or any other effect the proposal may have on the applicant's compliance with the Community Reinvestment Act;
(7) a copy of each newspaper publication required; and
(8) when an application is submitted to relocate the main office of the applicant from one state to another, a statement of the applicant's intent regarding retention of branches in the state where the main office exists prior to relocation.

Expedited processing per Part 303 is available for eligible depository institutions. For those applications which are not processed pursuant to the expedited procedures, preliminary consideration will be given in the Regional Office to applications to determine whether an examination of the applicant bank should be ordered. In all cases, however, a Summary of Investigation Form for Branch Applications will be completed. Please refer to the Case Managers Procedures Manual for additional processing and filing information.

Interstate Banking Branch Applications

For applications to establish a de novo branch that is not in the applicant's home state and in which the applicant does not already maintain a branch, the application must comply with the state's filing requirements. The FDIC needs to determine that the applicant is adequately capitalized as of the date of the filing and will continue to be adequately capitalized and adequately managed upon consummation of the transaction; and confirmation that the host state has a law permitting state "opt-in" elections to enable interstate branching, pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

For applications where the applicant already has one or more existing branches in a state other than the applicant's home state, a determination needs to be made that the application has not failed the host state's credit needs test and that it is reasonably helping to meet the credit needs of the communities which the branches serve.

Other Considerations for Branch Applications

As in the case of applications for deposit insurance, the provisions of the Community Reinvestment Act, the National Historic Preservation Act, and the National Environmental Policy Act of 1969, must be favorably resolved.

APPLICATIONS FOR CONSENT TO EXERCISE TRUST POWERS

Introduction

1. FDIC Section 333

The FDIC does not grant trust powers, but only gives its consent to exercise such powers as granted by state authorities. Section 333.2 of the FDIC's Rules and Regulations prohibits an insured state nonmember bank from changing the general character of its business without the FDIC's prior written consent. The test to determine when a change in character of business has occurred is left to the discretion of the FDIC. For trust powers, this normally occurs when a fiduciary relationship is created under the laws of the governing state authority. Therefore, it is general policy that unless a bank is exempted through the circumstances described in the Background section below, it must file a formal application with the FDIC to obtain prior written consent before it may exercise trust powers. It should also be noted that the statute applies only to banks. Separately chartered and capitalized uninsured trust company subsidiaries of banks need not apply for FDIC consent to exercise trust powers.

2. Background

In 1958 the FDIC articulated its basis for requiring consent to exercise trust powers (refer to page C-41 of the FDIC Trust Examination Manual), and established conditions for grandfathering consent. Banks granted trust powers by state statute or charter prior to December 1, 1950, regardless of whether or not such powers have ever been exercised, are not required to file an application with the FDIC for consent to exercise trust powers. Such consent is grandfathered with the approval for Federal deposit insurance.

Banks approved for Federal deposit insurance after December 1, 1950, are required to file an application to exercise trust powers, unless such filing was made simultaneously with the application for Federal deposit insurance.

3. Applications for Consent

Part 303 of the FDIC's Rules and Regulations governs the administrative handling of applications for consent to exercise trust powers. Application procedures are set forth in both Part 303 and the Case Managers Procedures Manual. Banks eligible for expedited processing under Part 303 (as defined therein) may file an abbreviated application. Application forms for both expedited and non-expedited processing are available at Regional Offices. Applications are reviewed in the context of the financial institution's ability to satisfactorily perform trust activities. In reviewing any such application, the statutory factors set forth in Section 6 of the Federal Deposit Insurance Act are also considered. Other factors which examiners should be aware of include:

a. Statement of Principles of Trust Department Management

The FDIC's "Statement of Principles of Trust Department Management" outlines minimum requirements for the sound operation of a trust department. Before final approval of any application for consent to exercise trust powers may be given, the applicant's board of directors is required to adopt the minimum requirements set forth in the "Statement".

b. Management Adequacy

To approve any application for consent to exercise trust powers, it must be concluded that management of the contemplated trust operation is capable. By adopting the "Statement of Principles of Trust Department Management", the applicant bank resolves to provide sufficient staff and facilities to meet minimum standards of competency in trust matters. Applications submitted for consent to exercise full trust powers by banks having inexperienced trust management, or management which is considered incapable of administering trust activities other than routine matters, should not be approved. Such applications should not be accepted for processing, but returned to the bank for resubmission at a later time. Where limited powers will suffice, the bank should be encouraged to amend its application for specified limited powers. Otherwise, the board of directors should be requested to seek qualified trust management if it wishes to obtain consent to exercise full trust powers. Nevertheless, Regional Directors may, when warranted, approve an application conditioned on the bank's hiring of qualified trust management which is acceptable to the FDIC.

c. Limited Trust Powers

Banks will sometimes be granted limited trust powers, usually confined to a few specific functions such as agent for employee benefit accounts, guardian of the property of minors, or capacities not requiring extensive expertise. In processing an application for consent to exercise limited trust powers, applicants should be required to specify the exact functions to be performed. At examinations of banks having limited trust powers, the examiner should determine that only authorized activities are being performed.

d. Unauthorized Trust Activities

Commercial banks may be found performing fiduciary services without having obtained full or limited trust powers, or the FDIC’s consent to exercise such powers. In these cases, the examiner should determine what services are being performed, and review all written customer agreements. If a bank is acting in any capacity requiring trust powers, the examiner should:

(1) cite a violation of state law for performing fiduciary services without trust powers (if applicable);
(2) cite a violation of FDIC Section 333.2 for changing the character of its business without the FDIC's prior written consent;
(3) advise management:
(a) it must discontinue accepting any additional appointments;
(b) it should (upon advice of counsel) discontinue performing fiduciary services, if it can do so without jeopardizing its accounts or incurring additional liability upon itself;
(c) that it must apply to its state authority for trust powers (if applicable); and
(d) that it must also apply to the FDIC for consent to exercise the powers.

