Office of Inspector General

November 18, 2002
Audit Report No. 03-006

DSC Procedures for Addressing Deviations from Business Plans by Newly Established Banks

TABLE OF CONTENTS

BACKGROUND 2

- **New Bank Application Process** 2
- **Application Review Process** 3
- **Examination Review Process** 4
- **Available Corrective Measures** 5
- **Newly Chartered State Non-Member Institutions** 6

RESULTS OF AUDIT 6

FDIC MONITORING OF CHANGES IN NEWLY CHARTERED BANKS' BUSINESS PLANS 7

ALTERNATIVE PROCESSES FOR ESTABLISHING NEW BANKS 12

Recommendation 17

STATUTORY AMENDMENTS IMPACTING REGULATORY OVERSIGHT 17

Recommendation 19

CORPORATION COMMENTS AND OIG EVALUATION 19

APPENDIX I: OBJECTIVE, SCOPE, AND METHODOLOGY 20

APPENDIX II: BEST PRACTICES 22

APPENDIX III: APPLICATION COMPARISON CHART 23

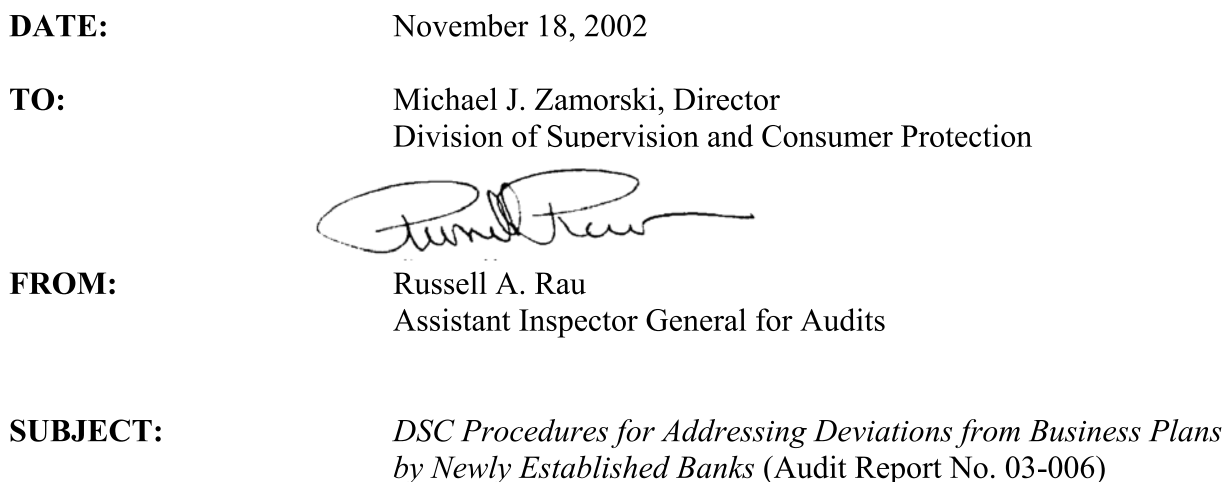
APPENDIX IV: CORPORATION COMMENTS 25

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20434

Office of Audits
Office of Inspector General

DATE: November 18, 2002

TO: Michael J. Zamorski, Director
Division of Supervision and Consumer Protection



FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: *DSC Procedures for Addressing Deviations from Business Plans by Newly Established Banks* (Audit Report No. 03-006)

The Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) has assessed the procedures followed by Division of Supervision and Consumer Protection (DSC) case managers and examiners when newly established banks deviate from their business plans. You requested this review and expressed concern that managers of some newly chartered banks were not adhering to the business plans approved by the FDIC during the new bank application process. You were especially concerned with Internet banks and how those institutions may have deviated from approved business plans. Furthermore, you were interested in what measures DSC was taking when such deviations were encountered.

The objective of our audit was to determine whether the procedures used by DSC case managers and examiners were adequate for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC. However, we also observed insurance risk exposures related to the transfer of bank charters. New banks, in effect, can be established through various regulatory and financial transactions that allow existing insured depository institutions to transfer their charters and insurance to new owners. When a new bank is created through the normal formation process, regulatory approval is sought through the application process for federal deposit insurance. However, other various transactions including mergers, acquisitions, assumptions, and changes in control are subject, by statute, to a less comprehensive application process because a new application for deposit insurance is not required. We expanded our scope to address this situation.

Additional details on our scope, objective, and methodology are contained in Appendix I.

BACKGROUND

New Bank Application Process

The Board of Directors of the FDIC is charged by Sections 5 and 6 of the Federal Deposit Insurance Act with the responsibility of acting on applications for federal deposit insurance by all depository institutions. The FDIC must evaluate each application for deposit insurance with consideration given to the following seven statutory factors:

- the financial history and condition of the depository institution;
- the adequacy of the depository institution's capital structure;
- the future earnings prospects of the depository institution;
- the general character and fitness of the management of the depository institution;
- the risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund;[1]
- the convenience and needs of the community to be served by the depository institution; and
- whether the depository institution's corporate powers are consistent with the purpose of the Act.

Application packages submitted to the FDIC require a detailed business plan that establishes a financial institution's goals and objectives, and should provide an in-depth analysis of how the business will organize its resources to meet its goals and how the institution will measure its progress. The business plan should demonstrate that the applicant has adequate policies, procedures, and management expertise to operate the proposed depository institution in a safe and sound manner. The plan should also demonstrate that the bank has the ability to attract and maintain adequate capital and reasonable market share, has good earnings prospects, and is responsive to community needs.

As part of the application process, the FDIC's DSC conducts a field investigation[2] that addresses each of the seven statutory factors. The appropriate DSC Regional Director has authority, with several exceptions, to approve a *de novo*[3] bank application for federal deposit insurance. However, any recommendation to deny an application must be approved by the FDIC's Board of Directors.

The FDIC Statement of Policy on Applications for Deposit Insurance, effective October 1, 1998, addresses situations where bank management deviates from the business plan approved by the FDIC. According to the Statement of Policy, any significant deviation from the business plan within the first 3 years of operation must be reported by the insured depository institution to the

---

[1] The FDIC operates two insurance funds: the Bank Insurance Fund (BIF) insures deposits in commercial banks and savings banks, and the Savings Association Insurance Fund (SAIF) insures deposits in federal savings and loan associations, federal savings banks, and state savings and loans.
[2] A field investigation is usually required before a federal deposit insurance application can be acted on by the regional office.
[3] A *de novo* institution is defined as a newly chartered bank.

primary federal regulator[4] before consummation of the change. This requirement is significant because the FDIC relies on the information contained in the applicant's business plan to assess risk presented to the insurance funds; deviations from the business plan could increase risk to the funds.

