FEDERAL DEPOSIT INSURANCE CORPORATION

Applications for Deposit Insurance

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Proposed statement of policy.

SUMMARY: As part of the FDIC's systematic review of its regulations and written policies under section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994, the FDIC is revising its Statement of Policy on ''Applications for Deposit Insurance.'' These revisions include changes to FDIC's policies regarding initial capitalization when a de novo bank is organized by certain well managed and well capitalized holding companies. Policies regarding stock benefit plans are amended and regional directors are given more discretion to act under delegated authority. Changes are also made to eliminate outdated information and to reflect current polices and practices that have not previously been incorporated into the Statement of Policy.

DATES: Comments must be submitted on or before January 7, 1998.

ADDRESSES: Send written comments to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, D.C. 20429. Comments may be hand delivered to the guard station located at the rear of the 17th Street building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (FAX number (202) 898–3838; Internet address: comments@FDIC.gov). Comments may be inspected and photocopied at the FDIC Public Information Center, Room 100, 801 17th Street NW, Washington, D.C., between 9:00 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: Cary H. Hiner, Associate Director, Division of Bank Supervision, (202) 898–6814; Jesse G. Snyder, Assistant Director, Division of Supervision, (202) 898–6915; Mark S. Schmidt, Assistant Director, Division of Supervision, (202) 898–6915; or Susan van den Toorn, Counsel, Regulation and Legislation Section, Legal Division, (202) 898–8707, FDIC, 550 17th Street, N.W., Washington, D. C. 20429.

SUPPLEMENTARY INFORMATION: The FDIC is conducting a systematic review of its regulations and written policies. Section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRIA) (12 U.S.C. 4803(a)) requires the FDIC to streamline and modify its regulations and written policies in order to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. Section 303(a) also requires the FDIC to remove inconsistencies and outmoded and duplicative requirements from its regulations and written policies. Also as part of the CDRIA review, on December 6, 1995, the FDIC published in the **Federal Register** a Notice of opportunity to comment on specific FDIC regulations and written policies. See 60 FR 62345. In response to that request, the FDIC received one comment regarding the Statement of Policy on ''Applications for Deposit Insurance'' (Statement of Policy). The commenter urged the FDIC to re-evaluate its position with regard to stock benefit plans established to compensate organizers and investors who place funds at risk during the organizational phase. Specifically, the commenter stated that the FDIC has objected to stock options proposed to be awarded to organizers who have placed funds at risk and noted that the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Board (FRB) do not object to such plans. The commenter urged the FDIC to take a position similar to the OCC and the FRB. The issues raised by the commenter are addressed below in the discussion of stock benefit plans and in the Statement of Policy.

Also as a part of the CDRIA review, the FDIC has determined that the Statement of Policy remains an important communication device with the banking industry. However, certain information has become outdated, while some issues of current importance either are not addressed or are not adequately addressed. As a consequence, the basic organizational structure of the Statement of Policy has been retained, while much of the content has been revised.

Four significant changes to the Statement of Policy are described below. In each of these instances, the change will provide the appropriate FDIC regional director, Division of Supervision (DOS), with the authority to approve deposit insurance applications which previously would have been forwarded to the FDIC's Washington Office for review and decision.

Wholly Owned Subsidiary of a Holding Company

The current Statement of Policy requires an initial capitalization in an amount that is sufficient to provide an 8 percent Tier 1 leverage capital ratio throughout the first three years of operation. The revised Statement of Policy provides that, in certain circumstances, the amount of the initial capital injection for a de novo institution may be reduced to a minimum of $2,000,000, or an amount that is sufficient to provide an 8.0 percent Tier 1 leverage capital ratio at the end of the first year of operation, whichever is greater. This option will be available when the proposed depository institution is to be formed as a wholly owned subsidiary of a holding company which meets the standards established for an ''eligible holding company,'' as set forth in § 303.22 of the FDIC's regulations. However, the holding company would also be required to provide a written commitment to maintain the proposed depository institution's Tier 1 leverage capital ratio at no less than 8.0 percent throughout the first three years of operation. This revision will allow a well managed holding company to provide less initial capital than would have been required under the former standard. This change is considered appropriate in recognition of the ability of the FDIC to reasonably quantify the financial capacity of the parent organization, and to allow the holding company to more efficiently allocate the resources of the entire organization. This amendment will permit the appropriate FDIC regional director (DOS) to act on proposals that contain these provisions when the other factors necessary for delegated authority have been met.

Operating Insured Offices

In certain instances, the applicant may request that the benchmark for evaluating the adequacy of capital be established such that the resultant proposed depository institution would be classified as well capitalized, as defined by its primary federal regulator. This provision would become applicable when the proposal involves the formation of a depository institution through the acquisition of an existing insured operating office (or offices). Criteria established for this lower initial capital benchmark would be that the acquisition involves substantially all of the assets and liabilities of the operating insured office, that the applicant provide reasonable evidence that the de novo institution's operations will be stabilized at inception, and that the proponent for the applicant be either an eligible holding company or an established banking group. The Statement of Policy uses an identified chain banking group as an example of one type of ''established banking group.'' However, the term is intended to cover a group of individuals that have served as directors or officers of an operating insured depository institution.