If a bank is acting in an agency capacity, the examiner should make a determination of the bank's duties and responsibilities.

Particular attention should be given to the degree of discretionary authority exercised. It should also be determined whether the bank is required to manage the assets, or to simply hold them subject to customer direction. If the bank's duties are those which require trust powers, the examiner should follow the procedures outlined in the preceding paragraph. Applications for consent to exercise trust powers subsequent to the discovery of unauthorized activities do not merit expedited processing. Such applications warrant consideration for approval subject to prior written conditions with management.

e. "Customer Service" versus "Fiduciary Activity"

It is not unusual for a bank to hold securities, notes, mortgages, or similar instruments in a "Customer Collections" department, collecting income and remitting it to customers. This could be considered a normal banking function not requiring trust powers. However, there have been instances where banks have entered into arrangements to make investment recommendations, buy and sell securities on their own authority, vote proxies, and otherwise deal with securities in the manner of a fiduciary. Banks have also entered into discretionary arrangements to execute repurchase agreements, or make other short-term investments using demand deposit accounts to settle transactions. Some escrow departments may hold, manage, rent, or otherwise administer real property in a manner, which reaches beyond conventional escrow relationships. All these activities constitute discretionary agencies typically requiring trust powers. Normally, the most important determining factor is the degree of discretionary authority exercised over funds and assets, with resulting exposure to contingent liabilities. Questionable cases should be submitted by the examiner to the Regional Office for determination.

f. Additional Information

Whether or not additional information is necessary to approve or recommend denial of an application for consent to exercise trust powers, is generally left to the discretion of the Regional Director. Additional information may be obtained by correspondence, telephone, or personal visit. Matters, which may be relevant in considering applications which, are not eligible for expedited processing include:

(1) Competition - If the lack of sufficient trust services in the trade area is of importance in determining a recommendation, competitive information should be secured from the Annual Report of Trust Assets of area banks.

(2) Trust Business Development - The size and scope of the proposed operation may be influenced considerably by the extent to which the applicant plans to use advertising, personal solicitation, and other public relations activities.

(3) Amount and Kind of Property and Potential Volume of Business - The sources of such data will vary. Any information as to trade area demographics, and the types of assets or property by which it is principally represented would, in some instances, prove beneficial.

(4) Deposit Structure - If collateral benefits to the bank, such as a substantial volume of new deposits in the banking department, are anticipated from the establishment of trust services, the bank may be required to provide full details. Caution is suggested in allowing too much weight in consideration for claims of collateral benefits, as these are often short-lived while the obligations of the trust services continue.

(5) Fixed Assets - If establishment of the trust department results in a significant increase in an already heavy fixed asset investment, full details should be requested.

(6) Deposit Insurance - As noted in FDIC Section 330.12, depending on the institution's Prompt Corrective Action capital category, pass-through deposit insurance may not be available on deposits of retirement and

employee benefit plans. This applies to deposits, which may obviously be made in the bank without regard to whether it has trust powers.

However, the likelihood of such deposits being made increases when banks acquire trust powers. The applicability of this section to applicants seeking consent should be ascertained. To the extent that deposits of such plans exist in the bank, or are contemplated, and pass-through deposit insurance is not available, care should be taken to ensure that procedures in both Parts 325 (Capital Maintenance) and 330 (Deposit Insurance Coverage) are being followed, and that corrective plans are in place.

C. CORPORATE STRUCTURE AND ORGANIZATION OF FIDUCIARY ACTIVITIES

1. General

The offering of trust services has long been regarded as an ancillary customer service, primarily the dominion of banks. However, toward the end of the twentieth century a number of forces have combined, with the result that fiduciary services are a dynamic and sought-after product line with significant profit potential. In the U. S., population trends have been a significant factor as the large post-World War II "baby boom" generation matures and accumulates wealth. The large size and consumer influence of this group has created much emphasis on wealth management and transfer. While this has presented trust service providers with more opportunity, it has also attracted competition from banking and non-banking industries. New delivery systems, new products, advances in technology, and consolidation within the financial industry, have all contributed to changes in how banks offer trust services. To properly evaluate these delivery systems the examiner needs an understanding of both the legal and functional organization of the bank's trust services.

The trust department, as a separate and visually distinct department of the bank, remains the most prevalent method for banks to deliver fiduciary services. However, the recent trend toward consolidation within the financial services sector has led to diverse restructuring and merger activity. In some instances, banks previously lacking trust product lines may have acquired them through mergers. In other cases, the "trust" line of business may have been purchased or sold by a bank. In some cases, trust services being provided by several individual banks owned by the same holding company may have been consolidated within one bank, or within a separately chartered trust company. In still other instances, a bank may have contracted with an unrelated outside party, to provide such services on-premises. Or conversely, the bank under examination may provide such services to other banks. In all cases, the examiner should seek to understand the organization, and review the structure of the delivery system for legality, reasonableness, and adequacy of compensation to the bank.

