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The Bankers' Statement – Winter 2014

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De Novo Banks

Following an extended dry spell for de novo bank applications, in what could be interpreted as a gesture to "kick-start" de novo conversations, the FDIC issued in November a somewhat "out of the blue" financial institutions letter (FIL-56-2014) containing a series of Q&As relating to procedural issues surrounding applications for deposit insurance.

For several years there has been a rumored informal "moratorium" by the FDIC on new charters, which the FDIC has continually denied, however the economic and regulatory climate has resulted in only one de novo application approval since 2010, one application approved in 2013, and only one application filed in 2014. De novo banks unfortunately figured prominently in recent bank failures during the economic downturn, and during that period the FDIC increased its heightened supervisory oversight of de novo institutions from three years to seven years.

The new guidance provides additional procedural and other insights to the FDIC's Statement of Policy on Applications for Deposit Insurance from October 1998, and includes updated information and insights relating to proposed de novo insurance applications.

In addition to reviewing regulatory procedures in the de novo process, it also provides insights as to initial capitalization issues and the nature and extent of expected business plans for de novo institutions. Key among the "good news" issues discussed by the FIL is the requirement for de novo banks to maintain an 8% Tier 1 leverage ratio for the first three years of operation as opposed to the first seven years, subject to the need for additional capital depending on the results of operations, risk profile and complexity of the organization. Applications are expected to take four to six months for approval after being deemed substantially complete, which provides sufficient latitude for the FDIC to obtain information it deems sufficient for the determination.

Whether economic and general regulatory conditions continue to inhibit the appetite of investors for de novo activity, as M&A activities pick up and opportunities are created the FDIC's guidance should be helpful to potential applicants in providing a better understanding of the process and timeframes involved in securing FDIC insurance for new banking entities.

Permissible Activities and Investments for State-Chartered Institutions

In another important and welcome announcement, on November 19, the FDIC issued Financial Institutions Letter FIL-54-2014 clarifying that insured state-chartered institutions that desire to engage in activities (or make investments) that are permissible for national banks or subsidiaries of national banks, directly or indirectly through a subsidiary of the state bank, may do so without formal FDIC pre-approval. The activity or investment must be permissible under state law, must pose no "significant risk to the deposit fund," and the bank must be and remain in compliance with required capital standards.

The FIL requires retention of certain documentation by the state bank to support its determination as outlined in the guidance, and limitations on investments and activities applicable to the proposed activity for national banks are likewise applicable to the state bank.

What constitute permissible activities and investments for banks and their affiliates, and what limitations and restrictions may apply, can be a very complicated analysis at best. A plethora of rules apply to applications and/or notices with a diverse variety of regulators when institutions are considering new activities and/or investments. While the action by the FDIC provides welcome regulatory guidance and relief, it is, however, always a best practice (and generally much safer) to make certain that each of the state and federal bank and non-bank agencies impacting a bank, its affiliates and/or its holding company, be consulted well in advance of any proposed new activities and/or formation of new subsidiary organizations in order to ascertain that the agencies are aware in advance of the institution's plans. Regulatory surprises are never a good thing, and bankers need to make certain that they understand what, if anything, needs to be done with the agency in advance of engaging directly or indirectly in an activity or making an investment and what, if any, limitations or restrictions may apply.