For either a chain banking group or a group of individuals to be considered an established group, the association must be in existence for at least three years. This provision has been added to the Statement of Policy in recognition that deposit insurance for a depository institution being established from operating offices does not present the same risks to the insurance funds as does the chartering of a start-up de novo institution. This provision also seeks to remove capital requirement inequities that may have existed under prior procedures with respect to certain corporate reorganization activities. This amendment will permit the appropriate FDIC regional director (DOS) to act on proposals that contain these provisions when the other factors necessary for delegated authority have been met.

Stock Financing by Insiders

Guidelines for borrowing arrangements by insiders have been revised. The reference to borrowing arrangements by an individual insider of more than 75 percent of the purchase price of the stock subscribed, or more than 50 percent of the purchase price of the aggregate stock subscribed by the insiders as a group, has been retained as a point of emphasis. However, the Statement of Policy has been amended by deleting the statement that borrowing arrangements in excess of the referenced percentage limits will ordinarily be presumed to be excessive. The burden of providing appropriate supporting information regarding borrowing arrangements will remain with the affected insiders. However, this amendment will permit the appropriate FDIC regional director (DOS) to evaluate all insider borrowing arrangements on their own merits, without having a set limit for those that will be considered excessive or otherwise inappropriate. This amendment will permit the appropriate FDIC regional director (DOS) to act on the proposal when insider borrowing arrangements are inconsequential to the total proposal, or are otherwise not detrimental, when the other factors necessary for delegated authority have also been met.

Similarly, borrowings by a holding company to capitalize a proposed depository institution will be evaluated in the context of the holding company's consolidated operations, rather than based on a 50 percent limit of the total initial capital of the proposed depository institution. However, the borrowing arrangement would need to meet any leverage guidelines established by the holding company's primary federal regulator and be reasonable. This amendment will permit the appropriate FDIC regional director (DOS) to act on a proposal that involves holding company debt financing of more than 50 percent, when the other factors necessary for delegated authority have been met.

Stock Benefit Plans

It is becoming increasingly common for organizers of de novo depository institutions to propose stock benefit plans. Such plans often include not only active officers, but also directors and, in some cases, organizers. Guidance in the current Statement of Policy on Applications for Deposit Insurance states that: ''It is anticipated that options or bonuses will be tied to specific performance criteria and will be limited to active management of the institution.''

This proposal provides for participation of both active officers and outside directors in stock benefit plans, although it is anticipated that such plans will focus primarily on active officers. It is also recognized that plans may be established to compensate organizers who placed funds at risk to finance the organization or who have provided professional or other services during the organizational phase. FDIC will separately review such plans designed to compensate organizers for services rendered.

The proposed directors and officers are a critical element in evaluating a proposed depository institution's application for deposit insurance, and the FDIC has found that management stability is generally an essential element for the ultimate success of a de novo depository institution. Therefore stock benefit plans which are being adopted in conjunction with the establishment of a depository institution should encourage the continued involvement in the depository institution by key management officials.

Guidelines are included in the Statement of Policy to provide standards to be used in evaluating the appropriateness of stock benefit plans. These guidelines are considered necessary to provide the applicant with basic guidance as well as to promote consistency within the FDIC itself. Some concepts are retained from the former Statement of Policy, such as a maximum 10 year limit on options. FDIC's current practice, although not explicitly stated in the current policy statement, of requiring that the strike price be established at no less than fair market value at the time of the grant, has now been explicitly stated. New concepts have been added which emphasize that the plan should encourage the continued involvement of the proposed management. It is believed that a vesting period covering the first three years of operation would be appropriate to assure continued involvement. A three year vesting was selected based on the FDIC's experience that a three year period provides reasonable assurance that the business plan will have been fully implemented and stabilized operations achieved. An additional concept adopted is a requirement that a stock benefit plan provide for an exercise or forfeiture clause which may be invoked by the depository institution's primary federal regulator in the event the capital falls below minimum requirements. This is believed necessary to ensure that the dilutive effects of outstanding stock options will not make it unduly difficult for an institution in need of additional capital to increase capitalization in a timely manner. The OCC also has an established policy of requiring exercise or forfeiture clauses in certain instances.

Stock benefit plans designed to compensate incorporators for personal funds placed at risk during the organization or for services rendered during the organization will be viewed somewhat differently than plans for active management and directors. Plans designed to compensate for past services need not be subject to vesting periods or restrictions on transferability, but FDIC will review the duration of the rights, strike price, and exercise or forfeiture clauses in the same manner as for plans designed to reward continuing management service. In addition, the FDIC will consider the incorporator's time, expertise, and financial commitment to the proposal and the amount and basis of any cash payments made or to be made to the incorporators for services rendered or funds placed at risk.

Stock appreciation rights and similar plans that involve a cash payment based directly on the market value of the depository institution's stock have been specifically identified as objectionable. These types of plans can result in an expense which would reduce the depository institution's capital. Such compensation plans cannot be quantified in relation to the capital adequacy factor and could be detrimental to the overall capital of a depository institution, particularly in its formative years.

If the proposed insured depository institution is to be a subsidiary 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.

The comments contained in this Statement of Policy relate solely to stock benefit plans which are being proposed in conjunction with the filing of a deposit insurance application and the establishment of an insured depository institution. The comments and guidelines are not intended to be applicable to established operating insured depository institutions. It is believed that this proposal would bring FDIC's policies into closer alignment with those of the other state and federal bank regulatory agencies.