On April 7, 2000, DSC issued a Regional Directors Memorandum entitled *Nonstandard Condition to Orders for Federal Deposit Insurance.* The memorandum provides guidance on implementation of a nonstandard condition to Orders[5] for federal deposit insurance that requires prior notification to the FDIC of significant deviations from the banks' approved business plans. In particular, the memorandum states that there have been situations where newly insured depository institutions have "drastically changed" from the business plan approved as part of the application for federal deposit insurance. The condition as described in the memorandum specifies "…that the bank shall operate within the parameters of the business plan submitted to and approved by the FDIC. Furthermore, during the first three years of operation, bank management shall notify the Regional Director of any proposed major deviation or material change from the submitted plan at least 60 days before consummation of the change."

Application Review Process

In accordance with the FDIC *Case Managers Procedures Manual*, case managers are assigned the responsibility for reviewing, evaluating, and processing all applications filed by institutions within their assigned caseloads. In processing insurance applications, case managers are responsible, in part, for determining the need for and arranging field investigations, reviewing the completed Report of Investigation and following up with applicants on any new concerns, and completing the Summary of Investigation.[6] If the region approves the application under delegated authority, the case manager must also prepare the Order for federal deposit insurance. If the region does not have delegated authority, the case manager must submit all of the related documentation to the Risk Management and Applications Section of the Washington office. Once the applicant provides evidence that all the conditions of the Order have been satisfied, and the chartering authority has approved the institution to open, the case manager will notify the FDIC's Executive Secretary Section of the Legal Division, which will then notify the new institution of the effective date of its insured status.

When the FDIC is the processing agency for applications involving mergers and changes in control, case managers are responsible, in part, for completing the Summary of Investigation. In

[4] The primary federal regulator is a financial institution's principal supervisory agency. The FDIC is the primary regulator of state non-member banks; the Office of the Comptroller of the Currency is the primary regulator of national banks; the Office of Thrift Supervision is the primary regulator for savings associations and savings and loan associations; and the Board of Governors of the Federal Reserve System (Federal Reserve Board) is the primary regulator of state member banks.

[5] Orders for insurance include standard and nonstandard conditions that may be included as a matter of routine in approving an application. Standard conditions can be imposed whether or not the applicant has agreed to their inclusion. Nonstandard conditions need to be agreed to by the applicant. However, if an institution does not agree to a nonstandard condition, the FDIC takes the position that the FDIC's Board of Directors has the authority to impose a nonstandard condition.

[6] *A Summary of Investigation - Federal Deposit Insurance* - a form that must be completed by case managers for all applications for deposit insurance. The form summarizes the findings of the investigation as related to each of the statutory factors and concludes with a statement as to whether the findings are "favorable" or "unfavorable."

mergers, if a disapproval is recommended, the region's recommendation and Summary of Investigation is forwarded to the Washington Office. If the regional office recommends an approval, an approval letter, the appropriate Order, and a letter to the U.S. Attorney General advising of the approval is prepared. In notices of changes in control, if a disapproval of the proposed acquisition of control is warranted, a copy of the notice and the Summary of Investigation is sent to the Washington Office for action. In cases where the transaction is approved, a letter is sent to the applicant conveying the FDIC's intent not to disapprove the transaction.

In accordance with the FDIC *Case Managers Procedures Manual*, Orders for federal deposit insurance allow the imposition of standard and nonstandard conditions. Standard and nonstandard conditions are used to impose restrictions and to establish operating parameters and controls on the institution for a set period of time, usually up to the first 3 years of operation. Standard conditions may include implementation of an accrual accounting system, the need for an annual audit, amount and type of capital, changes in ownership or management before opening, and other conditions relating to the findings on the statutory factors in Section 6 of the FDI Act. All other imposed conditions not contained within Section 303.26(d) or 303.2(ff) of the FDIC Rules and Regulations would be considered nonstandard.

One example of a nonstandard condition is the requirement for newly insured depository institutions to provide prior notification of any significant deviations from the business plan within the first 3 years of operation to its primary federal regulator. Although this requirement exists within the FDIC Statement of Policy on Applications for Deposit Insurance, the FDIC requires a nonstandard condition to Orders for federal deposit insurance to ensure that institutions adhere to this guidance and to provide the FDIC an opportunity to comment on changes in business plans. Conditions can also be placed when approving merger transactions. Section 303.67 of the FDIC Rules and Regulations retains the FDIC Board of Directors' authority to approve applications for merger transactions where the applicant does not agree in writing to comply with any conditions other than the standard conditions defined in Section 303.2 (ff) which may be imposed without the applicant's written consent.

Examination Review Process

DSC's *Manual of Examination Policies* states that newly chartered and insured institutions are to have a limited scope examination (visitation) within the first 6 months of operation and a full scope examination within the first 12 months of operation. Subsequent to the first examination and through the third year of operation, at least one examination should be performed each year.

In accordance with the DSC *Manual of Examination Policies*, examiners are assigned the responsibility for assessing the capability and performance of management and the board of directors of a financial institution by assigning a management rating based upon, but not limited to, an assessment of the institution's compliance with laws and regulations. As a result, examiners are charged with the responsibility of reviewing a bank's compliance with all applicable FDIC Statements of Policy. In accordance with the FDIC Statement of Policy on Applications for Deposit Insurance, any significant deviation from the business plan within the first 3 years of operation must be reported by the insured depository institution to the primary

federal regulator before consummation of the change. Based on this rule, examiners are expected to review for and report any potential contravention to this statement of policy.

The DSC *Manual of Examination Policies* also requires examiners to determine whether an institution has a profit plan or budget for the current and/or next operating year, and examiners are required to evaluate the adequacy of management's budget and other earnings analysis reports at each examination.[7] Specifically, within the Report of Examination, examiners are required to address a risk management question that asks examiners "are risk management processes adequate in relation to and consistent with, the institution's business plan, competitive conditions, and proposed new activities or products?" This question necessitates that examiners assess the bank's ability to plan, which requires an assessment of the strategic planning and budgeting process and of management's ability to forecast and plan future operations. Examiners are also expected, in part, to incorporate budgeted forecasts into their financial analysis of the earnings component, as well as to perform proactive analysis within the other financial component areas.

Available Corrective Measures

In the event of noncompliance with Orders and conditions, supervisory response can be taken in the form of reason and moral suasion, informal agreements, and formal actions. Informal agreements include obtaining a Bank Board Resolution or issuing a Memorandum of Understanding. Formal actions include Section 8(a) Termination of Insurance; Section 8(b) Cease and Desist Proceedings; Section 8(c) Temporary Cease and Desist Proceedings; and Section 8(e) and 8(g) Suspension and Removal Procedures. In addition, Civil Money Penalties may be sought, and Orders to correct safety and soundness deficiencies can be implemented. Furthermore, the use of written agreements, capital directives, prompt corrective action directives, and capital restoration plans may be employed to correct capital deficiencies. These corrective actions allow the FDIC to provide an appropriate response based on the degree and level of risk identified.