CHANGE IN BANK CONTROL ACT

Introduction

The Change in Bank Control Act of 1978, Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, amended Section 7(j) of the Federal Deposit Insurance Act. The amendments gave Federal banking agencies authority to disapprove changes in control of insured banks and bank holding companies. The appropriate agencies for changes in control are: the FDIC for insured nonmember banks, The Board of Governors of the Federal Reserve System for member banks and bank holding companies, the Comptroller of the Currency for national banks, and the Director of the Office of Thrift Supervision for savings associations and savings and loan holding companies. Previous reporting requirements relating to loans by banks secured by stock of other banks and management changes occurring after a change in control were retained with some modification and these requirements were extended to bank holding companies and loans secured by bank holding company stock. The FDIC's objectives in its administration of the Change in Bank Control Act are to enhance and maintain public confidence in the banking system by preventing identifiable serious adverse effects resulting from anticompetitive combinations of interest, inadequate financial support, and unsuitable management in these institutions. The FDIC will review each notice to acquire control of an insured State nonmember bank and disapprove transactions likely to have serious harmful effects.

Provisions of Law

Section 7(j) of the FDI Act; Subpart E, Section 303.80 of the FDIC's Rules and Regulations and the FDIC Statement of Policy, "Changes in Control in Nonmember Banks," set forth in detail all necessary requisites and instructions.

Procedures

Any person (broadly defined) seeking to acquire control (power to vote 25% or more of any class of voting securities) of any insured bank or bank holding company, is required to provide sixty days prior written notice to the appropriate agency. A person means an individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity. A Notice of Acquisition of Control form is required to be filed with the appropriate Regional Office, accompanied by a completed and signed Financial Report and Biographical Information form for each of the acquiring parties to the extent known. Certain newspaper publication requirements are also required as indicated in Part 303.

The FDIC reviews the information reported in a Notice to assess any anticompetitive or monopolistic effects of the proposed acquisition, to determine if the financial condition of any acquiring person is such as might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank, and to determine whether the competence, experience, or integrity of any inquiring person, or any of the proposed management personnel, indicates that it would not be in the interest of the depositors of the bank, or in the interests of the public, to permit such person to control the bank.

While processing and handling of Notices may parallel the procedures related to applications for deposit insurance, new branches, relocations, etc., at least one fundamental difference is present. In the case of statutory applications, the burden of making a case in support of a proposal falls on the applicant; in considering Notices, the FDIC exercises a veto, with a burden of sustaining a disapproval falling on the FDIC. Accordingly, in evaluating Notices, the FDIC need not find favorably on the various factors; the absence of unfavorable findings approximates tacit approval.

Regional Directors are delegated, with certain exceptions, authority to issue a written notice of the FDIC's intent not to disapprove an acquisition of control. Authority to disapprove has been delegated to the Director and Deputy Director (DOS) and where confirmed in writing by the Director to an associate director. If written views of the State authority recommend disapproval, or if an acquiring party discloses a conviction or a plea of no contest to a criminal charge involving dishonesty or breach of trust, the Regional Director makes a recommendation to Washington based on the findings under the factors.

The factors considered in evaluating Notices and the basis for disapproval are, in brief: whether the proposed acquisition of control would result in a monopoly; whether the effect the proposed acquisition of control in any section of the country may be substantially to lessen competition or to tend to create a monopoly, or would in any other manner be in restraint of trade; the financial condition of the acquiring party and its potential impact on the financial stability of the bank or prejudice the interests of depositors; the competence, experience or integrity of any acquiring person or proposed management; if any acquiring party neglects, fails, or refuses to furnish all the information required by the FDIC; or the effect on the Bank Insurance Fund or Savings Association Insurance Fund is adverse.

A transaction triggering the notice requirements may not result in the acquiring party actually gaining effective control of an institution. For example, a person acquiring 25% of voting control would not gain effective control if there were an existing shareholder with 50% of voting control. Nonetheless, the transaction triggers the notice requirement and a Notice should be evaluated as if it were an actual change in effective control. After once complying, further acquisitions by the same person in the same bank do not require filing of notices. An acquiring party who continuously remains within the definition of control needs to file only one notice per bank to be in compliance.

Certain types of transactions are exempt from prior notice requirements, such as those subject to Section 3 of the Bank Holding Company Act, Section 10 of the Home Owner's Loan Act, or Section 18 of the FDI Act, since they are covered by existing regulatory approval procedures. Accordingly, changes in control due to acquisitions by bank holding companies and those resulting from mergers, consolidations, or other similar transactions are not covered. Acquisition of shares of foreign banks are exempt, however, foreign banks with insured domestic branches are subject to the after-the-fact reporting requirements. Transactions resulting in voting control of 10% or more of any class of voting securities of banks whose securities are subject to the regulation requirements of Part 335 of the FDIC's Rules and Regulations are presumed to be acquisitions of control as are similar transactions of unregistered banks resulting in 10% or more control whereby the acquiring party would become the largest shareholder. These latter two are rebuttable presumptions of control. In addition, the following types of transactions are also exempt: a foreclosure of a debt previously contracted in good faith; testate or intestate successions; a bona fide gift; and; a transaction described in Section 2(a)(5) or 3(a)(5)(A) or (B) of the Bank Holding Company Act by a person there described.