Other Changes

In addition to these four major areas, other changes are being proposed to clarify issues that have arisen or to remove outdated or duplicative information. Noteworthy changes include the following:

• In conjunction with the FDIC's recent rescission of its Statement of Policy regarding Applications, Legal Fees, and Other Expenses (62 FR 15479, April 1, 1997), concise comments relative to fees incident to an application have been incorporated into the revised Statement of Policy.

• The Statement of Policy is amended to replace the statement that ''no dividends are to be paid until all initial losses have been recaptured* * *'', with ''during the first three years of operation, cash dividends shall be paid only from net operating profits* * *'' The Statement of Policy retains the requirement that no dividends be paid until an appropriate allowance for loan and lease losses has been established and overall capital is adequate. This amendment reflects the FDIC's current practice and provides reasonable accommodation to possible Subchapter S Corporation applicants.

• The Statement of Policy has been amended to authorize the appropriate FDIC regional director (DOS) to waive financial information for proposed officers and directors when the proposed depository institution is being formed as a wholly owned subsidiary of a holding company. This was adopted in recognition that, when the proposed depository institution is being formed as a wholly owned subsidiary of a holding company, personal financial information may not be not meaningful.

• Other amendments to the Statement of Policy relating to proposed management include deleting the statement that the chief executive officer is expected to be a qualified and experienced lending officer, and deleting a requirement that a majority of the proposed directors will reside within, or have significant business interests within 100 miles of the proposed depository institution. It is expected that a qualified lending officer will be provided for in the management structure. However, the chief executive officer need not be that person. Also, while the FDIC encourages local involvement in proposed depository institutions, a specific residency requirement is not considered necessary.

• The Statement of Policy has also been revised to require that the applicant commit the depository institution to obtain an audit by an independent public accountant annually for only a three year period, rather than the first five years. This will provide consistency with the other federal regulators regarding audit coverage requirements for de novo depository institutions.

This Statement of Policy is applicable only to applications for deposit insurance, and it is not intended to establish policy for other applications or actions undertaken by established operating insured depository institutions.

Public Comment

In addition to seeking public comments on the above revisions to the Statement of Policy, the FDIC also solicits specific comment on the issue of whether deposit insurance should be conferred upon certain applicants that are owned by public entities, specifically governmental units. The FDIC is concerned that due to their public ownership, such depository institutions present unique supervisory concerns which do not exist with privately-owned depository institutions. Leadership of a governmental unit is subject to change through elections and other means. The FDIC has concerns about the institution's ability to operate independently of the political process, a lack of continuity in the depository institution's policies, management and oversight which could result from changes in the public entity's leadership, and the institution's ability to raise capital through non-traditional sources. Moreover, such institutions may be formed to engage primarily in non-profit or charitable activities such as the promotion of local affordable housing. This raises the prospect of deposit insurance coverage being used for purposes other than those for which the system was created, namely, to promote the stability of the nation's financial system and to protect depositors' funds. See section 1 of the FDI Act (12 U.S.C. 1811), see also 77 Cong. Rec. 3837, 3840, 3923, 3924, 3925 (1933).

In light of these concerns, the FDIC will scrutinize an application for deposit insurance by a publicly-owned applicant very closely. The agency is unlikely to resolve satisfactorily all of the statutory factors which must be considered under section 6 of the FDI Act (12 U.S.C. 1816) in evaluating such an application. The FDIC is considering whether to add language to that effect to the Statement of Policy. The FDIC specifically solicits comment on this issue and whether language should be added to the Statement of Policy which addresses the question. The FDIC also requests comment on the advisability in general of conferring deposit insurance upon applicants which are owned by governmental units.

Banks that are owned by foreign governments and their subdivisions and banks that are owned or controlled by Native American tribes or bands will not be subject to the heightened scrutiny given to other types of publicly-owned depository institutions. Overarching legal and policy considerations, unique to these two categories of insurance applicants, outweigh any concerns that the FDIC may have regarding the ownership of such depository institutions by governmental entities. The respective legal and policy considerations for each category of depository institution are discussed in detail below.

With respect to banks that are owned by foreign governments and their subdivisions, the governing principle of the International Banking Act of 1978 (the IBA) (12 U.S.C. 3101 *et seq.*), the federal statute that governs the participation by foreign banks in domestic markets, is the concept of ''national treatment.'' This concept holds that a foreign bank operating in a particular nation should be accorded operating privileges which provide such banks with the opportunity for competitive equality with their host country counterparts. S. Rep. No. 95–1073 at 18 (1978), reprinted in 1978 U.S.C.C.A.N. 1421, 1438.

Congress adhered to the principle of national treatment in devising the IBA to help ensure that U.S. depository institutions operating overseas received equal treatment with their host country competitors. The financial systems of different nations have varying concentrations of privately-and publicly-owned enterprises. When seeking to promote the overseas operations of U.S. depository institutions in foreign countries through the principle of national treatment, the United States cannot draw a distinction between a nation that has a bank owned by the government and a nation that does not. National treatment by its very logic requires that all foreign depository institutions, whether publicly-or privately-owned, receive the same, consistent treatment when operating in the United States. This includes eligibility for deposit insurance which is often a condition of either a state or federal charter. For these reasons, an applicant for deposit insurance which is owned by a foreign government will not be subjected to heightened scrutiny by the FDIC simply because it is publicly owned.

