

FEDERAL RESERVE SYSTEM

Forest Merger Corporation
Arlington, Virginia

FBR TRS Holdings, Inc.
Arlington, Virginia

Order Approving Formation of Bank Holding Companies and Determination on Financial Holding Company Elections

Friedman, Billings, Ramsey Group, Inc., Arlington, Virginia ("FBRG"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has submitted applications and notices on behalf of Forest Merger Corporation ("Forest") and Forest's wholly owned subsidiary, FBR TRS Holdings, Inc. ("Holdings"), under sections 3 and 4 of the BHC Act in connection with a reorganization of FBRG and its subsidiaries. Forest and Holdings (jointly, "Applicants"), which are currently owned and controlled by FBRG, have requested the Board's approval under section 3 of the BHC Act (12 U.S.C. § 1842) to become bank holding companies and to acquire control of FBRG, FBR Asset Investment Corporation, Arlington ("Asset"), FBR Bancorp, Inc., Arlington ("Bancorp"), a financial holding company, and FBR National Bank & Trust, Bethesda, Maryland ("Bank").¹ On consummation of the proposal, FBRG

¹ In connection with the reorganization, Applicants have also requested the Board's approval under section 3 to acquire interests in the following banks: 5.2 percent of the voting shares of ITLA Capital Corporation, a bank holding company that controls Imperial Capital Bank, both in La Jolla, California; voting authority over 5.58 percent of the voting shares of Pacific Crest Capital, Inc., a bank holding company that controls Pacific Crest Bank, both in Agoura Hills, California; voting authority over 5.77 percent of the voting shares of Hingham Institution for Savings, Hingham, Massachusetts; voting authority over 9.7 percent of the voting shares of Bancorp Rhode Island, Inc., Providence, a bank holding

and Asset would be merged with and into Forest, with Forest as the surviving corporation, and Forest would be renamed Friedman, Billings, Ramsey Group, Inc. ("New FBR").

As part of this proposal, Applicants have also filed elections to become financial holding companies pursuant to section 4(k) and (l) of the BHC Act (12 U.S.C. § 1843(k) & (l)) and section 225.82 of the Board's Regulation Y (12 C.F.R. 225.82).

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 Federal Register 1,851; 3,531; and 3,885 (2003)). 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 sections 3 and 4 of the BHC Act.

FBRG, with total consolidated assets of \$496 million, is a bank holding company that qualifies as a financial holding company and is engaged primarily in securities underwriting and dealing, securities brokerage, investment

company that controls Bank Rhode Island, East Providence, both in Rhode Island; voting authority over 5.1 percent of the voting shares of The Banc Corporation, Birmingham, a bank holding company that controls The Bank, Warrior, both in Alabama; and voting authority over approximately 5.1 percent of the voting shares of Pacific Union Bank, Los Angeles, California.

Applicants have also requested the Board's permission under section 4 to acquire interests in the following savings associations: voting authority over 5.74 percent of the voting shares of First Bell Bancorp, Inc., Pittsburgh, parent company of Bell Federal Savings and Loan Association, Bellevue, both in Pennsylvania; voting authority over 5.67 percent of the voting shares of Quaker City Bancorp, Inc., parent company of Quaker City Bank, both in Whittier, California; and voting authority over 6.1 percent of the voting shares of Hawthorne Financial Corporation, parent company of Hawthorne Savings, F.S.B., both in El Segundo, California.

advisory, and merchant banking activities.² In the United States, FBRG conducts its securities and advisory activities through several subsidiaries subject to regulation by the Securities and Exchange Commission ("SEC"), including Friedman, Billings, Ramsey & Co., Inc., Arlington, a broker-dealer registered with the SEC under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. § 78o). Bank is the only bank controlled by FBRG and, with assets of \$90.2 million, it is the 107th largest depository institution in Maryland. Bank controls deposits of approximately \$33.4 million in the state, representing less than 1 percent of deposits in depository institutions in Maryland.³

Factors Governing Board Review of Transaction

The BHC Act sets forth the factors that the Board must consider when reviewing the formation of a bank holding company or the acquisition of a bank. These factors are the competitive effects of the proposal in the relevant geographic markets; the financial and managerial resources and future prospects of the companies and banks involved in the proposal; the convenience and needs of the communities to be served, including the records of performance under the Community Reinvestment Act (12 U.S.C. § 2901 *et seq.*) ("CRA") of the insured depository institutions involved in the transaction, and other supervisory factors.

The Board has considered these factors in light of a record that includes information provided by FBRG, confidential supervisory and examination information from various federal agencies, and publicly reported financial and other information. In addition, the Board has considered a public comment received on the proposal.

² Asset data for FBRG are as of September 30, 2002.

³ Asset data for Bank are as of December 31, 2002. Deposit and ranking data are as of June 30, 2002.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.⁴ This proposal represents an internal reorganization of the existing operations of FBRG and would not result in either an expansion of operations or the acquisition of an additional bank. There is also no evidence in this case that the transaction would lessen competition or create a monopoly in any relevant market. Based on all the facts of record, the Board has determined that competitive factors are consistent with approval of the proposal.

