



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

DIVISION OF CONSUMER AND  
COMMUNITY AFFAIRS

**SR 11-2**

**CA 11-2**

**February 2, 2011**

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK  
AND OFFICERS AND MANAGERS IN CHARGE OF CONSUMER AFFAIRS SECTIONS**

**SUBJECT: Examinations of Insured Depository Institutions Prior to Membership or  
Mergers into State Member Banks**

This letter clarifies the criteria for conducting safety-and-soundness, consumer compliance, Community Reinvestment Act (CRA), and trust examinations of insured depository institutions that are either (1) seeking to become state member banks;<sup>1</sup> or (2) merging with another institution where a state member bank would be the surviving entity. This letter largely reiterates existing examination criteria, but adds that a Reserve Bank must consult with appropriate Board staff and document its decision when waiving a pre-membership or pre-merger examination for a bank that would generally be subject to such an examination.

Pre-membership examinations of state nonmember banks, national banks, and savings associations seeking to convert to state membership status will not generally be required if the bank or savings association seeking membership meets the criteria for “eligible bank,” as set forth in section 208.2(e) of the Board’s Regulation H.<sup>2</sup> Additionally, examinations of state

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<sup>1</sup> With regard to existing supervised institutions that are seeking to become state member banks, the Federal Reserve and the other agencies of the Federal Financial Institutions Examination Council issued on July 1, 2009, a *Statement on Regulatory Conversions*. This statement, among other things, emphasized that the agencies will only consider applications undertaken for legitimate reasons and will not entertain regulatory conversion applications that undermine the supervisory process. Further, section 612 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) also imposes restrictions on certain charter conversions. Applications that involve state member bank conversions should be reviewed for consistency with both the interagency statement on regulatory conversions and any applicable Dodd-Frank restrictions.

<sup>2</sup> To meet these criteria, an insured depository institution must: (1) be well capitalized under Subpart D of Regulation H; (2) have a composite CAMELS rating of “1” or “2” (or equivalent composite rating for a savings association); (3) have a CRA rating of “outstanding” or “satisfactory”; (4) have a compliance rating of “1” or “2”; and (5) have no major unresolved supervisory issues outstanding (as determined by the Board or appropriate Federal

nonmember banks, national banks, and savings associations seeking to merge into a state member bank will not be required so long as the state member bank, on an existing and pro forma basis, will meet the criteria for “eligible bank.” Conversely, if the insured depository institution seeking conversion does not meet the eligibility criteria, or the surviving state member bank of a merger would not meet the criteria for “eligible bank,” a pre-membership or pre-merger examination generally should be conducted.<sup>3</sup>

In the case of safety-and-soundness examinations and consistent with a risk-focused approach, pre-membership or pre-merger examinations can be targeted, as appropriate, to the identified area(s) of weakness. The Reserve Bank, may, however, at its discretion, waive the examination requirement if it is determined that conducting an examination would be inconsistent with a risk-focused approach and/or would be unlikely to provide information that would assist materially in evaluating the statutory and regulatory factors that the Federal Reserve is required to consider in acting on the membership or merger application. In determining to waive an examination under this policy, the Reserve Bank must consult with appropriate Board supervisory staff and prepare and maintain documentation supporting its decision.

With respect to consumer compliance examinations, the Reserve Bank should review the most recent consumer compliance examination and any available supervisory information, including information from current risk assessments and interim supervisory events or targeted reviews. If significant weaknesses are identified, a pre-membership or pre-merger examination may be warranted, with a focus on the particular area of concern, even if a bank has a consumer compliance examination rating of “1” or “2.”

Since membership in the Federal Reserve System does not confer deposit insurance, CRA does not, by its terms, apply to membership applications. Nevertheless, a less-than-satisfactory CRA rating, especially if it reflects a chronic record of weak CRA performance, would presumably reflect unfavorably upon the abilities of management of the institution. In these situations, it may be appropriate to conduct a pre-membership CRA examination.

In the case of a CRA or consumer compliance examination, if the bank has either a less than satisfactory CRA performance record or significant consumer compliance weaknesses, a pre-membership or pre-merger examination may be appropriate. The Reserve Bank should consult with applications staff in the Division of Consumer and Community Affairs to determine whether such an examination is warranted.

With respect to trust examinations, Federal Reserve policy, articulated in SR letter 01-5 (SUP), is to determine the need for an examination of the trust activities of state chartered banks or trust companies based on the significance of fiduciary and transfer agent activities and an assessment of the level of risk the activities present to the institution before membership is granted.

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Reserve Bank in its discretion). In general, if significant trust or fiduciary activities are found to be conducted in a less-than-satisfactory manner, an insured depository institution would typically not meet requirement (5).

<sup>3</sup> In the case of an institution with a “needs to improve” or “substantial noncompliance” CRA rating, considerations for conducting a pre-membership examination are different, as indicated in subsequent text of this letter.

For those insured depository institutions that are not subject to a pre-membership or pre-merger examination under this policy statement, any required risk assessments and supervisory strategies should be completed no later than 30 days after the conversion or merger. To the extent issues or concerns arise, targeted or, if warranted, full-scope examinations of the converted or merged institution should be conducted as soon as possible after the conversion or merger. With respect to a state member bank that was formerly a savings association or that acquired a savings association, the risk assessment and supervisory strategy should pay particular attention to activities conducted by any service corporation subsidiary that may not be permissible for a state member bank, where such activities have not yet been conformed.<sup>4</sup>

In all circumstances, it remains the responsibility of each Reserve Bank to adhere to the examination frequency timeframes established by Federal Reserve policy, Section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), and Section 809 of the Gramm-Leach-Bliley Act (GLBA).<sup>5</sup> When the statutory deadline for an examination of an insured depository institution seeking membership is approaching, or has passed, a Federal Reserve examination of the institution should be conducted as soon as is practical after the institution becomes a state member bank.

This policy statement supersedes SR letter 98-28 (SUP), “Examinations of Insured Depository Institutions Prior to Membership or Mergers into State Member Banks.” For questions regarding this policy, please contact Kevin M. Bertsch, Associate Director, at (202) 452-5265 (community and regional banking organizations), or Betsy Cross, Associate Director, at (202) 452-3421 (large banking organizations), in the Division of Banking Supervision and Regulation; or Paul Robin, Manager, Oversight and Policy, at (202) 452-3240, or Beverly Smith, Manager, Banking Applications, at (202) 452-5291, in the Division of Consumer and Community Affairs.

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Supersedes:

- SR letter 98-28 (SUP), “Examinations of Insured Depository Institutions Prior to Membership or Mergers into State Member Banks”

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<sup>4</sup> The Board, in acting on a membership application, is required to consider whether the corporate powers to be exercised are consistent with the purposes of the Federal Reserve Act (12 USC 322). In addition, Section 208.3(d)(2) of Regulation H requires a state member bank to obtain the Board’s permission prior to changing the scope of powers it exercises.

<sup>5</sup> Pub.L. No. 102-242 and Pub.L. No. 106-102.

Cross Reference:

- SR letter 01-5 (SUP), “Examination of Fiduciary Activities”