Native American tribes or bands that own or control depository institutions can also be distinguished from a conventional governmental unit that seeks to open or acquire a depository institution. This is because under federal law, Native American tribes and bands function as both governmental and economic, for-profit entities. The Indian Reorganization Act of 1934 (the IRA) (25 U.S.C. 461 *et seq.*) authorizes not only the creation of tribal governments (see section 16 of the IRA, 12 U.S.C. 476), but also provides for the creation of tribal business corporations pursuant to section 17 of the IRA (25 U.S.C. 477). At the same time, however, a tribal government organized under section 16 of the IRA is not precluded from engaging in business activities. See *S. Unique Ltd.* v. *Gila River Pima-Maricopa Indian Community*, 138 Ariz. 384, 674 P.2d 1376 (Ct. App. 1984). Both tribal governments and corporations are restricted by the IRA with respect to their ability to sell, mortgage, or lease Native American trust or restricted land, but are otherwise free to engage directly in economic activity. This situation is in contrast to conventional governmental units which seldom engage in direct economic activity for profit. For this reason, the FDIC considers Native American tribes and bands that own or control a depository institution to be more analogous to private, for-profit entities than to governmental units in the context of their ownership or control. The FDIC therefore will not subject an applicant for deposit insurance which is owned or controlled by an Native American tribe or band to heightened scrutiny simply because of that ownership.

The Board of Directors of the FDIC hereby proposes the following revised Statement of Policy on Applications for Deposit Insurance.

Applications for Deposit Insurance

Introduction

The Board of Directors of the FDIC is charged by statute with the responsibility of acting upon applications for federal deposit insurance by all depository institutions [1] including any national bank, district bank, state bank, federal savings association, state savings association, savings bank, or trust company. In addition, the Board of the FDIC will also act upon applications for federal deposit insurance by an industrial bank (or similar depository institution which the Board of Directors finds to be operating substantially in the same manner as an industrial bank), or any other depository institution which is engaged in the business of receiving deposits, other than trust funds.

An insured depository institution which wishes to continue its insured status after withdrawing from the Federal Reserve System, or when converting from a mutual to a stock form of ownership by the chartering of an interim savings association under the provisions of section 10(o) of the Home Owners Loan Act, also must file an application with the FDIC for deposit insurance.

Procedures

Forms and instructions for applying for deposit insurance may be obtained from any regional office of the FDIC Division of Supervision (DOS). Completed applications should be filed with the appropriate regional office as that term is defined in § 303.2(g) of the FDIC's rules and regulations. Incorporators of proposed new depository institutions should file their applications with the FDIC and the appropriate chartering authority at the same time. Information provided to the chartering authority that is also needed as part of the deposit insurance application may be provided to the FDIC by appending a copy of the information to the FDIC application. Although use of the FDIC application form is not required, the material submitted to the FDIC must contain all information requested in the FDIC application form, unless otherwise indicated by FDIC. All incorporators must sign the FDIC's deposit insurance application certification page (pages 1 and 2 of the application form). It is strongly recommended that a representative(s) of the organizing group meet with the chartering authority and FDIC prior to filing an application to reach an understanding of the information requirements of each agency. It is believed this practice would facilitate processing and eliminate unnecessary delays. Information requirements may not be as extensive for applications sponsored by existing holding companies or other well established banking groups. Final action may be taken by the FDIC prior to final action by other regulatory authorities in those cases in which the FDIC has determined that there is no material disagreement on the action to be taken.

The procedures governing the administrative processing of an application for deposit insurance are contained in part 303, subpart B, of the FDIC's rules and regulations (12 CFR part 303). Processing of an application will not commence until it is substantially complete. An incomplete application may be returned to the applicant. The applicant must satisfy all terms of a conditional approval prior to deposit insurance becoming effective.

The policies contained herein are applicable for all proposed de novo depository institutions and operating institutions applying for deposit insurance, with the exception of applications submitted for the sole purpose of acquiring assets and assuming liabilities of an insured institution in danger of default. Policies are modified in those situations to reflect the urgent nature of the transaction. Guidance for those situations is contained in a separate section of this policy statement.

Subpart B of part 303 contains special filing and processing procedures for a state member bank which seeks to continue its insured status upon termination of membership in the Federal Reserve System and for interim institutions chartered to facilitate mergers.

Proposed New Depository Institutions

In considering applications for deposit insurance for a proposed new depository institution, the FDIC must evaluate each application in relation to the factors prescribed in section 6 of the Federal Deposit Insurance Act (hereafter the Act) (12 U.S.C. 1816). Those factors are:

[1] In the case of any interim federal depository institution that is chartered by the appropriate federal banking agency, the depository institution shall be an insured depository institution upon the issuance of the institution's charter by the agency. An application for federal deposit insurance generally is not required even if the federal interim is the surviving charter of a merger with another insured depository institution. *See* 12 CFR 303.62(b)(2) and the FDIC's Statement of Policy on Bank Merger Transactions (section 4.2). Any depository institution whose insured status is continued pursuant to section 4 of the Federal Deposit Insurance Act is not required to apply to continue its insured status. 12 U.S.C. 1814.

• The financial history and condition of the depository institution;
• The adequacy of its capital structure;
• Its future earnings prospects;
• The general character and fitness of its management;
• The risk presented by such depository institution to the deposit insurance fund;
• The convenience and needs of the community to be served by the depository institution; and
• Whether its corporate powers are consistent with the purposes of the Act.

The applicant will receive deposit insurance if all of these statutory factors plus the considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969 are resolved favorably. Additional guidance regarding the National Historic Preservation Act and the National Environmental Policy Act may be found in the respective FDIC Statements of Policy for each of these statutes.