[7] A profit plan is an overall forecast of income for the period based on management's decisions, intentions, and estimation of economic conditions, funding strategies, asset mix, pricing, growth objectives, interest rate and maturity mismatches, etc. Within the profit plan is a budget. The budget is essentially an expense control technique where management decides how much is intended to be spent during the period on individual overhead expense items.

Newly Chartered State Non-Member Institutions

The FDIC is the primary federal regulator for 588 institutions that were newly chartered during the years of 1997 - 2001. The Atlanta, San Francisco, and Chicago Regional Offices had the greatest number of new charter approvals during this time period. New charters within each region are shown in the following table.

Table 1: Newly Chartered Institutions Supervised by the FDIC (Years 1997 – 2001)

REGION	1997	1998	1999	2000	2001	TOTALS
Atlanta	28	29	39	31	20	**147**
Boston	2	2	3	1	3	**11**
Chicago	16	13	29	19	8	**85**
Dallas	7	9	7	3	10	**36**
Kansas City	15	13	13	16	6	**63**
Memphis	21	13	22	13	9	**78**
New York	9	10	21	9	6	**55**
San Francisco	25	33	25	15	15	**113**
TOTALS	**123**	**122**	**159**	**107**	**77**	**588**

Source: Division of Supervision and Consumer Protection

RESULTS OF AUDIT

The procedures used by FDIC case managers and examiners for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC are adequate. Examiners are taking steps to review and assess a bank's adherence to its approved business plan and/or subsequent strategic plans and budgets. Furthermore, the FDIC has taken recent initiatives through DSC's process redesigns and other interagency activities to strengthen the process. FDIC regional and Washington office management also have adequate preventive and corrective measures to help mitigate the risk of deviations from approved business plans and strategies.

While the policies and practices used by the FDIC to evaluate banks that have departed from the initial business plan projections are adequate, we found:

- Through the process of mergers, changes in control, and acquisitions, new banks can be established, in effect, without having to apply and be approved for federal deposit insurance. As a result, by statute, such institutions are subject to fewer factors as bases for disapproval.

- Amendments to Section 32 of the Federal Deposit Insurance Act provisions reduced regulatory controls over newly chartered banks and changes in control by eliminating the requirement that the primary federal regulator be notified of changes in bank

management. The amendment eliminated the advance notice requirement for financial institutions that had been in existence less than 2 years and for those institutions that had undergone a change in control within the past 2 years. In these situations, the placement of inadequate management could disrupt a bank's operations and adversely impact its financial condition.

In addition, based on our discussions with DSC officials in both the DSC Chicago and Atlanta Regional Offices, we learned of procedures developed within each region related to new bank oversight that may benefit other DSC regions. These "best practices" are described in Appendix II.

FDIC MONITORING OF CHANGES IN NEWLY CHARTERED BANKS' BUSINESS PLANS

The procedures used by FDIC case managers and examiners for evaluating and addressing new banks that have departed from initial business plan projections are adequate.

Our review did not evaluate the adequacy of the examiners' and case managers' analysis and assessment of those business plans or of the applications and notices received. However, we did review the supervisory oversight of the new banks during their first 3 years of operations. Our review focused on:

(1) the insurance application review process to determine whether there are preventive measures that can be implemented to limit the potential impact of unauthorized changes in business plans,
(2) the examination processes used by FDIC case managers and examiners to evaluate banks that have departed from the initial business plan projections, and
(3) the regulatory tools available to the FDIC to initiate effective corrective action when bank management materially deviates from an approved business plan or initiates an unsafe and unsound action.

Application Review Process

During the insurance application review process, regional and Washington office management generally have adequate preventive measures that can be implemented to limit the potential impact of unauthorized changes in business plans.

We determined that Orders for federal deposit insurance containing standard and nonstandard conditions are employed by the FDIC when approving deposit insurance applications. In addition, the FDIC uses written agreements[8] at times for other types of applications. The issuance of these Orders and written agreements allows the FDIC to employ proactive measures, lessen the potential impact of unforeseen problems, and potentially help prevent serious problems from developing. Furthermore, these documents help to mitigate risk in an institution

[8] A written agreement signed by bank management containing various operational obligations made to bank regulators.

by limiting the conditions and circumstances that may lead to problems early-on in the supervisory process.

The application review process generally allows adequate preventive measures to be implemented. In addition to establishing formal application submission and review procedures, application approvals can be processed with Orders and written agreements that are tailored to the risks of the institution. Of seven FDIC-regulated Internet-only institutions reviewed, we determined the following:

- four institutions submitted an application for federal deposit insurance and all four were approved with an accompanying Order;
- one institution was formulated through a change in control, and a notice of non-disapproval was granted with an accompanying written agreement; and
- two of the institutions were formulated through a Bank Holding Company acquisition and were approved through the Federal Reserve Board. The FDIC does not have the authority to request Orders or written agreements when the Federal Reserve Board is approving the transaction.

Based on our reviews of these transactions, we could not conclude on the usefulness or adequacy of Orders and written agreements; however, the following example provides an illustration of the FDIC's supervision of an institution with a written agreement.

An Internet-only institution was formulated through a Notice of Acquisition of Control that was processed through the FDIC. In processing the notice, the San Francisco Regional Office obtained bank management's commitment to adhere to the following commitments with respect to the first 3 years of operation of "Internet Bank C":

- the beginning paid-in capital funds shall not be less than $3.5 million;
- the Bank will maintain a Tier 1 Leverage Capital ratio of not less than 12 percent;
- the Bank shall operate within the parameters of the submitted business plan and will obtain prior approval from the Regional Director in connection with any proposed major deviations or significant changes from the submitted plan; and
- during the first 3 years after deposit insurance coverage is effective, the Bank shall obtain an annual audit of its financial statements by an independent public accountant.

Once regulatory non-objection was granted for the change in control, "Internet Bank C" began business in June 2000, and a visitation was conducted as of October 31, 2000. However, due to an inability to sustain banking operations, the holding company "Corporation C" requested authorization to cease operations and to liquidate the assets of the bank. This request was submitted in accordance with the terms of management's written agreement that required bank management to obtain prior approval for significant changes from the bank's submitted business plan. In short, the bank relinquished its state charter on January 26, 2001 and executed a Stipulation and Consent to the Issuance of an Order of Termination of Insurance on January 29, 2001. The bank is no longer in operation. Management's commitment to maintain a higher level of capital and to obtain prior approval for any proposed significant changes appears to

have helped limit potential loss to the insurance fund and ensure proactive supervisory oversight.