Persons acquiring control by exempt transactions while not required to give prior notice, are required to provide after-the-fact information on the transaction and other information regarding changes in management or policies of the bank. Personal financial and biographical information may be requested subsequent to changes in control of these types at the discretion of the Regional Director. Affected banks are required to report changes or replacement of chief executive officers or directors occurring within twelve months after change in control, including a statement of the past and current business and professional affiliations of the new chief executive officer or director.

Section 7(j) of the FDI Act also requires the chief executive officer of an insured bank that makes a loan secured or to be secured by 25% or more of the voting stock of another insured bank to report the facts to the appropriate regulatory agency. No report need be made where the stock is that of a newly organized bank prior to its opening. Through the definition of insured bank, the reporting requirement is extended to include loans secured by bank holding company stock.

Effective enforcement of Section 7(j) of the FDI Act requires examiners to review stockholder ledgers and records and review correspondence files to determine whether any nonexempt stock transactions have occurred which would constitute an acquisition of control, whether prior notice has been provided to the FDIC where required, and, if bank management has complied with the after-the-fact reporting requirements relating to bank stock loan reports and changes or replacement of the chief executive or directors. Review of stockholder records must be conducted with particular attention to the statutory definition of control, including the presumptions of control established in Part 303 of the FDIC's Rules and Regulations. All substantial change in ownership transactions between examinations should be reviewed, however, a relatively small transaction may trigger the notice requirements and the statutory definition of control does not necessarily imply effective control. Examiners should also be alert to the formation of voting trusts, assignments of proxies of duration beyond the customary annual meeting solicitations, and other similar arrangements which effectively transfer voting control and which may require prior notice. The statute and implementing regulations do not elaborate on what constitutes a group acting in concert. A series of transactions which are individually insignificant, but significant when aggregated, may indicate a subterfuge, particularly if the individuals or entities involved have other business or professional relationships. Consultation with the Regional Office would appear prudent should such a situation of this type be encountered.

Apparent violations regarding acquisitions consummated without filing of a prior notice should be communicated to the Regional Office by telephone and reported in the Supervisory Section of the Report of Examination. Apparent violations for failure to comply with the after-the-fact reporting requirements should be detailed in the open section of the report under Violations of Laws and Regulations since civil money penalties may be invoked (refer to the Civil Money Penalties Section of this Manual).

APPLICATIONS FOR RETIREMENT OF CAPITAL

Introduction

Refer to the current FDIC Statement of Policy on Capital in the Capital Section of this Manual. Section 303.241 of the FDIC Rules and Regulations contains the procedures to be followed when an institution seeks the FDIC’s prior approval to reduce the amount or retire any part of its common or preferred stock, or to retire any part of its capital notes or debentures.

There is concern that approval of a request to retire subordinated notes by a bank which is in danger of failure may in effect be granting preferred creditor status to the note holder. Consequently, unless a bank is in a condition which indicates it might fail within a reasonable time, the Regional Director should exercise delegated authority and approve the request.

Applicants should submit a letter application containing the following: type and amount of the proposed change to the capital structure and the reason for the change; a schedule detailing the present and proposed capital structure; the time period that the proposal will encompass; if the proposal involves a series of transactions affecting Tier 1 capital components which will be consummated in twelve months or less, the application shall certify that the insured depository institution will maintain itself as a well-capitalized institution as defined in Part 325 of the FDIC Rules and Regulations, both before and after each of the proposed transactions; if the proposal involves the repurchase of capital instruments, the amount of the repurchase price and the basis for establishing the fair market value of the repurchase price; a statement that the proposal will be available to all holders of a particular class of outstanding capital instruments on an equal basis, and if not, the details of any restrictions; and the date that the applicant’s board of directors approved the proposal. Expedited processing is available for eligible depository institutions as defined in Part 303.

Adequacy of the remaining capital is the chief factor considered in acting upon applications for capital retirement or reduction. In granting or withholding consent, the FDIC must consider the six statutory factors: the financial history and condition of the bank; the adequacy of its capital structure; its future earnings prospects; the general character of its management; the convenience and needs of the community to be served and whether or not its corporate powers are consistent with the purposes of the FDI Act.

Section 18(i) of the FDI Act deals specifically with the subject of capital retirement. The FDIC's Legal Division has ruled that the provisions of this section also apply to capital retirements or reductions relative to the following: retirements or reductions which are part of another proposal for which a current application has been filed for FDIC approval; conversion of capital notes or debentures to an equivalent amount of common stock or preferred stock; conversion of preferred stock to an equivalent amount of common stock; and repurchase and retention by a bank of its own capital as part of a stock option plan.

Capital Notes and Debentures

Insured State nonmember banks customarily seek the FDIC's consent to retire subordinated notes or debentures at the time of proposed issuance of such obligations. The Legal Division is of the opinion that where a replacement of capital issues is clearly of a formalistic nature only, without an effective reduction in the amount of the bank's capital and with no change to the governing terms and conditions of the instruments themselves, the replacement should not be deemed to come within Section 18(i)(1) of the FDI Act.

