

## FEDERAL RESERVE SYSTEM

Penn Bancshares, Inc.  
Pennsville, New Jersey

### Order Approving Acquisition of Shares of a Bank Holding Company

Penn Bancshares, Inc. (“Penn”), a bank holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under section 3 of the BHC Act<sup>1</sup> to acquire up to 24.89 percent of the voting shares of Harvest Community Bank (“HCB”), also of Pennsville.<sup>2</sup>

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (70 Federal Register 56,899 (2005)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

Penn, with total consolidated assets of approximately \$164.7 million, is the 102<sup>nd</sup> largest depository organization in New Jersey, controlling deposits of approximately \$150.5 million, which represent less than 1 percent of total deposits of insured depository institutions<sup>3</sup> in the state (“state deposits”).<sup>4</sup> HCB, with assets of approximately \$141.1 million, is the 110<sup>th</sup> largest depository organization in New Jersey, controlling approximately \$120.9 million in deposits. If Penn were

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<sup>1</sup> 12 U.S.C. § 1842.

<sup>2</sup> Penn and its officers and directors currently own 4.98 percent of HCB’s voting shares. Penn proposes to acquire the additional voting shares in negotiated purchases from shareholders and through open market purchases.

<sup>3</sup> In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

<sup>4</sup> Asset data are as of September 30, 2005. Deposit and ranking data are as of June 30, 2005, and reflect merger activity through December 14, 2005.

deemed to control HCB on consummation of the proposal, Penn would become the 74<sup>th</sup> largest depository organization in New Jersey, controlling approximately \$271.4 million in deposits, which represent less than 1 percent of state deposits.

The Board received approximately 73 comments on the proposal. Comments were submitted by HCB and government officials, private organizations, and individuals, including HCB and Penn shareholders and customers. Many commenters objected to the proposal on the grounds that the investment could create uncertainty about the future independence of HCB or result in Penn acquiring control of HCB and potentially harming its future prospects. A number of commenters also expressed concern that the proposal could have an adverse effect on competition and on the convenience and needs of the communities that HCB serves. The Board has considered these comments carefully in light of the factors that the Board must consider under section 3 of the BHC Act.

The Board previously has stated that the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company.<sup>5</sup> The requirement in section 3(a)(3) of the BHC Act, however, that the Board's approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated the acquisition by bank holding companies of between 5 and 25 percent of the voting shares of banks.<sup>6</sup> On this basis, the

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<sup>5</sup> See, e.g., C-B-G, Inc., 91 Federal Reserve Bulletin 421 (2005) ("C-B-G"); S&T Bancorp Inc., 91 Federal Reserve Bulletin 74 (2005) ("S&T Bancorp"); Brookline Bancorp, MHC, 86 Federal Reserve Bulletin 52 (2000) ("Brookline"); North Fork Bancorporation, Inc., 81 Federal Reserve Bulletin 734 (1995); First Piedmont Corp., 59 Federal Reserve Bulletin 456, 457 (1973).

<sup>6</sup> See 12 U.S.C. § 1842(a)(3).

Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company.<sup>7</sup>

Penn has stated that the acquisition is intended as a passive investment and that it does not propose to control or exercise a controlling influence over HCB. Penn has agreed to abide by certain commitments previously relied on by the Board in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company or bank for purposes of the BHC Act.<sup>8</sup> For example, Penn has committed not to exercise or attempt to exercise a controlling influence over the management or policies of HCB or any of its subsidiaries; not to seek or accept representation on the board of directors of HCB or any of its subsidiaries; and not to have any director, officer, employee, or agent interlocks with HCB or any of its subsidiaries. Penn also has committed not to attempt to influence the dividend policies, loan decisions, or operations of HCB or any of its subsidiaries. Moreover, the BHC Act prohibits Penn from acquiring shares of HCB in excess of the amount considered in this proposal or attempting to exercise a controlling influence over HCB without the Board's prior approval.<sup>9</sup>

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<sup>7</sup> See, e.g., C-B-G (acquisition of up to 24.35 percent of the voting shares of a bank holding company); S&T Bancorp (acquisition of up to 24.9 percent of the voting shares of a bank holding company); Brookline (acquisition of up to 9.9 percent of the voting shares of a bank holding company).