If the proposal contemplates the simultaneous establishment of a holding company, the application should discuss and disclose the proposed activities of the parent holding company as well as those of the proposed bank.

In those instances where the proposal involves the ownership of the depository institution as a subsidiary of an existing bank or thrift holding company, the FDIC will consider the financial and managerial resources of the parent organization in assessing the overall proposal and in evaluating the statutory factors prescribed in section 6 of the Act. In such circumstances, the application for deposit insurance should contain a copy of any information submitted to the holding company's primary federal regulator. Subpart B of part 303 of the FDIC's regulations discusses certain expedited procedures that may be available to eligible depository institutions or eligible holding companies (as those terms are defined in the regulation).

The FDIC may conduct examinations and/or investigations to develop essential information with respect to deposit insurance applications. The need to conduct an investigation, and its scope, will be determined by the appropriate regional director (DOS). Every effort will be made to coordinate any FDIC investigation with those conducted by other regulators.

The FDIC has formulated guidelines for evaluating deposit insurance applications which are designed to ease administration, prevent arbitrary judgment, and assure uniform and fair treatment to all applicants. A discussion of these guidelines follows.

Statutory Factors

1. Financial History and Condition

Proposed and newly organized depository institutions have no financial history to serve as a basis for determining qualifications for deposit insurance. Thus, the primary areas of consideration under this statutory factor are the ability of proponents to provide financial support to the new institution, investment in fixed assets, including leasing arrangements, and insider transactions. Lease transactions shall be reported in accordance with Financial Accounting Standards Board Statement 13 (Accounting for Leases). Applicants are expected to provide procedures, security devices, and safeguards at least equivalent to the minimums specified in the Bank Protection Act of 1968 (12 U.S.C. 1881–1884).

(a) Investment in Fixed Assets and Leases—The applicant's aggregate direct and indirect fixed asset investment, including lease obligations, must be reasonable in relation to its projected earnings capacity, capital, and other pertinent matters of consideration. Applicants are cautioned against the purchase of any fixed assets or entering into any noncancelable construction contracts, lease agreements, or other binding arrangements related to the proposal unless and until the FDIC approves the application.

(b) Insider Transactions—Any financial arrangement or transaction involving the applicant and an insider should be documented by the applicant to demonstrate that: (1) The proposed transaction with insiders is made on substantially the same terms as those prevailing at the time for comparable transactions with non-insiders and does not involve more than normal risk or present other unfavorable features to the applicant depository institution; and (2) the transaction must be approved in advance by a majority of the depository institution's incorporators. In addition, full disclosure of any arrangements with an insider must be made to all proposed directors and prospective shareholders. An insider means a person who is proposed to be a director, officer, or incorporator of an applicant; a shareholder who directly or indirectly controls 10 percent or more of a class of the applicant's outstanding voting stock; or the associates or interests of any such person.

2. Adequacy of the Capital Structure

Normally, the initial start-up 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. In addition, the depository institution must maintain an adequate allowance for loan and lease losses.

The adequacy of the capital structure of a newly organized depository institution is closely related to its 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. Initial capital should normally be in excess of $2,000,000, net of any pre-opening expenses that will be charged to the institution's capital after it commences business.

(a) Initial offering of stock—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. A price disparity provides insiders with a means to gain control disproportionate to their investment.

When securities are sold to the public, the disclosure of all material facts is essential. The FDIC's Statement of Policy regarding Offering Circulars provides additional guidance. A copy of the offering circular prepared by the applicant, together with the stock solicitation material and subscription agreement, should be submitted to the FDIC when they become available.

(b) Wholly owned subsidiary of a holding company—If the applicant is being established as a wholly owned subsidiary of an eligible holding company (as defined in part 303, subpart B), 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 8.0% at the end of the first year of

operation, based on a realistic business plan, or the initial capital injection meets the $2,000,000 minimum capital standard set forth in this Statement of Policy, or any minimum standards established by the chartering authority, whichever is greater. However, the holding company shall also provide a written commitment to maintain the proposed institution's Tier 1 leverage capital ratio at no less than 8.0 percent throughout the first three years of operation.

(c) Operating insured offices—If the proposal involves the acquisition of an insured operating office, or offices, the applicant may request that the benchmark for evaluating the adequacy of capital be an amount necessary for the resultant newly chartered institution to be classified as well capitalized, as defined by its primary federal regulator. In such cases, the appropriate regional director (DOS) may find favorably with respect to the capital factor based on a favorable finding with respect to the following:

• There is a realistic three year business plan which evidences stabilized operations at inception;

• The proposal involves substantially all assets and deposits attributable to the respective insured operating office(s); and

• The proponent is either an eligible holding company (as defined in part 303, subpart B) or is a banking group that the FDIC determines has demonstrated its ability to successfully manage an insured depository institution. (A qualified banking group should have an established association of at least three years. A chain banking group which is recognized as such by the FDIC is one type of banking group that is contemplated in this paragraph.)

(d) Stock financing by insiders—Financing arrangements by insiders of their investment in stock of the proposed new depository institution will also be carefully reviewed. Financing arrangements by an insider to purchase stock 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 of insiders are anticipated, information should be submitted with the application demonstrating that adequate alternative independent sources of debt servicing are available. Direct or indirect financing arrangements by insiders of more than 75 percent of the purchase price of the stock subscribed to by any one individual, or more than 50 percent of the purchase price of the aggregate stock subscribed by the insiders as a group, will require supporting comments in the application regarding the reason that the financing arrangements should be considered acceptable. If the insider financing arrangements are not considered appropriate, the FDIC may find unfavorably on the adequacy of the capital structure.