All new subordinated note and debenture agreements must contain a statement to the effect that the prior consent of the FDIC is required before any portion of the debt can be retired. The purpose of including the statement is to assure that all parties involved, including future holders of the notes, are aware of the requirements of Section 18(i)(1). Where periodic mandatory payments are required, the agreement and the notes may include the additional statement that these particular mandatory payments have already been consented to by the FDIC, if such advance consent has, in fact, been given.

APPLICATIONS FOR MERGERS

Introduction

It is the policy of the FDIC to preserve the soundness of the banking system and promote market structures conducive to competition. A proposed merger, consolidation, and purchase of assets and assumption of liabilities are all hereafter referred to collectively as "mergers."

Provisions of Law

Section 18(c) of the FDI Act (the "Act"), popularly known as the Bank Merger Act, provides that, except with the prior written approval of the FDIC, no insured depository institution may merge with any other insured depository institution, if the acquiring, assuming or resulting institution is to be a nonmember insured bank. The section also requires approval before an insured depository institution may merge with a noninsured bank or institution. The section contains special provisions for interstate merger transactions. These are subject to section 44 of the FDI Act. In addition, the FDIC will consider in evaluating merger applications the requirements of the Community Reinvestment Act. The factors to be considered in granting or withholding approval are those enumerated in Section 18(c) of the "Act". Subpart D of Part 303 of the FDIC Rules and Regulations governs the administrative handling of "merger" applications.

Paragraph (4) of Section 18(c) of the "Act" provides that, before acting on an application, the FDIC must request reports on the competitive factors involved from the Attorney General, the Comptroller of the Currency and the Board of Governors of the Federal Reserve System. These reports must ordinarily be furnished within 30 days, and the applicant will, if it so requests, be given an opportunity to submit comments to the FDIC respecting the contents of the competitive factor reports.

Paragraph (5) of Section 18(c) prohibits the FDIC from approving anticompetitive mergers. To establish that any anticompetitive effect is clearly outweighed in the public interest, the proponents must show that probable effect of the transaction in meeting convenience and needs is likely to benefit all seekers of banking services in the areas of competitive impact, rather than merely those who seek, for example, large loan and trust services, and that the expected benefit cannot reasonably be achieved through other, less anticompetitive means. The statute also requires the FDIC to consider in every case the financial and managerial resources, future prospects of the existing and proposed institutions, as well as the convenience and needs of the community to be served.

Under Section 8(q) of the "Act," whenever the liabilities of an insured depository institution are assumed by another insured depository institution; the insured status of the institution whose liabilities are assumed terminates on the date of receipt by the FDIC of satisfactory evidence of the assumptions, and separate insurance of all assumed deposits terminates at the end of six months from the date the assumption takes effect or, in the case of any time deposit, the earliest maturity after the sixth-month period.

Branch closings in connection with a merger transaction are subject to the notice requirements of Section 42 of the FDI Act, including requirements of notification to customers.

Statement of Policy - Bank Merger Transactions

The FDIC Statement of Policy on Bank Merger Transactions was revised effective October 1, 1998. The FDIC is prohibited by law from approving any merger that would tend to create or result in a monopoly, or which would further a combination, conspiracy or attempt to monopolize the business of banking in any part of the United States. Similarly, the FDIC may not approve a transaction whose effect in any section of the country may be to lessen competition substantially, or which in any other manner would be in restraint of trade. The FDIC may, however, approve any such transaction if it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served, for example, where approval of the merger may prevent the probable failure of one of the banks involved. In every case, the FDIC must also consider the financial and management resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served.

In evaluating the various factors prescribed and making the necessary judgments on proposed merger transactions, it is the intent and purpose of the FDIC to foster and maintain a safe, efficient and competitive banking system that meets the needs of all elements of the communities served. With these broad goals in mind, the FDIC will apply the specific standards listed in the Policy Statement in evaluating and deciding proposed bank merger transactions.

Procedures

Banks seeking the FDIC's consent to engage in a merger transaction must file a formal application with the FDIC on the appropriate form. The FDIC will not take final action on an application until notice of the proposed transaction is published in a newspaper or newspapers of general circulation in the appropriate community or communities, in accordance with the requirements of Section 303.65 of the FDIC's Rules and Regulations.

Section 303.64 of the FDIC Rules and Regulations provides for expedited processing to eligible applications. In evaluating a merger application, the FDIC considers the following factors: the extent of existing competition between and among the merging institutions, other depository institutions, and other providers of similar or equivalent services in the relevant product markets within the relevant geographic markets. In its analysis of the competitive effects of a proposed merger transactions, the FDIC will focus particularly on the type and extent of competition that exists and that will be eliminated, reduced or enhanced by the proposed merger transaction.

In order to determine the effect of the proposed merger on competition, it is necessary to identify the relevant geographic market. The delineation of such market can seldom be precise, but realistic limits should be established so the effect of the merger upon competition can be properly analyzed. The FDIC recognizes that different banking services may have different relevant geographic markets. However, the market should not be drawn so expansively as to cause the competitive effect of the merger to seem insignificant. Conversely, the market should not be drawn so narrowly as to place competitors in entirely different markets. After the relevant geographic market has been identified, the competitive effect of the proposed merger can be analyzed. A merger not having a substantially adverse competitive effect may nevertheless be disapproved if, after considering the banking factors, the FDIC concludes that the resultant bank will have inadequate capital, unsatisfactory management, or poor earnings prospects. Refer to the policy statement for further competitive effects analytical explanation.