Financial, Managerial, and Other Supervisory Considerations

The BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in a proposal and certain other supervisory factors. In evaluating the financial and managerial factors, the Board has reviewed confidential examination and other supervisory information evaluating the financial and managerial strength of Applicants; FBRG and its affiliates, including its regulated subsidiaries; and Bank.

After consummation of the proposal, New FBR would elect to be treated as a real estate investment trust ("REIT") under the Internal Revenue Code ("IR Code").⁵ New FBR and its subsidiaries and affiliates would continue to

⁴ 12 U.S.C. § 1842(c)(1).

⁵ See 12 U.S.C. §§ 856-860.

engage only in activities that are permissible for a financial holding company under section 4(k) of the BHC Act.

Certain requirements applicable to New FBR under the IR Code might limit its ability to serve as a source of financial strength to Bank, because the requirements may limit the amount of capital available to a bank subsidiary of a bank holding company that is organized as a REIT.⁶ Applicants note, however, that New FBR may downstream capital to Holdings and retain income earned at the Holdings level to support the operations of Bank.⁷

Applicants have also stated that, for a variety of business reasons unrelated to the BHC Act requirements, Applicants intend to discontinue being financial holding companies and to limit the activities of Bank to those of a limited-purpose trust company. In particular, Applicants have committed that, within six months of consummation of the proposed reorganization, Bank will limit its operations so that it no longer meets the definition of a bank under section 2(c)(1) of the BHC Act. New FBR would then cease to be a bank holding company.

Bank is currently well capitalized under relevant federal guidelines, and all the subsidiaries of FBRG that are subject to regulatory capital requirements exceed the required minimum capital levels. The Board notes that after accounting

⁶ Under the IR Code, the amount of non-REIT assets that a REIT may hold in a taxable REIT subsidiary, which is subject to taxation at ordinary corporate rates, is limited to 20 percent of the REIT's total assets. See 12 U.S.C. § 856(c). A REIT is also required to distribute 90 percent of its net income to its shareholders each year. See 12 U.S.C. § 857(a). Holdings, which would be the parent of Bancorp and Bank, would be organized as a taxable REIT subsidiary.

⁷ Applicants note that income earned by a taxable REIT subsidiary is not subject to the mandatory distribution requirement until paid as a dividend to the REIT. Moreover, funds invested by a REIT in its taxable REIT subsidiary are not subject to the mandatory distribution requirement.

for certain requirements under the IR Code, New FBR would have, pro forma, more than adequate capital to support the ongoing operations of Bank for six months.

The Board has carefully considered the financial and managerial resources of Applicants and Bank in light of all the facts of record, including commitments made by Applicants, and has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved are consistent with approval, as are other supervisory factors.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to 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 depository institutions under the CRA.⁸ The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of local communities in which they operate, consistent with safe and sound operation, and requires the appropriate federal supervisory agency to take into account the credit needs of its entire community, include low- and moderate-income neighborhoods, in evaluating bank holding company formation proposals. The Board has, therefore, carefully considered the effect of the proposal on the convenience and needs of the communities to be served in light of all the facts of record, including a comment received on the proposal, and the records of the relevant depository institutions under the CRA.⁹

⁸ See 12 U.S.C. § 2903(a)(2).

⁹ The commenter expressed concern about several institutions in which Applicants would hold less than a 10 percent voting interest by asserting that Home Mortgage Disclosure Act (12 U.S.C. § 2801 *et seq.*) ("HMDA") data reported by Hingham Institution for Savings ("Hingham") and Bell Federal Savings and Loan

The Board has long held that consideration of the convenience and needs factor includes a review of the records of the relevant depository institutions under the CRA. In this case, the Board notes that the proposal would effect a corporate reorganization and would not result in an expansion of operations or the acquisition of an additional bank. In addition, FBRG holds a small number of shares as a passive minority investor in several depository institutions over which it exercises no control.

As provided in the CRA, the Board evaluates the record of performance of an institution in light of examinations by the appropriate federal supervisors of the CRA performance records of that institution. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.¹⁰

The Board has reviewed in detail Bank's record of performance under the CRA, as well as information presented by Applicants related to the

Association ("Bell") revealed a pattern of excluding African-American and Hispanic communities and individuals in the Boston, Massachusetts, and Pittsburgh, Pennsylvania, Metropolitan Statistical Areas ("MSA"). The commenter also made a similar allegation based on a review of the HMDA data of Pacific Crest Mortgage Company for loans made in the Riverside County, California, MSA. Pacific Crest Mortgage is not affiliated with any company involved in this proposal.

The commenter also objected to one institution's participation in a loan program based on anticipated tax refunds. The Board notes that neither FBRG nor its subsidiaries or affiliates makes this type of loan.

