Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Supervision and Consumer Protection

TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Final Amendments to the FDIC Rules and Regulations Due to the Financial Services Regulatory Relief Act of 2006

EXECUTIVE SUMMARY

This memorandum details a proposed final rule to implement changes to the FDIC rules and regulations due to the Financial Services Regulatory Relief Act of 2006 (FSRRA), the Federal Deposit Insurance Reform Act of 2005, and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005. The proposed changes were approved by the FDIC Board as an interim rule on December 19, 2007, and published in the Federal Register on January 14, 2008. No comments were received during the 60-day comment period, and the final rule mirrors the interim rule.

Section 608 of the FSRRA – Section 5(i)(5) of the Home Owners' Loan Act (HOLA) permits Federal savings associations to undergo a conversion into one or more national or state banks. Section 608 of the FSRRA clarifies that conversions under Section (5)(i)(5) of the HOLA that result in more than one bank require deposit insurance applications from each resulting institution. This required conforming amendments to Part 303 of the FDIC rules and regulations.

Section 606 of the FSRRA – Section 606 of the FSRRA eliminated the need for the responsible Federal banking agency to request competitive factors reports and eliminated the post-approval waiting period for mergers that solely involve an insured depository institution and one or more of its affiliates. Certain amendments to Part 303 were necessary to clarify the regulation and make it consistent with the Congressional intent of Section 606 of the FSRRA. In addition, changes to Part 303 were necessary to reflect the consolidation of the two former deposit insurance funds into one Deposit Insurance Fund by the Federal Deposit Insurance Reform Act of 2005 (FDIRA).

Concur:

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Sara A. Kelsey
General Counsel

Attachment

Section 705 of the FSRRA – Section 7(j) of the Federal Deposit Insurance Act (FDI Act) requires prior notice of changes in control of insured institutions. Section 705 of the FSRRA amended Section 7(j)(1)(D) of the FDI Act to allow the appropriate Federal banking agency to extend the period for disapproval if the agency determines additional time is needed to analyze any proposed changes in the institution's business plan or the future prospects of the institution. Section 705 of the FSRRA also added "the future prospects of the institution" to the list of grounds for disapproval in Section 7(j)(7) of the FDI Act. The changes to Section 7(j) of the FDI Act required conforming amendments to Part 308 of the FDIC rules and regulations.

Section 707 of the FSRRA – Section 707 of the FSRRA added Section 7(a)(2)(C) to the FDI Act authorizing the Federal banking agencies to furnish examination reports and other confidential supervisory information to Federal and state agencies with supervisory or regulatory authority over the examined entity, to officers, directors and receivers of examined entities, and to any other person that the Federal banking agency determines to be appropriate. This change required conforming amendments to Part 309 of the FDIC rules and regulations.

RECOMMENDATION

The Division of Supervision and Consumer Protection recommends that the Board of Directors (Board) adopt and approve the amendments to Parts 303, 308, and 309 of the FDIC rules and regulations detailed in the attached Notice of Final Rule to conform the FDIC rules to the statutory changes described above. DSC also recommends that the Board authorize the Executive Secretary to cause the final rule to be published in the Federal Register.

SECTION 608 OF THE FSRRA

Section 608 of the FSRRA amended Section 5(i)(5) of the Home Owners' Loan Act to read as follows:

> CONVERSION TO NATIONAL OR STATE BANK.
> (A) IN GENERAL.--Any Federal savings association chartered and in operation before the date of enactment of the Gramm-Leach-Bliley Act, with branches in operation before such date of enactment in 1 or more States, may convert, at its option, with the approval of the Comptroller of the Currency for each national bank, and with the approval of the appropriate State bank supervisor and the appropriate Federal banking agency for each State bank, into 1 or more national or State banks, each of which may encompass 1 or more of the branches of the Federal savings association in operation before such date of enactment in 1 or more States subject to subparagraph (B).
> (B) CONDITIONS OF CONVERSION.--The authority in subparagraph (A) shall apply only if each resulting national or State bank--(i) will meet all financial, management, and capital requirements applicable to the resulting national or State bank; and (ii) if more than 1 national or State bank results from a conversion under this subparagraph, has received approval from the Federal Deposit Insurance Corporation under section 5(a) of the Federal Deposit Insurance Act.

Section 303.20 of the FDIC rules and regulations previously established the scope of Subpart B as:

> "This subpart sets forth the procedures for applying for deposit insurance for a proposed depository institution or an operating noninsured depository institution under section 5 of the FDI Act (12 U.S.C. 1815). It also sets forth the procedures for requesting continuation of deposit insurance for a state-chartered bank withdrawing from membership in the Federal Reserve System and for interim institutions chartered to facilitate a merger transaction."