In addition to the competitive analysis, the FDIC will consider prudential factors. These include the existing institutions overall condition, including capital, management and earnings. Apart from competitive considerations, the FDIC normally will not approve a proposed merger transaction where the resulting institution would fail to meet existing capital standards, continue with weak or unsatisfactory management, or whose earnings prospects, both in terms of quantity and quality are weak, suspect or doubtful. In assessing capital adequacy and earnings prospects, particular attention will be paid to the adequacy of the allowance for loan and lease losses. In evaluating management, the FDIC will rely to a great extent on the supervisory histories of the institutions involved and of the executive officers and directors that are proposed for the resultant institution.

The Convenience and Needs factor is also evaluated. Under this factor, the FDIC will consider the extent to which the proposed merger transaction is likely to benefit the general public through higher lending limits, new or expanded services, reduced prices, increased convenience in utilizing the services and facilities of the resulting institution, or other means. The FDIC, as required by the Community Reinvestment Act, will also note and consider each institution's CRA performance evaluation record. An unsatisfactory record may form the basis for denial or conditional approval of an application.

The commitment to pay or payment of unreasonable or excessive fees and other expenses incident to an application reflects adversely upon the management of the applicant institution. The FDIC will closely review expenses for professional or other services rendered by present or prospective board members, major shareholders or other insiders for any indication of self-dealing to the detriment of the institution. As a matter of practice, the FDIC expects full disclosure to all directors and shareholders of any arrangement with an insider. In no case will the FDIC approve an application where the payment of a fee, in whole or part, is contingent upon any act or forbearance by the FDIC or by any other federal or state agency or official.

Where banking offices are to be closed in connection with the proposed merger transaction, the FDIC will review the merging institution's conformance to any applicable requirements of section 42 of the FDI Act concerning notice of branch closing as reflected in the interagency Policy Statement Concerning Branch Closing Notices and Policies. Although the appropriate application must be filed with the FDIC and statutory factors are considered in the case of "interim" (mergers or other transactions involving an existing bank and a newly chartered bank or corporation for the purpose of corporate reorganization) and other corporate reorganizations (transactions involving banks controlled by the same holding company or transactions involving banks or their subsidiaries), these types of transactions normally do not have any effect on competition or otherwise have significance under relevant statutory standards set forth in Section 18(c) of the FDI Act. The guidelines set forth above for "mergers" have only general applicability and may have no applicability depending on the specific circumstances involved in individual transactions.

APPLICATIONS BY UNDERCAPITALIZED DEPOSITORY INSTITUTIONS FOR A WAIVER TO ACCEPT, RENEW OR ROLLOVER BROKERED DEPOSITS

Provisions of Law

Section 224 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 added Section 29 to the FDI Act, prohibiting the acceptance, renewal or rollover of brokered deposits by any undercapitalized insured depository institution (bank or savings association) except on specific application to and waiver of the prohibition by the FDIC.

Section 337.6 of the FDIC's Rules and Regulations provides guidance and detail on when an institution is considered undercapitalized, when certain deposits are considered "brokered" for purposes of the prohibition, and the circumstances under which a waiver from the prohibition may be obtained. Section 303.243 contains the procedures to follow to file with the FDIC for a brokered deposit waiver. Expedited processing of these filings is extended to eligible depository institutions with the caveat that for purposes of this filing, eligible depository institutions may be adequately capitalized, according to the definition found in Section 325.103 of the FDIC's Rules and Regulations, rather than well-capitalized as is required for other filings.

The regulation takes a broad view of when an institution is considered undercapitalized and a narrow view of the circumstances under which a waiver may be obtained with the result and expectation that such institutions will not accept new brokered deposits and over some reasonable time frame all undercapitalized depository institutions utilizing brokered deposits will have to either meet applicable capital standards or eliminate brokered deposits from their books.

Procedures

Undercapitalized insured depository institutions may file waiver applications under section 337.6 with the Regional Office where they are headquartered. Institutions may apply for a waiver in letter form or on an optional application form. Applications should contain: the time period for which the waiver is requested, a statement of the policy governing the use of brokered deposits in the institution's overall funding and liquidity management program; the volume, rates and maturities of the brokered deposits held currently and anticipated during the waiver period sought, including any internal limits placed on the terms, solicitation and use of brokered deposits; how brokered deposits are costed and compared to other funding alternatives and how they are used in the institution's lending and investment activities, including a detailed discussion of asset growth plans; procedures and practices used to solicit brokered deposits, including an identification of the principal sources of such deposits; management systems overseeing the solicitation, acceptance and use of brokered deposits; a recent consolidated financial statement with balance sheet and income statements; and the reasons the institution believes its acceptance, renewal or rollover of brokered deposits would pose no undue risk.

Authority is delegated to Regional Directors or Deputy Regional Directors to approve or deny brokered deposit waiver applications. Based upon a preliminary review, any delegate may grant a temporary waiver for a short period in order to facilitate the orderly processing of a filing for a waiver. A waiver should be for a fixed period, generally no longer than two years, and may be revoked by the FDIC at any time by written notice to the institution.