¹⁰ The Interagency Questions and Answers Regarding Community Reinvestment provide that a CRA examination is an important and often controlling factor in the consideration of an institution's CRA record. See 66 Federal Register 36,620 and 36,639 (2001).

convenience and needs factor. Before its acquisition by FBRG, Bank, then doing business as Rushmore Trust and Savings, FSB ("Rushmore"), received an overall rating of "satisfactory" from its primary federal supervisor, the Office of Thrift Supervision ("OTS"), at its most recent evaluation for CRA performance, as of June 1999.¹¹

Each of the institutions in which Applicants would have an investment of less than 10 percent also received a "satisfactory" or better rating from its federal supervisory agency in its most recent examination for CRA performance.¹² Moreover, examiners found no evidence of prohibited discrimination, other illegal credit practices, or violations of the fair lending laws at any of the depository institutions involved in the proposal.

Based on all the facts of record, the Board has concluded that considerations related to the convenience and needs of the communities to be served, including the CRA performance records of the institutions involved, are consistent with approval.

Nonbanking Activities

In connection with the reorganization, Applicants have also filed notices under section 4(c)(8) and (j) of the BHC Act to retain interests of greater

¹¹ Rushmore converted to a national bank immediately prior to its acquisition by FBRG in 2001.

¹² These institutions received the following ratings from the federal supervisors as of the dates indicated: (1) Hingham, "satisfactory," Federal Deposit Insurance Corporation ("FDIC"), January 2001; (2) Bell, "satisfactory," OTS, June 2001; (3) Imperial Capital Bank, "satisfactory," FDIC, March 2001; (4) Pacific Crest Bank, "satisfactory," FDIC, September 2002; (5) Quaker City Bank, "outstanding," OTS, June 2001; (6) Hawthorne Savings Bank, F.S.B., "outstanding," OTS, July 2002; (7) Bank Rhode Island, "satisfactory," FDIC, July 2002; (8) The Bank, "satisfactory," Federal Reserve Bank of Atlanta, September 2001; and (9) Pacific Union Bank, "outstanding," FDIC, April 2001.

than 5 percent of the voting shares of three savings and loan associations held by FBRG and thereby engage in operating savings and loan associations.¹³ To approve the notices, the Board must determine that the proposed acquisitions may reasonably be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.¹⁴

FBRG has indicated that it expects the proposal would improve the financial position and future business prospects of the organization. The proposal also represents a reorganization of FBRG, and would not entail the acquisition of any new banking interests or commencement of any new nonbanking activities. Therefore, the Board has concluded that the conduct of the proposed nonbanking activities within the framework established in this order, prior orders, and Regulation Y is unlikely to result in any of the adverse effects noted above that would not be outweighed by the public benefits of the proposal, such as gains in efficiency.

Accordingly, based on all the facts of record, the Board has determined that the balance of public interest factors that it must consider under the standard of section 4(j) of the BHC Act is favorable and consistent with approval.

Conclusion Regarding Bank Holding Company Formation

Based on the foregoing, the Board has determined that the applications and notices should be, and hereby are, approved.¹⁵ In reaching its

¹³ The Board has previously determined that operating a savings association is closely related to banking for purposes of section 4(c)(8) of the BHC Act. See 12 C.F.R. 225.28(b)(4)(ii).

¹⁴ See 12 U.S.C. § 1843(j)(2)(A).

¹⁵ The commenter requested that the Board hold a 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

conclusion, the Board has considered all the facts of record in light of the factors the Board is required to consider under the BHC Act.

The Board's approval is specifically conditioned on compliance by Applicants with all the commitments made in connection with the applications and notices. For purposes of this action, the commitments relied on by the Board in reaching its decision 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 banking acquisitions shall not be consummated before the fifteenth calendar day after the effective date of this order, and the proposal shall not be consummated later than three months after the effective date of this order,

makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authority. The Board's regulations provide for a hearing under section 4 of the BHC Act if there are disputed issues of material fact that cannot be resolved in some other manner. 12 C.F.R. 225.25(a)(2). Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 C.F.R. 225.16(e).

The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the public has had ample opportunity to submit comments on the proposal, and in fact, the commenter has submitted a written comment that the Board has considered carefully in acting on the proposal. The request fails to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. Moreover, the commenter's request fails to demonstrate why its written comments do not present its views adequately or why a meeting or hearing would otherwise 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 hearing on the proposal is denied.

unless such periods are extended for good cause by the Board or the Federal Reserve Bank of Richmond, acting pursuant to delegated authority.

Financial Holding Company Elections

Applicants have also filed with the Board elections to become financial holding companies pursuant to section 4(k) and (l) of the BHC Act and section 225.82 of Regulation Y. Applicants have certified that Bank is well capitalized and well managed and have provided all the information required under Regulation Y.

The Board has reviewed the examination ratings received by Bank under the CRA and other relevant examinations and information. Based on all the facts of record, the Board has determined that these elections to become financial holding companies will become effective on consummation of the proposal, if on that date Bank remains well capitalized and well managed and has at least a satisfactory CRA rating.

By order of the Board of Governors,¹⁶ effective March 14, 2003.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁶ Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.