



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 15-11

CA 15-9

October 13, 2015

**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
Merger into a State Member Bank**

Applicability: This guidance applies to insured depository institutions that are seeking to become state chartered member banks of the Federal Reserve System (state member banks) as well as insured depository institutions merging with another institution where a state member bank would be the surviving entity, including those with \$10 billion or less in total consolidated assets.

The Federal Reserve is issuing this letter to provide further explanation on its criteria for waiving or conducting pre-membership safety-and-soundness and consumer compliance examinations of insured depository institutions that are either (1) seeking to become state member banks;¹ or (2) merging with another institution where a state member bank would be the surviving entity. Further, this letter provides clarification to previously issued guidance as to the eligibility criteria for when the Federal Reserve may waive a pre-membership or pre-merger examination.²

¹ With regard to existing insured depository 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*, at <http://www.ffiec.gov/press/pr070109.htm>. This statement emphasized, among other things, 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 Act) also imposes restrictions on certain charter conversions. The Federal Reserve will review applications that involve state member bank conversions for consistency with both the interagency statement on regulatory conversions and any applicable Dodd-Frank Act restrictions.

² With the issuance of this SR/CA letter, SR letter 11-2 / CA letter 11-2, "Examination of Insured Depository Institutions Prior to Membership or Mergers into State Member Banks," is superseded.

Criteria for Waiving a Pre-Membership or Pre-Merger Examination

A safety-and-soundness or consumer compliance examination of a state nonmember bank, national bank, or savings association seeking to *convert its status to a state member* will not generally be required prior to the conversion if the institution seeking membership meets the criteria for “eligible bank,” as set forth in the Board’s Regulation H,³ plus the additional safety-and-soundness and consumer compliance criteria listed below (together referred to as “eligibility criteria”).⁴ To meet the Regulation H “eligible bank” criteria, an insured depository institution must:

1. be well capitalized under Regulation H, subpart D, Prompt Corrective Action;
2. have a composite CAMELS rating of “1” or “2” (or equivalent composite rating for a savings association);
3. have a Community Reinvestment Act (CRA) rating of “outstanding” or “satisfactory”;
4. have a consumer compliance rating of “1” or “2”; and
5. have no major unresolved supervisory issues outstanding (as determined by the Board or appropriate Federal Reserve Bank in its discretion), including adverse supervisory findings or ratings by the current primary regulator or Consumer Financial Protection Bureau (CFPB).⁵

In addition, the insured depository institution seeking membership must meet the following additional safety-and-soundness criteria:

6. The management component of CAMELS is rated “1” or “2”;
7. The on-site “close date”⁶ of the most recent full-scope safety-and-soundness examination is less than nine months from the date of the application for membership;
8. There have been no material changes to the bank’s business model since the most recent report of examination and no material changes are planned for the next four quarters;⁷ and

³ 12 CFR 208.2(e).

⁴ Note that a bank may be subject to a consumer compliance pre-membership or pre-merger examination or CRA review even if it meets all waiver eligibility criteria for safety-and-soundness examination. Similarly, a pre-membership or pre-merger safety-and-soundness examination may be warranted even though the bank meets all of the waiver criteria for consumer compliance and/or CRA.

⁵ In general, if significant trust or fiduciary activities were found to be conducted in a less-than-satisfactory manner, an insured depository institution would typically not meet this requirement.

⁶ The close date of an on-site examination is defined as the last date that the examination team is physically onsite at the institution. For examinations for which all or a portion of the work is performed off-site, the close date is defined as the earlier of the following dates: (1) the date when the analysis (including loan file review) is completed and ready for the examiner-in-charge review; or (2) the date when the preliminary exit meeting is held with management which can be conducted either on-site or off-site by conference call.

⁷ A “material change” would be an event that would materially affect the institution’s balance sheet and income statement, such as a sizeable growth, sale, or wind-down of a major business line or assets, or change in senior leadership positions, such as the chief executive officer, the chief financial officer, or the chairman of the board.

9. The annual growth in total assets, measured as of the most recent quarter end on the institution's Consolidated Reports of Condition and Income, is under 25 percent and planned growth over the next year is less than 25 percent.

In cases where a state nonmember bank, national bank, or savings association is *merging with a state member bank* and the surviving institution is a state member bank, a safety-and-soundness or consumer compliance examination of the state nonmember bank, national bank, or savings association will not be required so long as the state member bank meets all of the eligibility criteria on an existing and pro-forma basis. For example, the state member bank would not meet all of the eligibility criteria if its total assets were to increase by 25 percent or more on a pro-forma basis considering both organic growth and assets from the merging institution. Other examples of situations that may cause the merging state member bank to not meet the eligibility criteria include, but would not be limited to, a change in senior leadership, a change in strategy, and a situation where the institution with which it is merging is rated less than satisfactory, has major unresolved supervisory issues, or brings new business lines or products to the state member bank.

Process for Determining Whether to Waive a Safety-and-Soundness Examination

In all cases, the Reserve Bank must consult with Board supervisory staff when determining whether to waive a safety-and-soundness examination under this policy. Under certain circumstances, a pre-merger or pre-membership examination may be waived even when an institution fails to meet one or more of the safety-and-soundness related eligibility criteria. This can occur if the Reserve Bank, in consultation with Board supervisory staff, determines that conducting a safety-and-soundness examination would be unlikely to provide information that would assist in evaluating the statutory and regulatory factors that the Federal Reserve is required to consider in acting on the membership or merger application.