POLICY STATEMENT ON ENCOURAGEMENT AND PRESERVATION OF MINORITY OWNERSHIP OF FINANCIAL INSTITUTIONS

Introduction

In recognition of the unique status of minority-owned depository institutions in the financial system, it is the policy of the DOS to proactively preserve minority ownership of financial institutions and to encourage minority participation in the management of financial institutions. This policy is intended to be consistent with the FDIC's broader mission of preserving the soundness of the banking system and promoting fair market structures conducive to competition and community service.

For the purposes of this policy statement, the term minority-owned institution means an FDIC-insured depository institution where more than 50% of the voting stock is owned or controlled by minority individuals or organizations, or in the case of a mutual depository institution, the majority of the Board of Directors, account holders and the community which it serves are members of a minority group. The term "minority" means any Black American, Native American, Hispanic American, or Asian American.

Statutory Requirements

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) contains several provisions relating to the preservation of minority ownership of financial institutions. These statutes provide a framework for this policy statement.

Section 13(k) of the FDI Act deals with emergency acquisitions of distressed savings associations. Section 13(k)(2)(B) addresses the acquisition of minority-controlled depository institutions by stating: "the FDIC shall seek an offer from other minority-controlled depository institutions before seeking an offer from other persons or entities.

Section 13(f)(12) of the FDI Act eliminates the $500,000,000 asset cut-off for acquisition of a distressed minority-controlled bank by an out-of-state minority-controlled depository institution or depository institution holding company.

Section 308 of FIRREA sets goals to preserve minority ownership of financial institutions. These goals are set out as:

1. Preserving the number of minority depository institutions;
2. Preserving the minority character in cases of merger or acquisition;
3. Providing technical assistance to prevent insolvency of institutions not now insolvent;
4. Promoting and encouraging creation of new depository institutions; and
5. Providing for training, technical assistance, and education programs.

Discussion

The Division of Supervision becomes involved in the creation of new minority ownership through its responsibility for acting on applications for federal deposit insurance and mergers and reviewing notices of acquisition of control. For those minority applicants who are not familiar with the required laws, procedures or forms, technical expertise and assistance should be made available through DOS Regional Offices.

One very effective method of preserving minority ownership is to maintain the health of existing minority-owned depository institutions. In this regard, DOS is committed to a program of regular examination of all banks for which it has primary supervisory responsibility. This examination program is intended to detect deteriorating trends and to work with management to correct them. Correction of any adverse trends in institutions normally is handled through regular supervisory channels. In the event that management is unable to effect correction because of a lack of resources or technical expertise, DOS will provide assistance where practical. Additionally, DOS encourages other depository institutions to be available to provide technical expertise to minority-owned institutions.

Training, education and technical assistance are available through the FDIC in such areas as call report preparation, consumer affairs and civil rights, and accounting. FDIC personnel generally are available for attendance at conferences or seminars dealing with issues of concern to minority groups.

Procedures and Related Matters

Applications - Notices of acquisition of control and applications for deposit insurance and merger from minority-owned institutions will be submitted to the appropriate regional office and processed under established procedures. Those applications which involve creation or preservation of minority ownership also will be considered in the context of the effect of the transaction on the goal of preserving minority ownership. Technical assistance in the completion of the documentation of these applications is available upon request from the regional office.

Operating Institutions in Need of Assistance - Through its normal supervision, the FDIC will be aware of institutions in need of remedial or preventative attention. Field examiners and regional office staff will make suggestions and offer assistance, which an institution is free to accept. Institutions are also urged to make their needs known to the Regional Director who will do all they can to help. To the extent possible, the FDIC will consider invitations to participate in seminars, conferences and workshops directed to minority audiences.

Request for Financial Assistance - Requests from minority groups for assistance in resolving a failing minority-owned depository institution will be considered at the same time as assistance requests or failing bank bids received from non-minority groups; however, preference generally will be given to a minority group proposal. Technical assistance in preparing these applications is available upon request.

Failing Banks - In the event a minority-owned bank deteriorates into a failing condition, a list of eligible bidders is compiled. Generally, preference will be given to qualified minority bidders located 1) in the same local market area, 2) in the same state, and 3) nationwide. Trade associations will be contacted for names of possible interested parties which may be contacted. Groups interested in becoming bidders must have appropriate clearance from other responsible regulatory agencies.

APPLICATIONS PURSUANT TO SECTION 19 OF THE FDI ACT – CRIMES INVOLVING DISHONESTY OR BREACH OF TRUST OR MONEY LAUNDERING, OR PRETRIAL DIVERSION PROGRAMS FOR SUCH OFFENSES

Provisions of Law

Section 19 of the FDI Act prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty, breach of trust, money laundering, or who has agreed to enter into a pretrial diversion or similar program for such offense, from becoming or continuing as an institution-affiliated party, owning or controlling, directly or indirectly an insured depository institution, or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured institution.

Section 19 imposes a duty upon the insured institution to make a reasonable inquiry regarding an applicant's history, which consists of taking steps appropriate under the circumstances, consistent with applicable law, to avoid hiring or permitting participation in its affairs by a person who has a conviction or program entry for a covered offense. The FDIC believes that, at a minimum, each insured institution should establish a screening process that provides the insured institution with information concerning any convictions or program entry pertaining to a job applicant. This would include, for example, the completion of a written employment application (although other alternatives may be appropriate) that requires a list of all convictions and program entries. The FDIC will look to the circumstances of each situation to determine whether the inquiry is reasonable.