<sup>8</sup> See, e.g., C-B-G; S&T Bancorp; Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996); First Community Bancshares, Inc., 77 Federal Reserve Bulletin 50 (1991). Penn's commitments are set forth in the appendix.

<sup>9</sup> HCB claimed that Penn and the president, a director, and an officer of Penn, as well as a HCB shareholder who is a business associate of Penn's president, have already acted together to acquire more than 5 percent of the shares of HCB without prior approval of the Board, as required under section 3 of the BHC Act. The Board has reviewed information provided by Penn and HCB and confidential supervisory information regarding the current ownership of both organizations, including information about the ownership of HCB's shares

The Board has adequate supervisory authority to monitor compliance by Penn with its commitments and can take enforcement action against Penn if it violates any of the commitments.<sup>10</sup> The Board also has authority to initiate a control proceeding<sup>11</sup> against Penn if facts presented later indicate that Penn or any of its subsidiaries or affiliates, in fact, controls HCB for purposes of the BHC Act.<sup>12</sup> Based on these considerations and all the other facts of record, the Board has concluded that Penn would not acquire control of, or have the ability to exercise a controlling influence over, HCB through the proposed acquisition of voting shares.

#### Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal supervisors of the organizations involved in the proposal, publicly

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by individuals associated with Penn, in light of the Board's rules and precedent for aggregating shares held by a company and persons associated with the company. The record does not support a finding that Penn, its president, the director and the officer of Penn, and the HCB shareholder have acted together to acquire more than 5 percent of the voting shares of HCB in violation of the BHC Act.

<sup>10</sup> See 12 U.S.C. § 1818(b)(1).

<sup>11</sup> See 12 U.S.C. § 1841(a)(2)(C).

<sup>12</sup> HCB asserted that despite Penn's commitments, Penn would control HCB after consummation of the proposal and thereby potentially harm the future prospects of HCB. As noted, the Board believes that the facts of record, including the commitments made in this case, do not support this conclusion and that the Board has adequate supervisory authority to monitor and enforce Penn's compliance with its commitments.

reported and other financial information, information provided by the applicant, and public comments received.<sup>13</sup>

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of measures, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. When applicable, the Board also evaluates the financial condition of the combined organization on consummation, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.<sup>14</sup>

Penn and its subsidiary bank, The Pennsville National Bank (“PNB”), Pennsville, are well capitalized and would remain so on consummation

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<sup>13</sup> HCB claimed that Penn is in violation of state law because Penn has not yet filed an application with, and received approval from, the New Jersey Department of Banking and Insurance (“Banking Department”) under the New Jersey banking statutes. Penn has represented that it plans to file an application with the Banking Department after the proposal is approved by the Board. The Federal Reserve provided notice of the application filed with the Board to the Banking Department, as required under section 3 of the BHC Act, and the Board has consulted with the department. The Banking Department has not filed any comments with the Board about this proposal. As in other proposed transactions that might be subject to approval from multiple banking supervisory agencies, an applicant must obtain all required regulatory approvals in accordance with applicable law. The Board’s approval of this proposal is conditioned on Penn obtaining any approval required by New Jersey law.

<sup>14</sup> As previously noted, the current proposal provides that Penn would acquire only up to 24.89 percent of HCB’s voting shares and would not be considered to control HCB. Under these circumstances, the financial statements of Penn and HCB would not be consolidated.

of the proposal. Based on its review of the record, the Board believes that Penn has sufficient financial resources to effect the proposal. The proposed transaction would be funded from Penn's general corporate resources.

The Board also has considered the managerial resources of the organizations involved.<sup>15</sup> The Board has reviewed the examination records of Penn, PNB, and HCB, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws. Penn, PNB, and HCB are considered to be well managed.