An example of a state nonmember[9] bank that was formulated through a Notice of Acquisition of Control without an Order or written agreement is discussed later in this report under the condition entitled *Alternative Processes For Establishing New Banks* (see page 12).

Examination Review Processes

The examination processes used by FDIC case managers and examiners to evaluate banks that have departed from the initial business plan projections are adequate. Examiners do not provide and policies do not require clear and distinct assurance within the Reports of Examination that they have performed a comprehensive review of the bank's business plans, and their comments are generally restricted to discussing areas of concern and potential criticism. However, the lack of such assurance and comments is mitigated by examiners reviewing and comparing actual operations to forecasted projections while assessing earnings and management's planning process.

Of 24 new banks we reviewed from the Chicago Region, the FDIC examiners did not note any significant departures from the approved business plans and/or subsequent strategic plans and budgets. While examiners did identify institutions that exceeded or failed to meet growth and/or income projections, only limited analysis and commentary was provided on the underlying assumptions of the banks' business plans and/or subsequent strategic plans and budgets. Specifically, the Reports of Examination and Visitation Reports did not document the review or the analysis performed on the approved business plans' assumptions for the anticipated level and volatility of interest rates; local economic conditions; funding strategies, including E-banking initiatives; asset and liability mix and pricing; and interest rate and maturity mismatches. The lack of consistency and detail of information found within the banks' approved business plans and/or subsequent strategic plans and budgets makes meaningful comparisons difficult to formulate and limits the analysis possible by DSC examiners.

For example, one institution's strategic plan stipulated, in part, that loans would be generated and sold through loan participations and direct home equity loan originations, while the only budget reference to the loan portfolio was on an aggregate basis with corresponding interest and yield income data. Furthermore, the deposit mix was also limited to an aggregate budget reference to Interest Bearing and Non-Interest Bearing Deposits with corresponding interest and expense data. Due to the lack of detail that banks provide in business plans, any analysis or comparison of asset and liability mix and pricing, funding strategies, and anticipated level and volatility of interest rates would be limited. Despite these limitations, our concern is mitigated due to the existence of other compensating measures within the examination process. In particular, examiners conduct reviews of the component factors for Liquidity and for Sensitivity to Market Risk. These reviews would address the banks' performance in the above noted areas regardless of whether those areas are compared and contrasted against the assumptions formulated within the banks' approved business plans and/or strategic plans and budgets.

---

[9] A state chartered institution that is not a member of the Federal Reserve System.

In six of the seven Internet-only banks reviewed, FDIC examiners identified significant departures from the approved business plans and/or subsequent strategic plans and budgets. These included eliminating brick and mortar[10] operations, changing loan mixtures, and incurring greater levels of potentially volatile deposits. The examiners generally identified business plan deviations similar to those we identified during our independent review of the banks' forecasted financial positions in comparison to the actual financial positions. The banks' actual financial positions were derived from corresponding Call Reports and Uniform Bank Performance Reports as of December 31, 2000.

Available Corrective Measures

We reviewed the six institutions that deviated from the initial projections in their business plans and/or strategic plans and budgets. As the primary regulator, FDIC case managers and examiners had adequate recourse to initiate effective corrective action when bank management materially deviated from an approved business plan or initiated an unsafe and unsound action.

For example, in connection with an Application for Federal Deposit Insurance submitted to the FDIC by "Internet Bank D," the Chicago Regional Office undertook a comprehensive review of the application and of the related business plan. In due course, approval was subject to eight conditions set forth in an Order for federal deposit insurance. Two of these conditions were as follows:

- during the first 3 years, the bank will maintain no less than an 8 percent Tier 1 capital ratio and
- the bank shall operate within the parameters of the submitted business plan. Any proposed major deviations or material changes from the submitted plan, in particular, changes pertaining to Internet operations, shall receive the prior written approval of the [FDIC] Regional Director.

However, during the first Safety and Soundness Examination, examiners discovered that bank management had been operating under a revised business plan without regulatory approval. As identified in the report of examination, the bank's Board of Directors unanimously approved a revised operating budget less than 1 month after the bank opened. According to the report of examination, bank management officials stated that they considered the original plan outdated and not realistic. In addition, the report stated that a revised plan was not submitted because bank management believed that it would have further delayed the regulatory approval process. As a result of this finding, the regional office requested the bank to submit a Safety and Soundness Compliance Plan (SSCP) pursuant to Section 39 of the Federal Deposit Insurance Act. The SSCP required the board to create a revised business plan with new financial projections and to resolve to maintain a Tier 1 Capital to Total Assets ratio of 14 percent or greater. The bank was also required to submit monthly financial statements and to meet with the regional office on a quarterly basis. The SSCP was in place within approximately 4 months from the initial point of discovery by the examiners.

[10] Brick and mortar- popular name for the fixed assets owned by a bank including branch offices, ATMs, and the back office.

The case manager responsible for this bank stated that adequate avenues exist to pursue the level of corrective action needed in a timely and effective manner. Furthermore, he indicated that if management had not been cooperative, Section 39 would have allowed the FDIC to go to a direct and immediate Cease and Desist Order.

Bank Business Plans Guidelines Adopted by the FDIC

When we initiated this audit, there were no written standards or guidelines available to new bank charter applicants for preparing business plans. Our review of newly chartered banks' business plans maintained at the DSC Chicago Regional Office indicated that there were variances within the levels of detail provided in business plans submitted to the FDIC during the application process. The business plan provides important operational benchmarks against which the regulators can measure and evaluate the newly chartered bank's progress during the first 3 critical years of operation.

DSC has undertaken a process redesign initiative, which has involved in-depth assessments of the FDIC's supervision of state nonmember banks to identify procedures for improving efficiency. Phase one of the DSC redesign initiative was divided into five broad working groups and various subcommittees. The DSC New Bank Applications Subcommittee (New Bank Subcommittee), comprised of FDIC DSC officials, was established to improve the FDIC application process for deposit insurance. That group independently determined that a new applicant's "business plan should be the primary document in the application and we [the FDIC] should provide detailed guidelines for the content and presentation of that business plan." In its report, the New Bank Subcommittee disclosed that it learned of an interagency effort to establish guidelines, which produced similar results, and recommended that DSC fully endorse that effort. Under Section 304 of the Riegle Community Development and Regulatory Improvement Act of 1994, the four federal banking agencies continue to develop forms that promote consistency and uniformity in a manner that reduces federal regulatory burden on the banking industry.