The conforming amendment added the following sentence at the end of Section 303.20 to expressly confirm the applicability of Subpart B of Part 303 to banks resulting from a "break-up conversion."

> "Each bank that results from the conversion of a Federal savings association into multiple banks pursuant to section 5(i)(5) of the Home Owners' Loan Act, 12 U.S.C. § 1464(i)(5), is treated as a proposed depository institution or a de novo institution, as appropriate, for purposes of this subpart."

SECTION 606 OF THE FSRRA

Section 606 of the FSRRA made two changes to the Bank Merger Act that apply to mergers that solely involve an insured depository institution and one or more of its affiliates (Affiliate Mergers). First, for such mergers, it eliminated the requirement for the responsible Federal banking agency to request competitive factors reports from either the other Federal banking agencies or the Attorney General of the United States. Secondly, it eliminated the post-approval waiting period for such mergers. Prior to the FSRRA the applicant in an Affiliate Merger had to wait up to thirty days after approval before it could consummate the transaction.

The changes in the Bank Merger Act due to the FSRRA were accomplished by changing the definition of corporate reorganization which was previously defined in Section 303.61(b) of the FDIC rules and regulations as:

> *"Corporate reorganization* means a merger transaction between commonly-owned institutions, between an insured depository institution and its subsidiary, or between an insured depository institution and its holding company, provided that the merger transaction would have no effect on competition or otherwise have significance under the statutory standards set forth in section 18(c) of the FDI Act (12 U.S.C. 1828(c)). For purposes of this paragraph, institutions are commonly-owned if more than 50 percent of the voting stock of each of the institutions is owned by the same company, individual, or group of closely-related individuals acting in concert."

The changes made by Section 606 of the FSRRA, however, indicate a Congressional conclusion that there are no competitive concerns for a broader class of mergers than those identified by the FDIC's regulation. Specifically, the FSRRA uses the term "affiliate" rather than "commonly-

owned" as defined by the FDIC rules and regulations. Therefore, Section 606 of the FSRRA has enabled the FDIC to simplify the definition in Section 303.61(b) to read as follows:

> "*Corporate reorganization* means a merger transaction that involves solely an insured depository institution and one or more of its affiliates."

Thus, the processing procedures for corporate reorganizations (the lack of competitive factors reports and the post-approval waiting period) now apply to any merger transaction between an insured depository institution and one or more of its affiliates as prescribed by Section 606 of the FSRRA.

SECTION 2102 OF THE FDIRA

Section 2102(a) of the Federal Deposit Insurance Reform Act of 2005 (FDIRA) merged the BIF and the SAIF into a new fund, the Deposit Insurance Fund. In addition, the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 repealed section 5(d)(3) of the FDI Act which addressed conversions from one insurance fund to the other. Among the many consequences of this legislative action, it obviated the need for special rules governing merger transactions that involved conversion from one fund to another. As a result, the discussion in Section 303.63(d) regarding such conversions was no longer necessary and was deleted.

The deleted text read as follows:

> "*Optional conversions.* If the proposed merger transaction is an optional conversion, the merger application shall include a statement that the proposed merger transaction is a transaction covered by section 5(d)(3) of the FDI Act (12 U.S.C. 1815(d)(3))."

SECTION 705 OF THE FSRRA

Section 7(j) of the FDI Act requires 60 days prior notice of proposed changes in control of insured institutions and further sets forth the grounds upon which an agency may disapprove a proposed change in control. Section 705 of the FSRRA added "unfavorable future prospects of the institution" to the list of grounds for disapproval in Section 7(j)(7) of the FDI Act. Section 7(j)(7) was amended to state that the appropriate Federal banking agency may disapprove any proposed acquisition if … "(C) either the financial condition of any acquiring person or the future prospects of the institution is such as might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank;"

The changes to Section 7(j)(7) of the FDI Act required conforming amendments to Part 308 of the FDIC rules and regulations. Section 308.111 of the FDIC rules and regulations previously stated:

> "The following are grounds for disapproval of a proposed acquisition of control of an insured nonmember bank:
> (a) The proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize

> the banking business in any part of the United States;
> (b) The effect of the proposed acquisition of control in any section of the United States may be to substantially lessen competition or to tend to create a monopoly or would in any other manner be in restraint of trade, and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;
> **(c) The financial condition of any acquiring person might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank;**
> (d) The competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the interest of the depositors of the bank, or in the interest of the public to permit such person to control the bank;
> (e) Any acquiring person neglects, fails, or refuses to furnish to the FDIC all the information required by the FDIC; or
> (f) The FDIC determines that the proposed acquisition would result in an adverse effect on the Deposit Insurance Fund."