Several commenters contended that Penn's investment could cause confusion among HCB's shareholders, customers, and employees about the continued independence of HCB and could compromise HCB's ability to retain employees. As noted above, Penn has committed that it will not attempt to influence HCB's operations, personnel decisions, pricing of services, activities, or dividend, loan, or credit policies; or to exercise a controlling influence over HCB. The Board believes that these and the other commitments made by Penn

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<sup>15</sup> HCB alleged that Penn owns more than 5 percent of HCB's voting shares and asserted that Penn is, therefore, in violation of federal securities laws and regulations requiring Penn to file certain reports. As previously noted, the record does not support a finding that Penn has acquired more than 5 percent of the voting shares of HCB. Moreover, the Federal Deposit Insurance Corporation ("FDIC"), rather than the Board, is the appropriate agency to investigate and adjudicate any violations of federal securities laws and regulations pertaining to the securities of state nonmember banks such as HCB. See 12 CFR Part 335. The Board has consulted with the FDIC, which is investigating HCB's assertion in light of the relevant laws and regulations. The Board believes the FDIC has adequate supervisory authority to monitor and enforce Penn's compliance with those laws and regulations.

clarify that the company will maintain a passive role as an investor in HCB and that the operation of HCB will continue to be the responsibility of HCB's management. No evidence has been presented to show that the purchase of shares of HCB on the open market by Penn would adversely affect the financial condition of HCB or Penn.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and the future prospects of the organizations involved in the proposal are consistent with approval, as are the supervisory factors under the BHC Act.

#### Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposed bank acquisition that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. Section 3 also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition<sup>16</sup> in any relevant banking market unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.<sup>17</sup>

The Board previously has stated that one company need not acquire control of another company to lessen competition between them substantially.<sup>18</sup>

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<sup>16</sup> Several commenters expressed concern that consummation of the proposal would provide Penn with the ability to exert control over HCB, with a resulting adverse effect on competition.

<sup>17</sup> See 12 U.S.C. § 1842(c)(1).

<sup>18</sup> See, e.g., SunTrust Banks, Inc., 76 Federal Reserve Bulletin 542 (1990); First State Corp., 76 Federal Reserve Bulletin 376, 379 (1990); Sun Banks, Inc., 71 Federal Reserve Bulletin 243 (1985) ("Sun Banks").

The Board has found that noncontrolling interests in directly competing depository institutions may raise serious questions under the BHC Act and has stated that the specific facts of each case will determine whether the minority investment in a company would be anticompetitive.<sup>19</sup>

HCB contends that the relevant geographic market for reviewing this transaction is Salem County, New Jersey, and not the Philadelphia banking market (“Philadelphia Market”).<sup>20</sup> HCB asserts that Salem County is the relevant market because of the county’s population and economic demographics and because all of Penn’s and HCB’s offices and the vast majority of their customer bases are, according to HCB, in Salem County. In reviewing this contention, the Board has considered a number of factors to identify the economically integrated market that represents the appropriate local geographic banking market for purposes of analyzing the competitive effects of this proposal.

The Board has reviewed the geographic proximity of the Philadelphia Market’s population centers and the worker commuting data from the 2000 census, which indicated that more than 35 percent of the labor force residing in Salem County commuted to work elsewhere in the Philadelphia Market. In addition, several large banks without a branch in Salem County, but with branches elsewhere in the Philadelphia Market, advertise in the local telephone directory and through radio, television, and newspapers that serve the county. Moreover, small-business lending

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<sup>19</sup> See, e.g., BOK Financial Corp., 81 Federal Reserve Bulletin 1052, 1053-54 (1995); Mansura Bancshares, Inc., 79 Federal Reserve Bulletin 37, 38 (1993); Sun Banks at 244.