The FDIC has worked closely with the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Conference of State Bank Supervisors to develop the Interagency Charter and the Federal Deposit Insurance Application form and instructions. The Federal Reserve Board did not participate in this project. The new application requires the submission of a business plan and includes guidelines on preparing business plans. On March 11, 2002, a DSC Regional Directors Memorandum was issued to adopt the new application form. Such procedures require bank management to clearly state its goals and objectives, thereby enhancing the regulators' ability to oversee newly chartered institutions.

Conclusion

The procedures used by FDIC case managers and examiners for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC are adequate. Examiners are taking steps to review and assess a bank's adherence to its approved business plan and/or subsequent strategic plans and budgets. Furthermore, through DSC's process redesign and other interagency activities, the FDIC has taken initiatives to strengthen both the insurance application process and regulatory oversight process.

ALTERNATIVE PROCESSES FOR ESTABLISHING NEW BANKS

Through the process of mergers, acquisitions, and changes in control, new banks can be established, in effect, without having to apply and be approved for federal deposit insurance. It is possible for an existing institution to be acquired, dismantled, and replaced with a high-risk operating structure. In certain transactions, the FDIC, as primary federal regulator, is not authorized by statute to address the potential adverse effect on the deposit insurance funds when the Federal Reserve Board is the approval agency of transactions involving state non-member banks. The Bank Holding Company Act of 1956, section 3(a), requires, in part, that financial institutions obtain the Federal Reserve Board's prior approval for any action taken that causes a bank to become a subsidiary of a bank holding company. The FDIC does not have an interagency agreement with the Federal Reserve Board that allows the FDIC to provide comments on the assessment factors in the context of holding company mergers, acquisitions, and changes in control when the FDIC is the primary regulator of a bank. Institutions that dramatically change business operations may, by statute, be subject to fewer factors as bases for disapproval. As a result, these institutions may increase risks to the deposit insurance funds because they are not subject to the regulatory application process established for granting deposit insurance to new banks.

Application for Federal Deposit Insurance

Section 5 of the Federal Deposit Insurance (FDI) Act requires, in part, that any depository institution engaged in the business of receiving deposits may become an insured depository institution upon application to and examination by the FDIC and approval by the Board of Directors. Section 5 also states that before approving an application for deposit insurance, consideration shall be given to the seven evaluation factors enumerated in Section 6 of the FDI Act (see page 2). In addition, the FDIC's Statement of Policy on Applications for Deposit Insurance outlines specific standards that the FDIC will apply when evaluating and acting on an application for federal deposit insurance.

Notification of Change in Control

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 FDI Act. The amendments gave federal banking agencies the authority to disapprove changes in control of insured banks and bank holding companies. The appropriate agencies for approving changes in control are:

- the FDIC for insured state nonmember banks,
- the Federal Reserve Board for state member banks and bank holding companies,
- the Office of the Comptroller of the Currency for national banks, and
- the Office of Thrift Supervision for savings associations and savings and loan holding companies.

The amendments to Section 7(j) of the FDI Act do not apply to a transaction that is subject to:

- Section 3 of the Bank Holding Company Act of 1956;
- Section 18(c) of this FDI Act; or
- Section 10 of the Home Owners' Loan Act.[11]

For each proposed change in control, Section 7(j) of the FDI Act describes the factors that the responsible federal banking agency is to consider. These factors include the financial condition, competence, experience, and integrity of the acquiring person/persons and the effect of the transaction on competition. In assessing the financial condition of the acquiring entity, the federal banking agency should consider the acquiring entity's financial condition if it might jeopardize the financial stability of the bank or prejudice the interest of the depositors of the bank. When processing a Summary of Investigation for a notice of acquisition of control, a comment regarding the bank's financial condition is required. 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 Owners' 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 changes in control of insured banks resulting from mergers, consolidations, or other similar transactions are not covered by Section 7(j) of the FDI Act.

Application for Bank Holding Company Transactions

The Bank Holding Company Act of 1956, section 3(a) requires, in part, that financial institutions obtain the Federal Reserve Board's prior approval:

- for any action that causes a company to become a bank holding company;
- for any action taken that causes a bank to become a subsidiary of a bank holding company;
- for any bank holding company to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 percent of the voting shares of the bank;
- for any bank holding company or subsidiary, other than a bank, to acquire all or substantially all of the assets of a bank; or
- for any bank holding company to merge or consolidate with any other bank holding company.

For each acquisition, merger, or consolidation under this section, the Federal Reserve Board is to consider the competitive factors, banking and community factors, supervisory factors, treatment of certain bank stock loans, and managerial resources. The banking and community factors to be considered include the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served. The managerial resources to be considered of a company or bank shall include

---

[11] Section 10 of the Home Owners' Loan Act covers transactions applicable to Savings and Loan Holding Company transactions similar to Section 3 of the Bank Holding Company Act of 1956.

consideration of competence, experience, and integrity of the officers, directors, and principal shareholders of the company or bank.

Application for Mergers

Section 18(c) of the FDI Act provides, in part, that insured depository institutions may merge with any other insured depository institution with the prior written approval of the responsible agency, which shall be:

- The FDIC, if the acquiring, assuming, or resulting institution is to be a state nonmember insured bank.
- The Office of the Comptroller of the Currency, if the acquiring, assuming, or resulting institution is to be a national or a district bank.
- The Federal Reserve Board, if the acquiring, assuming, or resulting institution is to be a state member bank.
- The Office of Thrift Supervision, if the acquiring, assuming, or resulting institution is to be a savings association.

The section also requires the FDIC's approval before an insured depository institution may merge, consolidate, assume liability to pay deposits, or transfer assets in consideration of the assumption of deposits with a noninsured bank or institution. For each proposed merger transaction, the responsible agency is directed to take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served.

The FDIC's Statement of Policy on Bank Merger Transactions outlines specific standards that the FDIC will apply when evaluating and acting on proposed merger transactions. In particular, the FDIC will consider the following statutory factors under Section 18(c):

- 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.
- Prudential factors, including the existing institutions' overall condition, that considers capital, management, and earnings.
- The convenience and needs of the community, to which the proposed merger transaction is likely to benefit the general public.
- The expenses for professional or other services rendered by present or prospective board members, major shareholders, or other insiders.

Comparison of Application Processes

The deposit insurance application process is, by statute, generally more comprehensive than processes for other kinds of applications or notices. In particular, the approval process for:

- Mergers - does not require the appropriate federal banking agency to consider the transaction's possible impact on the deposit insurance funds, and the process does not require an initial Tier 1 Capital to Assets Leverage Ratio of 8 percent or more.
- Change in Control - does not require the appropriate federal banking agency to consider the financial stability of the depository institution, except as it relates to the financial condition of the acquiring person/entity. In addition, the process does not require an initial Tier 1 Capital to Assets Leverage Ratio of 8 percent or more. However, an appropriate federal banking agency may object to any proposed change in control notice if it finds that the transaction would result in an adverse effect on the deposit insurance funds.
- Bank Holding Company and Financial Holding Company Formations and Acquisitions - does not require the appropriate federal banking agency to consider the transaction's possible impact on the deposit insurance funds, and the process does not require an initial Tier 1 Capital to Assets Leverage Ratio of 8 percent or more. If the applicant is proposing to use acquisition debt, then a less stringent level of capital is required. The subsidiary bank must maintain a ratio of Gross Capital to Assets of 8 percent or more.