When the proposed depository institution is being established as a subsidiary of an existing holding company, the funding source being utilized by the holding company for its capital contribution will be evaluated in the context of the holding company's consolidated operations.

In such cases, the FDIC will need to be provided with assurance that the holding company's proposed leverage is within the guidelines of its primary federal regulator.

No loans for stock purchases are to be refinanced by the newly established institution. Deposits or other funds of the proposed depository institution at correspondent banks are not to be used as compensating balances for loans to insiders. During the first three years of operations, cash dividends shall be paid only from net operating profits, and shall not be paid until an appropriate allowance for loan and lease losses has been established and overall capital is adequate.

3. Future Earnings Prospects

Before approving an application for deposit insurance, the FDIC must have reasonable assurance that the new institution can be operated profitably. Therefore, the incorporators will need to demonstrate through realistic and supportable estimates that, within a reasonable period (normally three years), the earnings of the applicant will be sufficient to provide an adequate profit.

The applicant must also maintain its books and records in accordance with the principles of accrual accounting.

4. General Character and Fitness of the Management

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 under the Uniform Financial Institution Rating System.[2] Since in most instances the management of a proposed depository institution will not have an operating record as a functioning unit, 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.

All proposed depository institutions shall provide at least a five-member board of directors. The identity and qualifications of the proposed full-time chief executive officer should be made known to the FDIC as soon as possible, preferably when the application is filed with the appropriate FDIC regional director (DOS). Proponents must advise the FDIC, in writing, of any change in the directorate, senior active management, or a change in the ownership of stock by any person of 10% or more of the total shares of either the depository institution or its holding company prior to opening.

(a) Fees and expenses—The commitment to or payment of unreasonable or excessive fees and other expenses incident to an application will reflect adversely upon the management of the applicant institution. Fees and other organizational expenses incurred or committed to should be fully supported.

Expenses for professional or other services rendered by insiders will receive special review for any indication of self-dealing to the detriment of the bank and its other shareholders. 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 an FDIC 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 federal or state agency or official.

(b) Stock benefit plans—Stock benefit plans, including stock options, stock warrants, and similar stock based compensation plans will be reviewed by FDIC and must be disclosed to all potential subscribers. A description of any such plans proposed should be included in the application submitted to the regional director. It is expected that stock benefit plans will be primarily focused on active management of the institution, although some participation by outside directors is not objectionable. The structure of stock benefit plans should encourage the continued

[2] A 2 rating under the Uniform Financial Institution System is generally indicative of a satisfactory record of performance in light of the institution's particular circumstances.

involvement of the participants, and serve as an incentive for the successful operation of the institution. It is recognized that plans may be proposed to compensate organizers for funds placed at risk during the organization phase or as remuneration for services provided.

Stock benefit plans should contain no feature that would encourage speculative or high risk activities, serve as an obstacle or otherwise impede the sale of additional stock to the general public, or be structured in such a manner as to serve as a conduit to convey control of a depository institution to the insiders. Listed below are factors that the FDIC will consider in reviewing stock benefit plans proposed for directors and active officers:

- 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. For example, a vesting of approximately equal percentages each year over the initial three years of operations is a type of provision that would be appropriate to ensure such continued involvement. This requirement may be waived for participants awarded only a nominal number of shares.
- Rights granted should not be transferable by the participant;
- The exercise price of stock rights shall not be at 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 primary state or federal regulator.

The FDIC will separately review stock benefit plans established to compensate incorporators who have placed personal funds at risk to finance the organization of the institution or who have provided professional or other services in conjunction with the organization. In reviewing the reasonableness of such plans, the FDIC will not require vesting or restrictions on transferability, but will review the duration of the rights, strike price and exercise or forfeiture clauses in the same manner as discussed above. In addition, the FDIC will consider:

- The incorporator's time and expertise, and financial commitment to the proposal; and
- The amount and basis of any cash payments which will be made to the incorporator for services rendered or as return on funds placed at risk.

It is recognized that the incorporators may wish to adopt different types of compensation plans which are structured to meet the unique circumstances of the proposed depository institution. 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 substantively stock based plans will be evaluated based on the foregoing stock benefit plan criteria. Stock appreciation rights and other 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.

(c) Background and biographical information—Insiders must file financial and biographical information in connection with the deposit insurance application. The FDIC may request a report from the Federal Bureau of Investigation or other investigatory agencies on these individuals. Fingerprinting of individuals may be required. Background checks and fingerprinting may be waived by the appropriate FDIC regional director (DOS) for individuals who are currently associated with, or have had a recent past association with, an insured depository institution. When the proposed depository institution is being established as a wholly owned subsidiary of an eligible holding company, the appropriate FDIC regional director (DOS) may waive financial information for those persons who are being proposed as directors or officers of the applicant. Background checks conducted by other federal financial institution regulators in connection with charter applications are generally adequate for the FDIC if the other regulators agree to notify the FDIC of instances in which further investigation is warranted.

In the event any present or prospective director, officer, employee, controlling stockholder, or agent of the applicant has been convicted of any criminal offense involving dishonesty, breach of trust, or money laundering, or has agreed to enter into a pretrial diversion or similar program in connection with a prosecution of such offense, the applicant must obtain the FDIC's written consent, under section 19 of the Act (12 U.S.C. 1829), before any such person may serve in one or more of those capacities. Guidelines regarding section 19 applications may be obtained from the appropriate FDIC regional office (DOS).