Upon notice of a conviction or program entry, the institution should obtain forms and instructions from, and file an application with, the appropriate FDIC Regional Director. The application must be filed by an insured depository institution on behalf of a person, unless the FDIC grants a waiver of that requirement. The FDIC will consider such waivers on a case-by-case basis where the institution shows substantial good cause for granting a waiver.

The above information represents a partial summary of the requirements of Section 19. For definitions of terms and additional guidance, examiners should refer to the FDIC Statement of Policy on Section 19 of the FDI Act.

Examiner Responsibilities

Examiners should review conformance with the FDIC Statement of Policy for Section 19 of the FDI Act during examinations of institutions where risk-scoping activities indicate a material degree of risk with respect to this area. The scope or depth of these reviews should comply with the guidelines detailed in the risk-focused supervision examination modules.

APPLICATIONS PURSUANT TO PART 362 OF THE FDIC's RULES AND REGULATIONS – ACTIVITIES AND INVESTMENTS OF INSURED DEPOSITORY INSTITUIONS

Revised Part 362 and related amendments to Part 303 became effective January 1, 1999. The revised rule provides the framework for which certain state-chartered banks or their majority-owned subsidiaries may engage in activities that are not permissible for national banks or their subsidiaries. The institution's chartering authority must permit all contemplated activities.

Under Part 362, well-capitalized, state-chartered banks or their subsidiaries may engage in certain otherwise impermissible activities without seeking specific FDIC consent if the bank complies with any limits or conditions restricting those activities. Other activities require depository institutions to submit either a notice or application to the FDIC.

The notice procedure is designed to expedite the processing of requests from banks meeting various eligibility requirements. Activities to which notice processing has been extended include securities underwriting and real estate investment activities.

OTHER APPLICATIONS

Subpart F of Part 303 – Change of Director or Senior Executive Officer

Insured state nonmember banks are to give the FDIC written notice at least 30 days prior to adding or replacing any member of its board of directors, employing any person as a senior executive officer of the bank, or changing the responsibilities of any senior executive officer so that the person would assume a different senior executive officer position if:

(1) The bank is not in compliance with all minimum capital requirements applicable to the bank

(2) The bank is in troubled condition, or

(3) The FDIC determines, in connection with its review of a capital restoration plan that such notice is appropriate

Waivers to the pre-filing requirement may be applied for and granted if delay would threaten the safety or soundness of the bank or not be in the public interest. In the case of the election of a new director not proposed by management at a meeting of the shareholders, the prior 30-day notice is automatically waived provided that a complete notice is filed with the appropriate regional director within two business days after the individual's election.

Subpart I – Mutual-to-Stock Conversions

An insured state chartered mutually owned savings bank that proposes to convert from mutual to stock form shall file with the FDIC a notice of intent to convert to stock form.

At a minimum, such notice shall contain:

- The plan of conversion with specific information concerning the record date used for determining eligible depositors and the subscription offering priority;
- Certified board resolutions relating to the conversion;
- A business plan including a discussion of how the capital acquired in the conversion will be used, expected earnings for at least a three year period following the conversion and a justification for any proposed stock repurchase;
- The charter and bylaws of the converted institution
- The bylaws and operating plans of any other entities formed in connection with the conversion transaction such as a holding company or charitable foundation;
- A full appraisal report, prepared by an independent appraiser of the value of the converting institution and the pricing of the stock to be sold in the conversion transaction;
- Detailed descriptions of any proposed management or employee stock benefit plans or employment agreements and a discussion of the rationale for the level of benefits proposed;
- Indemnification agreements;
- A preliminary proxy statement and sample proxy;
- Offering circular(s);
- All contracts or agreements relating to solicitation, underwriting, market-making or listing of conversion stock and any agreements among members of a group regarding the purchase of unsubscribed shares;
- A tax opinion concerning the federal income tax consequences of the proposed conversion;
- Consent from experts to use their opinions as part of the notice; and
- An estimate of conversion-related expenses.

The FDIC shall review the notice and other materials for considerations such as: the proposed use of the proceeds, the adequacy of the disclosure materials, the participation of depositors in approving the transaction, the appropriateness of any proposed increased compensation and other remuneration to be granted to officers and directors, the adequacy and independence of the appraisal of the value of the mutual savings bank for purposes of determining the price of the shares of stock to be sold and the extent to which the proposed conversion transaction conforms with the various provisions of the mutual-to-stock conversion regulations of the Office of Thrift Supervision.

The FDIC will issue either a letter of non-objection if the FDIC determines that the proposed conversion transaction would not pose a risk to the institution's safety or soundness, or a letter of objection. In the latter case, if the FDIC determines either that the proposed conversion transaction poses a risk to the institution's safety or soundness, violates a law or regulation, or presents a breach of fiduciary duty, the objection letter would instruct the institution not to consummate the transaction until such point as the objection letter is rescinded.

Other Filings

Golden Parachute and severance plan payments – Pursuant to section 18(k) of the FDI Act and Part 359 of the FDIC Rules and Regulations, an insured depository institution or depository institution holding company may not make golden parachute payments or excess nondiscriminatory severance plan payments unless permission is obtained.

For additional information and guidance on the various applications, please also refer to:

- The Division of Supervision and Consumer Affairs **Formal and Informal Action Procedures Manual**, and
- The Division of Supervision and Consumer Protection **Case Managers Procedures Manual**.