A detailed chart in Appendix III compares the more comprehensive deposit insurance application process to the change in control application process and comparable factors under the bank holding company application process.

The Formation of "Internet Bank A"

"Internet Bank A" is an actual example of a state non-member financial institution that was acquired and used to create, in effect, a new financial institution. In June 1999, "Internet Bank A," formerly "State Bank B," was sold by "State Bank B's" holding company to "Financial Corporation A." Only the stock of the bank was exchanged in the transaction, and the bank's holding company and subsidiaries were not part of the agreement. The transaction was structured as a change of control with a bank holding company purchasing a one-branch bank. The Federal Reserve Board reviewed and approved the application by "Financial Corporation A" to become a bank holding company and the change of control transaction to acquire "State Bank B." The bank was to be run as a combined entity with brick and mortar operations and with an Internet presence. However, 1 year after the change of control, management ceased the brick and mortar operations, liquidated all assets associated with the original bank, and released all the previous bank managers. The financial institution was converted into an Internet-only bank. Due to the complete change in business operations, management oversight, and customer focus, this institution essentially became a new bank.

This transaction was not subject to the regulatory application process established for granting deposit insurance. As a result, by statute, the institution was subject to fewer factors as bases for disapproval. In particular, the institution was able to maintain a lower capital level and was provided a shorter statutory processing time period than the new bank application process. "Internet Bank A" formulated an agreement with the governing State Banking Department to maintain a minimum Tier 1 Leverage Capital ratio of 7 percent, while statutory guidelines for new banks require a minimum Tier 1 Leverage Capital ratio of 8 percent or higher. Furthermore, of the seven FDIC Internet-only banks we analyzed, two of them - "Internet Bank B" and

"Internet Bank C" - provided management commitments to maintain a Tier 1 Leverage Capital ratio of 10 percent and 12 percent, respectively.

"Internet Bank A" was not subject to the FDIC's involvement in approving the application or having an Order for insurance put in place. The lack of an Order prevented the issuance of standard and nonstandard conditions for federal deposit insurance by the FDIC. The following is a usual nonstandard condition to Orders for federal deposit insurance:

> The bank shall operate within the parameters of the business plan submitted to the FDIC. Furthermore, during the first 3 years of operations, the bank shall notify the Regional Director of any proposed major deviation or material change from the submitted plan 60 days before consummation of the change.

In addition, the institution was not subject to the FDIC's initial Report of Investigation and to a visitation 6 months after obtaining deposit insurance, which would have been required for a new bank application for federal deposit insurance. If "Financial Corporation A" did not also have to submit an application to become a bank holding company, it would have avoided an in-depth review of "Internet Bank A's" financial condition, except as it relates to the financial condition of the acquiring person/entity. While the processing and handling of an Interagency Notice of Change in Control 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 the burden of sustaining disapproval falling on the FDIC. Accordingly, in evaluating Notices, the FDIC need not find favorably on the various factors; the absence of unfavorable findings implies approval.

Conclusion

"Internet Bank A" is an example of just one transaction, and each transaction is unique. Accordingly, judgment is needed to assess the terms of each application and/or notice in conjunction with management's stated objectives and business plans. However, when a merger, acquisition, or change in control essentially creates a new bank, such institutions are subject, by statute, to fewer factors as bases for disapproval. Specifically, in certain cases, the FDIC, as primary federal regulator, is not authorized by statute to consider the potential adverse effect on the deposit insurance funds when the Federal Reserve Board is the approval agency for transactions involving state non-member banks.

At our exit conference, management indicated that for the past several years the Corporation has pursued amendments to the Bank Merger Act and Bank Holding Company Act that would require the primary federal regulators to consider risk to the insurance fund when approving mergers, acquisitions, or changes in control. To date, the amendments have not been included in any legislation passed or being considered by the Congress. Management further stated that, absent such amendments, it would be difficult for the Corporation to achieve working agreements with the Federal Reserve Board to address the issues we have raised because doing so may be considered contrary to existing statutes and the prevailing opinions of other regulators, Congress, and the Administration.

Recommendation

We recommend that the Director, DSC:

(1) Continue pursuit of amendments to the Bank Merger Act and Bank Holding Company Act that would require each approving agency's consideration of the potentially adverse effects on the insurance funds of any proposed bank merger or holding company formation or acquisition. DSC should consider including amendments that would enable the Corporation to be involved in evaluating the potential risks to the insurance funds when the FDIC is the primary regulator of a bank but is not the approving agency of the related holding company merger, acquisition, or change in control transaction.

STATUTORY AMENDMENTS IMPACTING REGULATORY OVERSIGHT

Amendments to Section 32 of the FDI Act provisions reduced regulatory controls over newly chartered banks and changes in control by eliminating the prior notification requirement for changes in bank management. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPR Act) amended Section 32 of the FDI Act, which requires advanced notification to regulators when appointing directors and officers in certain institutions. The amendment eliminated the advance notice requirement for financial institutions that had been in existence less than 2 years and for those institutions that had undergone a change in control within the past 2 years. In these situations, the placement of inadequate management could disrupt a bank's operations and adversely impact its financial condition.

FIRREA added Section 32 to the FDI Act, which is implemented by Section 303.100 of the FDIC Rules and Regulations. This law requires insured state nonmember banks to give the FDIC written notice at least 30 days prior to the effective date of any addition or replacement of a member of the 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:

- the bank is not in compliance with all minimum capital requirements applicable to the bank as determined on the basis of the bank's most recent report of condition or report of examination;
- the bank is in troubled condition; or
- the FDIC determines, in connection with its review of a capital restoration plan required under section 38(e)(2) of the FDI Act or otherwise, that such notice is appropriate.

The EGRPR Act subsequently amended Section 32 by eliminating the prior notice requirement for institutions and holding companies that have been chartered for less than 2 years and that have undergone a change in control within the preceding 2 years.

The DSC New Bank Subcommittee, which was formed during phase one of DSC's process redesign initiative, recommended that the FDIC should include a standard condition in the Order granting deposit insurance, that would reinstate Section 32 requirements. The subcommittee's

conclusion was that "regulatory oversight would be enhanced and risk to the fund would be lower for new institutions." The New Bank Subcommittee also evaluated potential barriers to this action, which include that reinstating Section 32 requirements would increase the regulatory burden on newly insured institutions and Congress may not support a standard condition since the EGRPR Act removed prior notification.