Proponents should be aware of the prohibitions against interlocking management officials which are applicable to depository institutions and depository institution holding companies and which are contained in the Depository Institution Management Interlocks Act (12 U.S.C. 3201).

(d) Fidelity insurance, policies, and audit coverage—An insured depository institution should maintain sufficient fidelity bond coverage on its active officers and employees to conform with generally accepted industry practices. Primary coverage of no less than $1 million is ordinarily expected. Approval of the application may be conditioned upon acquisition of adequate fidelity coverage prior to opening for business.

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 for deposit insurance coverage are expected to commit the depository institution to obtain an audit by an independent public accountant annually for at least the first three years after deposit insurance coverage is granted. The FDIC may determine,[3] on a case-by-case basis, that a separate audit is unnecessary where the applicant is owned by another company and the proposed depository institution will undergo an audit performed by an independent public accountant as part of an audit of the consolidated financial statements of its parent company.

5. Risk Presented to the Bank Insurance Fund or Savings Association Insurance Fund

This factor is intended to be broadly interpreted. For example, this factor may be resolved unfavorably based on an unsound business plan. The FDIC expects that an applicant will submit a business plan commensurate with the capabilities of its management and the financial commitment of the

[3] In a situation in which the FDIC is not to be the primary federal regulator, these determinations will be made in consultation with the primary federal regulator.

incorporators.[4] Applicants must 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, or significant funding from 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.

6. Convenience and Needs of the Community To Be Served

The essential considerations in evaluating this factor are the deposit and credit needs of the community to be served, the nature and extent of the opportunity available to the applicant in that location, and the willingness and ability of the applicant to serve those financial needs.

The applicant must clearly define the community it intends to serve and provide information on that community, including economic and demographic data and a description of the competitive environment. The applicant should also define the services to be offered in relation to the needs of the community. The proposed depository institution's Community Reinvestment Act documentation, including any applicable public file information, prepared in accordance with the requirements of the institution's primary federal regulator, plays an integral part in the FDIC's evaluation of the convenience and needs of the community to be served.

7. Consistency of Corporate Powers

Pursuant to section 24 of the Act (12 U.S.C. 1831a), 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 banking agency. Similarly, the Home Owners' Loan Act (12 U.S.C. 1464) provides that a state 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. Applicants shall agree in the application not to exercise prohibited powers, whether granted by charter or statute, after deposit insurance has been granted, unless prior approval has been obtained from its federal regulator.

State nonmember banks may not exercise trust powers without the prior written approval of the FDIC.

Operating Noninsured Institutions

This section discusses the evaluation of applications for federal deposit insurance submitted by operating noninsured institutions. The FDIC's criteria for evaluating applications submitted by operating institutions are generally the same as those for proposed depository institutions.

The FDIC must consider the seven factors found in section 6 of the Act, which are discussed above.

The condition of an applicant institution will be determined from all available information and will generally include an on-site examination as part of the investigation process. Results of the examination should reflect an institution that is fundamentally sound, although some modest weaknesses may exist. The nature and severity of deficiencies found should not be material, and the institution must be stable and able to withstand business fluctuations.

Capital ratios will be calculated using financial statements prepared in accordance with the ''Instructions—Consolidated Reports of Condition and Income'' or ''Thrift Financial Reports'' in use for FDIC-insured institutions at the time. An applicant's capital adequacy will be measured in relation to the capital ratios established in the capital regulations of the institution's primary federal regulator. Based on an analysis of the type and quality of the institution's assets, the kind of powers exercised, the institution's funding sources, or other factors, an initial capital level higher than the minimum levels prescribed may be required. The analysis will include consideration of such matters as whether the applicant is relatively new,[5] has embarked upon a substantive change in powers exercised, or has experienced erratic growth patterns in recent years.

As part of the application investigation process, the FDIC will discuss with the applicant its future operating intentions. If any change in its kind or level of activity is expected following, or as a result of, the approval of its FDIC membership, the applicant may be requested to submit a plan for maintaining adequate capital in the future.

Unless waived in writing by the FDIC, an applicant shall have a full scope audit conducted by an independent public accountant prior to submitting an application and shall submit a copy of the auditor's report as part of the application.

Section 24 of the Act (12 U.S.C. 1831a) limits the powers of insured state banks, and the Home Owners' Loan Act (12 U.S.C. 1464) limits the powers of state 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.

Proposed Depository Institutions Formed for the Sole Purpose of Acquiring Assets and Assuming Liabilities of an Insured Institution in Default

Because of the urgent nature of this type of transaction, the procedures described above for insuring proposed depository institutions are modified when the institution is being formed for the sole purpose of acquiring assets and assuming liabilities of an insured institution in danger of default. Such institutions are approved based on the statutory factors contained in section 6 of the Act; however, the procedures for resolving these factors are modified significantly.

The financial history and condition of the institution is determined to a great extent on the quality of assets purchased and the types of liabilities assumed in the transaction.

The minimum capital requirement for these transactions is such that the resultant depository institution would

[4] Any significant deviation from the business plan within the first three years of operation must be reported by the insured depository institution to the appropriate federal regulator before consummation of the change.

