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Federal Reserve Provides Clarity into its Application Process

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The Bankers' Statement – Summer 2014

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On February 24, 2014, the Federal Reserve provided better insight into issues that may delay or prevent its approval of applications and notices relating to transactions, including mergers and branch or line of business expansions. The Federal Reserve's supervisory letter also announced that it would begin publishing a semi-annual report in the second half of 2014 to enhance transparency in the bank applications and notice process. The report will identify the primary issues leading to the denial or withdrawal of filings and include statistics on the length of time taken to process applications as well as the volume of approvals, denials and withdrawals.

The supervisory letter discussed the common issues that led to the withdrawal of 700 applications from 2009 to 2012. Financial institutions that are planning a transaction where the Federal Reserve is or may be involved in any way should note the following concerns that may prevent approval:

Less-than-satisfactory ratings for safety and soundness

Despite having a satisfactory composite rating, organizations with less-than-satisfactory component ratings for risk management, financial condition, bank management or bank capital will face barriers to approval of proposed actions, particularly for expansions. The Federal Reserve noted that financial and management considerations underlie a majority of withdrawals. Only in limited circumstances will the Federal Reserve consider proposals from organizations with a composite rating of "3" or one or more component ratings of "3" for safety and soundness. However, an organization with such ratings must convince the Federal Reserve that the proposal would not distract from safety and soundness problems, but would, instead, strengthen the organization.

Less-than-satisfactory ratings for, or adverse public comments relating to, consumer compliance or Community Reinvestment Act (CRA) performance

A less-than-satisfactory rating for consumer compliance or CRA will usually result in unfavorable action on an application filed with the Federal Reserve. However, the Federal Reserve may evaluate the nature and severity of consumer compliance issues, the institution's history of consumer compliance, the corrective steps taken, the institution's size in relation to its consolidated assets, the proposal's potential to distract from corrective action, and whether branch openings will address a weakness in the bank's CRA performance or meet a need for banking services in low- to moderate-income or minority areas.

Although not a leading cause of withdrawals, public comments remain a legally required consideration for certain applications and notices. If adverse public comments relate to consumer compliance or CRA performance, the Federal Reserve (and other agencies) may hesitate to approve such proposals without performing an extensive review, which can result in substantial delays.

Concerns about the proposed organization's management or financial condition

The current or future financial condition of a proposed combined organization can also prevent approval. Common financial issues raising an alarm for the Federal Reserve include: inadequate capitalization on a pro forma basis, poor capital quality and holding companies with insufficient resources or ability to support their insured depository institutions (IDIs). If a proposed expansion would require incurring debt, the organization must have the ability to meet its debt obligations without resorting to high levels of dividends or payments from its IDIs.

The Federal Reserve also extensively reviews the integrity, financial responsibility and competence of any officers, directors and principal shareholders of an applicant. Several factors that may raise doubts about an individual's capacity to fulfill principal roles include: associations with failed IDIs, bankruptcy filings, defaults on obligations for IDIs or the Deposit Insurance Fund, criminal convictions and acts resulting in government enforcement actions.

Less-than-satisfactory Bank Secrecy Act and anti-money laundering compliance programs

Institutions will face significant barriers to approval if they fail to effectively combat money laundering activities or to otherwise comply with the Bank Secrecy Act. The Federal Reserve will review the primary supervisor's assessment of compliance and note any formal or informal enforcement actions resulting from program violations or deficiencies.

Business plans that increase risk to the organization or raise safety and soundness concerns

The Federal Reserve evaluates proposed business plans in light of an organization's current condition and the surrounding economic environment to identify any increased risk or safety and soundness concerns. Significant red flags arise when the Federal Reserve finds the following: overly aggressive business strategies contemplating rapid or excessive growth; significant out-of-territory lending or reliance on unstable funding; plans for concentrating assets, liabilities, product offerings, customers, revenues or business activities; and proposals for entry into a new line of business without the necessary managerial experience or expertise.

Proposed transactions involving requests for Regulation W exemptions

If a proposal would require obtaining a Regulation W exemption for an IDI, the Federal Reserve will not contemplate approval until the FDIC agrees to the exemption request and finds no unacceptable risk to the Deposit Insurance Fund. The requesting institution must also contact any appropriate supervisors and agencies to acquire their consent to the exemption.

Even with this new insight into the Federal Reserve's application process, we always recommend that institutions discuss any planned transactions or expansionary activities with all of their regulators before treading too far into the process. It is important to address any issues on a regulator's radar before negotiating and entering into a transaction, and certainly before commencing the applications process.