The New Bank Subcommittee also proposed an alternate solution to include a nonstandard condition in insurance application Orders. This is a similar approach to that taken by DSC in the April 7, 2000 Regional Directors Memorandum entitled *Nonstandard Condition to Orders for FDIC Insurance* which clarified procedures to be followed in situations where new banks deviated materially from their approved business plans. Standard conditions in an Order for insurance may be imposed on institutions, while nonstandard conditions must receive an agreement from the applicant in writing. According to the New Bank Subcommittee report, the OCC has "regulation 914" notices that require prior notice of changes in senior executive officers or board directors.

Notices of Change in Control

As we discussed previously, new banks can be established through various regulatory and financial transactions that allow existing insured depository institutions to transfer their charters and insurance to others.

The amendment of Section 32 through the EGRPR Act eliminated the advance notice requirement for changes in management in financial institutions that had undergone a change in control within the past 2 years. While the New Bank Subcommittee has recommended the reinstatement of Section 32 procedures for newly chartered institutions, there still remains a regulatory oversight weakness for those institutions undergoing a change in control. There appear to be no policies or procedures that encourage the use of and provide guidance on issuing nonstandard commitments for changes in control. However, the regulator can request the controlling financial institution or bank holding company to provide a written agreement regarding such issues as prior notification of changes in business plans or maintaining minimal Tier 1 Leverage Capital levels at the request of the regulator. We observed such a written agreement involving a change in control approved through the DSC San Francisco Region. When the FDIC is the primary regulator responsible for approving a notice of change in control, there is more leverage for the FDIC to obtain written assurances from bank management.

Conclusion

In the absence of regulatory authority, the OIG agrees with the findings of DSC's New Bank Subcommittee, in that the regulatory oversight would be enhanced and the risk to the fund would be lower for new institutions if Section 32 requirements were restored. In our view, the regulatory oversight of new institutions formed through changes in control would be strengthened if Section 32 requirements were restored.

Recommendation

We recommend that the Director, DSC:

(2) Request DSC to further study the potential risks and recommendations developed by DSC's New Bank Subcommittee regarding amendments made to Section 32 of the FDI Act and consider the need for an interagency effort to reinstate controls over newly chartered banks and changes in control through restoration of the prior notification requirements for changes in bank management.

CORPORATION COMMENTS AND OIG EVALUATION

On November 14, 2002, the DSC Director provided a written response to the draft report. The response is presented in Appendix IV to this report. DSC proposed an acceptable alternative action for our first recommendation and concurred with the second recommendation of the report.

As an alternative action for recommendation 1, DSC stated that it would consider pursuit of amendments to the Bank Merger Act and Bank Holding Company Act in consultation with the other federal agencies and will refer the recommendation to the Federal Financial Institutions Examination Council's (FFIEC) Task Force on Supervision. DSC intends to make this referral by March 31, 2003.

DSC concurred with recommendation 2 and stated that it would conduct a study to determine the need for prior notification requirements for changes in bank management which were removed through provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The study will be completed by March 31, 2003. Both recommendations are resolved but will remain undispositioned and open until we have determined that agreed-to corrective actions have been implemented and are effective.

In response to several Regional best practices presented in this report, DSC has already shared the best practices, along with the entire draft report, with the DSC Regional Directors.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to assess the procedures used by DSC case managers and examiners for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC. We also observed insurance risk exposures related to the transfer of bank charters and expanded our scope to address this situation. Our review was limited to newly chartered financial institutions and Internet banks for which the FDIC is the primary federal regulator.

To accomplish our objective and expanded scope, we:

- reviewed a sample of the Visitation Reports and Safety and Soundness Reports of Examination (ROE) completed by DSC on new bank operations during the years of 1997, 1998, 1999, and 2000;
- reviewed bank applications, notifications, and related business plans;
- reviewed Reports of Investigations and Summary of Investigation reports;
- reviewed applicable laws, regulations, and statements of policies;
- reviewed and analyzed Uniform Bank Performance Reports and Call Reports;
- reviewed relevant sections of the DSC *Manual of Examination Policies* and *Case Managers Procedures Manual*;
- interviewed DSC Washington senior management; and
- interviewed DSC Chicago and Atlanta management.

We selected all seven Internet-only banks for which the FDIC is the primary federal regulator and a judgmental sample of 24 newly chartered banks from the Chicago Region for which the FDIC is the primary federal regulator. For all banks selected, we reviewed the FDIC's assessment of the banks' performance and noted the identification of any deviations from the approved business plans and the actions taken by DSC. Furthermore, for the seven Internet banks selected, we also reviewed the banks' business plans and independently analyzed current financial data to determine if there were any deviations from actual performance. We obtained our sample data from the FDIC's Bank Information Tracking System (BITS) through the Forest and Trees Application System, and from the FDIC's former Division of Research and Statistics.

We limited our assessment of DSC's system of internal controls to reviewing the policies and procedures for assessing institutions' adherence to business plans and implementation of those policies and procedures by examiners. We did not test internal controls over these processes. Further, we did not (1) review Government Performance and Results Act reporting, (2) test for fraud or illegal acts, (3) test for compliance with laws and regulations, or (4) determine the reliability of computer-processed data obtained from the FDIC's computerized systems.

We performed fieldwork in DSC headquarters and the Chicago and Atlanta regional offices. The audit fieldwork was conducted from January 2001 until July 2002. Due to a request by the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs to review the failure of Superior Bank, critical audit team members were re-assigned, and this review was suspended for part of 2001 and 2002. Subsequently, we conducted additional work to update our analysis

and conclusions. We conducted our audit in accordance with generally accepted government auditing standards.

APPENDIX II

BEST PRACTICES

Based on our discussions with DSC officials in both the DSC Atlanta and Chicago Regional Offices, we learned of procedures developed within each region related to new bank oversight that may benefit other DSC regions. These practices are listed below by each DSC Region.

Atlanta

- Case managers are involved during the early stages of the bank application process, starting with the investigations of institutions applying for deposit insurance. This practice helps to establish familiarity and maintain continuity in the case managers' supervision of these institutions.
- DSC regional management develops and participates in an outreach program referred to as "Directors' College." These are regularly scheduled events held with bank directors throughout DSC Atlanta's jurisdiction. It is a good opportunity for FDIC management to familiarize new bank management with the regulatory oversight process and general expectations.

Chicago

- A "New Bank Committee" was formed to review the region's procedures for receiving and approving new bank applications. The group recommended improvements to more proactively identify and manage emerging risks associated with *de novo* banks. Recommendations were to:

  1. Centralize the processing of all new bank applications into an Applications Unit (AU) so that the number of regional office staff reviewing new bank applications is limited. The smaller group is more likely to readily identify and consistently address emerging risks in new banks.