<sup>20</sup> The Philadelphia Market is the Philadelphia/South Jersey banking market and is defined as Burlington, Camden, Cumberland, Gloucester, and Salem Counties, all in New Jersey; and Bucks, Chester, Delaware, Montgomery, and Philadelphia Counties, all in Pennsylvania.

data submitted by depository institutions in 2004 under the Community Reinvestment Act (“CRA”) regulations<sup>21</sup> of the federal supervisory agencies indicated that approximately 25 percent of the total number of small business loans made to businesses in Salem County were made by depository institutions without a branch in the county but with branches elsewhere in the Philadelphia Market. Based on these facts and other information, the Board reaffirms that Salem County should be included in the Philadelphia Market and that the Philadelphia Market is the appropriate local geographic banking market for purposes of analyzing the competitive effects of this proposal.

If PNB and HCB were viewed as a combined organization, consummation of the proposal would be consistent with Board precedent and the Department of Justice Merger Guidelines<sup>22</sup> in the Philadelphia Market. The market would remain moderately concentrated as measured by the HHI and numerous competitors would remain in the market.<sup>23</sup>

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<sup>21</sup> See, e.g., 12 CFR 228 et seq.

<sup>22</sup> Under the revised Department of Justice Merger Guidelines, 49 Federal Register 26,823 (June 29, 1984), a market is considered moderately concentrated if the post-merger HHI is between 1000 and 1800 and highly concentrated if the post-merger HHI is more than 1800. The Department of Justice has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The Department of Justice has stated that the higher than normal thresholds for an increase in the HHI when screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

<sup>23</sup> Penn is the 53<sup>rd</sup> largest depository organization in the Philadelphia Market, controlling \$150.5 million in deposits, which represents less than 1 percent of the total deposits in depository institutions in the market (“market deposits”). HCB is the 61<sup>st</sup> largest depository institution in the market, controlling \$120.9 million in deposits. If considered a combined banking organization on consummation of the proposal, Penn and HCB would be the 39<sup>th</sup> largest depository institution in the Philadelphia Market, controlling \$271.4 million

The Department of Justice also has reviewed the proposal and has advised the Board that it does not believe that the acquisition would likely have a significantly adverse effect on competition in any relevant banking market. The appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Accordingly, in light of all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market and that competitive considerations are consistent with approval of the proposal.

#### Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the CRA.<sup>24</sup> The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their

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in deposits, which would represent less than 1 percent of market deposits. The HHI for the Philadelphia Market would remain unchanged at 1043. One hundred and thirty-two depository institutions would remain in the market.

Market deposit data are as of June 30, 2005, and reflect mergers and acquisitions through December 14, 2005. Market share data are based on calculations that include the deposits of thrift institutions at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. See, e.g., Midwest Financial Group, 75 Federal Reserve Bulletin 386, 387 (1989); National City Corporation, 70 Federal Reserve Bulletin 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the calculation of market share on a 50 percent weighted basis. See, e.g., First Hawaiian, Inc., 77 Federal Reserve Bulletin 52, 55 (1991).

<sup>24</sup> 12 U.S.C. § 2901 et seq.

safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating bank expansionary proposals.<sup>25</sup>

The Board has considered carefully the entire record, including Penn's commitments not to control HCB or its operations and policies, the federal agencies' evaluations of the CRA performance records of PNB and HCB, data reported by PNB and HCB under the Home Mortgage Disclosure Act ("HMDA"),<sup>26</sup> other information provided by Penn, confidential supervisory information, and public comment received on the proposal.<sup>27</sup> Several commenters generally criticized PNB's level of service to its community, including the bank's level of community and small business lending. One commenter specifically criticized PNB's record of lending to small businesses owned by minorities.

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a

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<sup>25</sup> 12 U.S.C. § 2903.

<sup>26</sup> 12 U.S.C. § 2801 et seq.

<sup>27</sup> Several commenters expressed concern about PNB's branching policies and possible branch closures, reductions in service, and job losses after consummation of the proposal and generally objected to the transaction because PNB would implement its policies and procedures at HCB. As previously noted, Penn has agreed to a set of passivity commitments that prevent it from, among other things, attempting to influence the policies and business decisions of HCB, including the credit decisions of HCB and the locations or operations of HCB's branches. The effect of a proposed acquisition on employment in a community is not among the factors included in the BHC Act. See Wells Fargo & Company, 82 Federal Reserve Bulletin 445, 457 (1996).

detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.<sup>28</sup>

PNB received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of October 27, 2003 ("2003 Evaluation"). HCB also received a "satisfactory" rating at its most CRA performance evaluation by the FDIC, as of January 11, 2002.