After the conforming amendment, Section 308.111 states:

> "The following are grounds for disapproval of a proposed acquisition of control of an insured nonmember bank:
> (a) The proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize the banking business in any part of the United States;
> (b) The effect of the proposed acquisition of control in any section of the United States may be to substantially lessen competition or to tend to create a monopoly or would in any other manner be in restraint of trade, and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;
> **(c) Either the financial condition of any acquiring person <u>or the future prospects of the institution</u> might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank;**
> (d) The competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the interest of the depositors of the bank, or in the interest of the public to permit such person to control the bank;
> (e) Any acquiring person neglects, fails, or refuses to furnish to the FDIC all the information required by the FDIC; or
> (f) The FDIC determines that the proposed acquisition would result in an adverse effect on the Deposit Insurance Fund."

SECTION 707 OF THE FSRRA

Section 707 of the FSRRA amended section 7(a)(2) of the FDI Act, adding at the end, a new subsection (C) which expanded the Federal banking agencies' authority to disclose examination reports and other confidential supervisory information. This addition expanded the information that is eligible for disclosure from certain specified "exempt records" to any "confidential supervisory information." In addition, the FSRRA authorized several new categories of permissible recipients of such information. Prior to the FSRRA, the permissible recipients were: depository institutions, Federal financial institution regulatory agencies, state banking agencies, and certain other agencies. After FSRRA, examination reports and other confidential supervisory information can be disclosed to (1) any Federal and State agencies with supervisory or regulatory authority over the depository institution or examined entities; (2) officers, directors, and receivers of the depository institution or examined entities; and (3) any other person that the Federal banking agency determines to be appropriate.

On November 30, 1995, the FDIC issued a final rule entitled "Disclosure of Information." The rule contained Section 309.6 entitled "Disclosure of exempt records." Section 309.6(b)(3) of the FDIC rules and regulations previously described the authorized disclosure of exempt records to Federal financial institution regulatory agencies, state banking agencies, and certain other agencies. The amendment added a new sentence at the end of section 309.6(b)(3) as follows:

> "Finally, the Director, or designee, may in his or her discretion and for good cause, disclose reports of examination or other confidential supervisory information concerning any depository institution or other entity examined by the Corporation under authority of Federal law to: (1) any other Federal or State agency or authority with supervisory or regulatory authority over the depository institution or other entity; (2) any officer, director, or receiver of such depository institution or entity; and (3) any other person that the Corporation determines to be appropriate."

The legislative history of FSRRA does not provide a definitive rationale for this addition. The Senate Banking Committee report accompanying FSRRA merely states that:

> "GLBA gave the Federal Reserve Board authority to provide confidential supervisory information concerning an examined entity to another supervisory authority, an officer, director, or receiver of the examined entity, or any other person determined by the supervisory agency to be appropriate. This section gives the same authority to all federal banking agencies." S. Rep. No. 109-256 (2006).

The legislative history of the GLBA likewise does not explain the rationale for this expanded authority. We surmise that one reason may be that financial holding companies, after enactment of GLBA, were able to control insurance companies and securities firms. Accordingly Congress may have recognized that the FRB, as the supervisor of financial holding companies, may need to share information with state insurance regulators and the SEC as the functional regulators of insurance companies and securities firms. In FSRRA, Congress may have concluded that the primary Federal regulator for the subsidiary banks may have the same need.

While FSRRA and above regulatory amendment give the FDIC the authority to disclose confidential supervisory information, the FDIC is not required to make such disclosure. Denial of a request for disclosure of confidential supervisory information under Part 309 is a final agency action reviewable under the Administrative Procedure Act (APA), 5 U.S.C. § 702.

There is no process for internal appeals from such denials. Thus an aggrieved party would seek judicial review of any such denial as "final agency action". Judicial review of agency action under the APA is limited in the following ways: (1) judicial review is limited to the agency record; (2) agencies are given deference in interpreting statutes and regulations they administer; and (3) judicial review is limited to final agency action.[1] The standard of review under the APA is narrow and "[t]he court is not empowered to substitute its judgment for that of the agency."[2] Moreover, "[t]he agency decision need only have a rational basis, and it does not have to be a decision which the court would have made."[3]

Staff Contacts

Division of Supervision and Consumer Protection: Brett A. McCallister
Review Examiner
(573) 875-6620 Ext. 4223

Legal Division: Robert C. Fick
Counsel
(202) 898-8962

[1] *Camp v. Pitts*, 411 U.S. 138, 142 (1973).
[2] *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971) (overruled on other grounds by *Califano v. Sanders*, 430 U.S. 99, 105 (1977)).
[3] *James City County, Va. v. EPA*, 12 F.3d 1330, 1338 (4th Cir. 1993).