  2. Require quarterly attestation and supporting documentation from each bank/thrift relative to compliance with the business plan submitted in the application. Assign initial monitoring of compliance with applicable business plans to the AU.

  3. Formally incorporate the AU's ongoing assessment of emerging risks and the findings of the Regional Office Management Information Group's biannual *Review of Newly Insured Institutions Report* directly into the application process to make sure that these concerns are specifically and adequately addressed in all new bank reviews.

APPENDIX III

Comparison of Statutory Evaluation Factors for New Bank Applications for Deposit Insurance and Change in Control Applications

Application for Federal Deposit Insurance under FDI Act §5	Comparable[a] Factors Considered by Primary Federal Regulator-Change in Control under FDI Act §7(j)	Comparable Factors Considered by Federal Reserve Board-Acquisition of Bank Shares or Assets under BHCA §3(a)
The financial history and condition of the depository institution.	§7(j)(7)(C); 12 CFR 308.111(c), to some degree.	§3(c)(2); 12 CFR 225.13(b)(1)
The adequacy of the depository institution's capital structure.	§7(j)(7)(C); 12 CFR 308.111(c), to some degree.	§3(c)(2); 12 CFR 225.13(b)(1)
The future earnings prospects of the depository institution.	No comparable factor.	§3(c)(2); 12 CFR 225.13(b)(1)
The general character and fitness of the management of the depository institution.	§7(j)(7)(D); 12 CFR 308.111(d)	§3(c)(5); 12 CFR 225.13(b)(2)
The risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund.	§7(j)(7)(F); 12 CFR 308.111(f)	No comparable factor.
The convenience and needs of the community to be served by such depository institution.	§7(j)(7)(B); 12 CFR 308.111(b)	§3(c)(1)(B); 12 CFR 225.13(b)(3)
Whether the depository institution's corporate powers are consistent with the purposes of the Act.	No comparable factor.	No comparable factor.
Other Factors		
Regulatory capital requirement: Tier 1 leverage capital ratio of not less than 8% for the first 3 years of operation.	Tier 1 leverage capital ratio of not less than 3% for institutions with a CAMELS rating of 1 and not less than 4% for all other institutions.	For creation of small bank holding companies and acquisitions of additional banks or companies by bank holding companies, each insured depository subsidiary is expected to be well-capitalized, which for bank holding companies with consolidated assets under $150 million, "well capitalized" means that the bank holding company maintains a total risk-based capital ratio of 10 percent or greater and a tier 1 risk based capital ratio of 6 percent or greater, and it is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board. For bank holding companies with assets of $150 million or more, the Board has established a minimum ratio of Tier

[a] "Comparable" indicates that some factors may be bases for disapproval of applications, while others are considered.

Application for Federal Deposit Insurance under FDI Act §5	Comparable[a] Factors Considered by Primary Federal Regulator- Change in Control under FDI Act §7(j)	Comparable Factors Considered by Federal Reserve Board- Acquisition of Bank Shares or Assets under BHCA §3(a)
		1 capital to total assets of 3 percent for strong bank holding companies and for bank holding companies that have implemented the Board's risk-based capital measure for market risk. For all other bank holding companies, the minimum ratio of Tier 1 capital to total assets is 4 percent.
Procedures		
Statutory processing time limitation for standard applications: Not to exceed 1 year.	Time limitation of 60 days unless extended, not to exceed 180 days.	An application or notice shall be deemed approved if the Board fails to act on the application or notice within 91 calendar days after the date of submission to the Board of the complete record on the application.
Regional Office time frame for processing guideline: 120 days from receipt.	Regional Office time frame for processing guideline: 45 days from receipt.	Application approved by local Federal Reserve bank within 30 days of acceptance of application for processing, then sent to Board for action within 60 days.
Expedited processing available.	Expedited processing available.	Expedited processing available for well-capitalized and well-run bank holding companies.
Incomplete applications not accepted.	§7(j)(7)(E)	§3(c)(3)(A)
Burden of Proof		
The burden of making a case in support of a proposal falls on the applicant.	The FDIC exercises a veto, with a burden of sustaining disapproval falling on the FDIC. Accordingly, the FDIC does not need to find favorably on the various factors; the absence of unfavorable findings approximates tacit approval.	The Board exercises a veto, with a burden of sustaining disapproval.

CORPORATION COMMENTS

Federal Deposit Insurance Corporation
550 17th St. NW Washington DC, 20429

Division of Supervision and Consumer Protection

November 13, 2002

TO: Stephen M. Beard
Deputy Inspector General
Office of Inspector General

FROM: Michael J. Zamorski *Michael J. Zamorski*
Director
Division of Supervision and Consumer Protection

CONCUR: John F. Bovenzi
Deputy to the Chairman and Chief Operating Officer

SUBJECT: Draft Report Entitled *DSC Procedures for Addressing Deviations from Business Plans by Newly Established Banks* (Assignment Number 00-810)

The Division of Supervision and Consumer Protection (DSC) appreciates the opportunity to respond to this revised draft report. The initial objective of this Office of Inspector General (OIG) evaluation was to "determine whether the procedures used by DSC case managers and examiners were adequate for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC." Your audit found DSC's procedures to be adequate.

The report concludes with two recommendations:

1. Continue pursuit of amendments to the Bank Merger Act and Bank Holding Company Act that would require each approving agency's consideration of the potentially adverse effects on the insurance funds of any proposed bank merger or holding company formation or acquisition. DSC should consider including amendments that would enable the Corporation to be involved in evaluating the potential risks to the insurance funds when the FDIC is the primary regulator of a bank but is not the approving agency of the related holding company merger, acquisition, or change in control transaction.

   DSC Response:

   We have considered this recommendation; however, the recommendation would require interagency implementation and we feel that DSC must consider this issue in consultation with the other Federal agencies. Therefore, DSC will refer the recommendation to the FFIEC's Task Force on Supervision. This referral will be made by March 31, 2003.

2. Request DSC to further study the potential risks and recommendations developed by DSC's New Bank Subcommittee regarding amendments made to Section 32 of the FDI Act and consider the need for an interagency effort to reinstate controls over newly chartered banks and changes in control through restoration of the prior notification requirements for changes in bank management.

   DSC Comment:

   We agree with the recommendation that DSC study the need for prior notification requirements for changes in bank management. It should be noted that offsite monitoring and visitations, examinations, outreach, and reporting requirements emanating from the nonstandard "change in business plan" condition can frequently detect changes in management. This study will be completed by March 31, 2003.

Appendix II contains several Regional best practices, which you uncovered during your review. We have shared these best practices, along with the entire draft report, with the DSC Regional Directors.