In the 2003 Evaluation, examiners found that PNB exceeded the standards for satisfactory performance for lending in its assessment area and demonstrated a good record of lending to small businesses. Examiners reported that PNB ranked second out of 243 peer lenders in originating home mortgage loans and that the bank's commercial loan portfolio was substantially composed of loans to small businesses. Examiners also noted no evidence of illegal discrimination or other illegal credit practices.

Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

### Conclusion

Based on the foregoing and all other facts of record, the Board has determined that the application should be, and hereby is, approved.<sup>29</sup> In reaching

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<sup>28</sup> See Interagency Questions and Answers Regarding Community Reinvestment, 66 Federal Register 36,620 and 36,639 (2001).

<sup>29</sup> HCB requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authority. Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide

this conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.<sup>30</sup> The Board's approval is specifically conditioned on compliance by Penn with the conditions imposed in this order and all the commitments made to the Board in connection with the application, including the commitments discussed in this order, and receipt of all required regulatory approvals. The conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The acquisition of HCB's voting shares shall not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended

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an opportunity for testimony. 12 CFR 225.16(e). The Board has considered carefully HCB's request in light of all the facts of record. In the Board's view, HCB has had ample opportunity to submit its views, and in fact, submitted written comments that the Board has considered carefully in acting on the proposal. HCB's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

<sup>30</sup> HCB also requested that the Board delay action on the application until the Banking Department has evaluated the proposal. As previously noted, the Board has accumulated a significant record in this case, including reports of examination, confidential supervisory information, public reports and information, and public comment. Moreover, the BHC Act and Regulation Y require the Board to act on proposals submitted under those provisions within certain time periods. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that further delay in considering the proposal is not necessary.

for good cause by the Board or by the Federal Reserve Bank of Philadelphia, acting pursuant to delegated authority.

By order of the Board of Governors,<sup>31</sup> effective December 19, 2005.

*(signed)*

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Robert deV. Frierson  
Deputy Secretary of the Board

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<sup>31</sup> Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

## APPENDIX

In connection with its application to acquire up to 24.89 percent of HCB, Penn commits that it will not, directly or indirectly:

- (1) exercise or attempt to exercise a controlling influence over the management or policies of HCB or any of its subsidiaries;
- (2) seek or accept representation on the board of directors of HCB or any of its subsidiaries;
- (3) serve, have or seek to have any representative serve as an officer, agent, or employee of HCB or any of its subsidiaries;
- (4) take any action that would cause HCB or any of its subsidiaries to become a subsidiary of Penn or any of its subsidiaries;
- (5) acquire or retain shares that would cause the combined interests of Penn and its subsidiaries, and their respective officers, directors, and affiliates, to equal or exceed 25 percent of the outstanding voting shares of HCB or any of its subsidiaries;
- (6) propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of HCB or any of its subsidiaries;
- (7) solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of HCB or any of its subsidiaries;
- (8) attempt to influence the dividend policies or practices of HCB or any of its subsidiaries;
- (9) attempt to influence the investment, loan, or credit decisions or policies; pricing of services; personnel decisions; operations activities (including the location of any offices or branches or their hours of operation, etc.); or any similar activities or decisions of HCB or any of its subsidiaries;
- (10) dispose or threaten to dispose of shares of HCB or any of its subsidiaries in any manner as a condition of specific action or nonaction by HCB or any of its subsidiaries; or

- (11) enter into any other banking or nonbanking transactions with HCB or any of its subsidiaries, except that Penn may establish and maintain deposit accounts with depository institution subsidiaries of HCB; provided that the aggregate balance of all such accounts does not exceed \$500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with HCB or any of its subsidiaries.