[5] This statement of policy provides that the initial capital for a new or proposed depository institution should be sufficient to provide a leverage ratio of Tier I capital to total estimated assets of at least 8.0% throughout the first three years of operations. This standard shall also be applied to a recently organized institution applying for insurance.

be ''adequately capitalized,'' as defined in the capital regulations of its primary federal regulator, which should be augmented by an adequate allowance for loan and lease losses. It is emphasized that this is a minimum standard, and a higher capital level may be required. The initial capital requirements may be based on a realistic projection of the estimated retained deposits. However, the proposed depository institution will be required to provide a written commitment to achieve the minimum capital position shortly after consummation if the volume of deposits is underestimated.

Proponents should contact the appropriate FDIC regional office (DOS) as soon as possible if they intend to bid on a failing institution. Due to the time constraints involved with this type of transaction, information submissions and applications will be abbreviated. Generally, a letter request accompanied by copies of applications filed with other federal or state regulatory authorities will be sufficient. Other information will be requested only as needed by the appropriate FDIC official.

Relationships With Other Federal Regulators

Nothing in these guidelines is intended to relieve the applicant of any requirements imposed by a depository institution's primary federal regulator. Any differences in requirements between the FDIC and the institution's primary federal regulator will be resolved during the investigation process.

By order of the Board of Directors.

Dated at Washington, DC, this 23rd day of September, 1997.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 97–26234 Filed 10–8–97; 8:45 am]

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FEDERAL DEPOSIT INSURANCE CORPORATION

Bank Merger Transactions

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Proposed statement of policy.

SUMMARY: The FDIC is proposing to revise its Statement of Policy on Bank Merger Transactions by updating it to reflect legislative and other developments that have occurred since the Statement of Policy was last revised in 1989. The proposed revision also gives additional guidance by including new provisions and clarifying some existing provisions. The proposal is a part of the FDIC's systematic review of its regulations and written policies under the Riegle Community and Regulatory Improvement Act of 1994 and is intended to be read in conjunction with the merger provisions of the FDIC's proposed amendments dealing with applications filed with the FDIC, which also appears in this issue of the **Federal Register**.

DATES: Comments must be received by January 7, 1998.

ADDRESSES: Send written comments to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429. Comments may be hand delivered to the guard station located at the rear of the 17th Street building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (FAX number (202) 898–3838; Internet address: comments@FDIC.gov). Comments may be inspected and photocopied at the FDIC Public Information Center, Room 100, 801 17th Street NW, Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: Kevin W. Hodson, Review Examiner, Division of Supervision, (202) 898–6919; Martha Coulter, Counsel, Legal Division, (202) 898–7348, Federal Deposit Insurance Corporation, Washington, DC 20429.

SUPPLEMENTARY INFORMATION: Section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act), 12 U.S.C. 4803(a), requires that each of the federal banking agencies (the FDIC, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision) conduct a review of its regulations and written policies, for two general purposes. These purposes are: (1) To streamline and modify the regulations and policies in order to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability; and (2) to remove inconsistencies and outmoded and duplicative requirements.

As part of this review, the FDIC has determined that its Statement of Policy on Bank Merger Transactions (Policy Statement or Statement) should be revised. The primary purpose of the revision is to update the Statement to reflect statutory changes and other developments that have taken place since its last revision in 1989. In addition, certain clarifications and refinements are being proposed, as well as new provisions intended to give guidance in areas not previously addressed by the 1989 Statement. The proposed revisions are discussed more fully below.

Recent Developments. Among the proposed revisions to the Statement are those resulting from statutory changes, including the CDRI Act, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act), and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).[1] Section 321(b) of the CDRI Act reduced the post-approval, pre-consummation waiting period for certain merger transactions from 30 days to 15 days (see 12 U.S.C. 1828(c)(6)). Section 102 of the Interstate Act, codified at 12 U.S.C. 1831u, provided for interstate bank mergers. FIRREA broadened the coverage of the Bank Merger Act, 12 U.S.C. 1828(c), to include savings associations and eliminate the Federal Savings and Loan Insurance Corporation (FSLIC).[2]

Each of these changes caused related references in the 1989 Statement to become out-dated or incomplete, a situation the proposed new Statement corrects. For example, because the Bank Merger Act now applies to thrift institutions as well as banks, the proposed Statement replaces the term ''bank'' with ''depository institution.'' It also deletes a reference to the FSLIC. In addition, the proposed Statement includes references to interstate mergers and to the CDRI Act's 15-day post-approval waiting period.

In addition to statutory changes, there have been other developments that warrant revision of the 1989 Statement. For example, the 1989 Statement refers to the use of ''IPC'' deposits (deposits of individuals, partnerships, and corporations) in FDIC merger analysis. However, IPC deposit data is no longer collected by the FDIC. Accordingly, the proposed revisions indicate that the FDIC now uses ''total deposits'' in evaluating the competitive effects of a proposed merger.

Another development was the 1995 amendment of the FDIC's regulations implementing the Community Reinvestment Act (CRA) (*see* 60 FR 22156 (May 4, 1995)). Changes the FDIC made to its CRA regulations include elimination of the requirement for CRA statements and revision of the CRA performance standards to be applied by the FDIC. These changes are reflected in the proposed new Statement.

[1] The citations for these statutes are, respectively, Pub. L. 103–325, 108 Stat. 2160; Pub. L. 103–328, 108 Stat. 2338; and Pub. L. 101–73, 103 Stat. 183.

[2] FIRREA sections 201 and 221.