Process for Determining Whether to Waive a Consumer Compliance Examination or CRA Review

For consumer compliance and CRA, the Reserve Bank should review the most recent supervisory information, including consumer compliance examinations, reviews, and risk assessments, from the appropriate primary banking regulatory agency and the CFPB, if applicable, and consult with applications staff and supervisory staff in the Board's Division of Consumer and Community Affairs (DCCA) when determining whether to waive a consumer compliance examination under this policy. However, if the institution seeking to convert to a state member bank is rated less-than-satisfactory for consumer compliance, a pre-membership or pre-merger examination should be conducted.

In addition, if the review of supervisory information from the appropriate primary banking regulatory agency and the CFPB, if applicable, identifies significant weaknesses, a pre-membership or pre-merger consumer compliance 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."⁸ In such cases, the Reserve Bank should also consult with applications and supervisory staff in DCCA.

⁸ Supervisory matters not captured in the examination rating could raise significant concerns that may warrant a pre-membership or pre-merger examination. Examples of such events that could raise serious concerns about consumer compliance include (a) a continuous monitoring event; (b) litigation; (c) investigations by other agencies, such as the

Because 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 is appropriate for the Reserve Bank to include in the pre-membership examination a review of the institution's CRA performance, as well as management's plans and programs to ensure that the organization meets its CRA obligations going forward.

Documentation Requirement for a Waived Safety-and-Soundness or Consumer Compliance Examination

The Reserve Bank must prepare and maintain documentation supporting its decision not to conduct a pre-membership or pre-merger safety-and-soundness or consumer compliance examination. Documentation should include a memorandum summarizing how the institution meets each of the eligibility criteria or a justification for the waiver for cases where the institution does not meet one or more of the eligibility criteria. The supporting memorandum should summarize the Reserve Bank's review of the two most recent full-scope safety-and-soundness and consumer compliance examinations conducted by the appropriate primary banking regulatory agency and, when applicable, the CFPB.

Scope and Documentation of the Safety-and-Soundness or Consumer Compliance Examination

All pre-membership or pre-merger safety-and-soundness or consumer compliance examinations can be risk focused and targeted, as appropriate, to the identified area(s) of weakness. Furthermore, the Reserve Bank is not required to issue a report to the institution; however, the review should be documented in a memorandum that is maintained together with the application documents.

To fulfill the examination requirement for an insured depository institution or savings association that is a subsidiary of a bank holding company or savings and loan holding company (hereafter referred to as holding company) with consolidated assets equal to or greater than \$50 billion, the supervisory team will generally rely on information gathered through the existing continuous monitoring program. The team is also expected to consider findings from recent examinations that assessed specific risks, lines of business, or control functions, and from reviews such as the Comprehensive Capital Analysis and Review, the mid-cycle supervisory stress test for banks and holding companies, the holding company resolution plans, and the insured depository institution resolution plan. In the event the results of continuous monitoring and prior examinations do not provide the information necessary to assess specific areas of weakness, the supervisory team will conduct a targeted examination.

Supervisory Expectations Post-Merger or Charter Conversion

In all cases, the Reserve Bank remains responsible for adhering to the required frequency timeframes established by Federal Reserve policies and regulations for both safety-and-soundness and consumer compliance examinations. When the statutory deadline for the examination of an insured depository institution seeking membership is approaching, or has passed, a Reserve Bank should conduct an examination of the institution as soon as is practical

Department of Justice, or the Department of Housing and Urban Development; and (d) other information – such as a spike in consumer complaints.

after it becomes a state member bank. The Reserve Bank should notify Board supervisory staff if the examination mandate will be missed for whatever reason.

In addition, for institutions with \$10 billion or more in total consolidated assets, the Reserve Bank should complete the risk assessments and supervisory strategies required for safety-and-soundness no later than 30 days after the conversion or merger, regardless of whether the institution met the eligibility criteria. In preparing the risk assessment and supervisory strategy for a state member bank that was formerly a savings association or that acquired a savings association, the Reserve Bank 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.⁹

For questions regarding this guidance, please contact:

- Division of Banking Supervision and Regulation:
 - Community Banking Organizations: Laura A. Macedo, Senior Supervisory Financial Analyst, at (202) 452-5268, and Anthony B. Cain, Manager, at (202) 912-4377;
 - Regional Banking Organizations: Keith J. Coughlin, Manager, at (202) 452-2056;
 - Large and Foreign Banking Organizations: Kwayne Jennings, Manager, at (202) 452-3088, and Celeste M. Molleur, Manager, at (202) 452-2783;
- Division of Consumer and Community Affairs: Carol Evans, Assistant Director, at (202) 452-2051, or Melissa Vanouse, Manager, Banking Applications, at (202) 452-3488.

In addition, institutions may send questions via the Board's public website.¹⁰

Michael S. Gibson
Director
Division of Banking Supervision
and Regulation

Eric S. Belsky
Director
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Supersedes:

- SR letter 11-2 / CA letter 11-2, "Examination of Insured Depository Institutions Prior to Membership or Mergers into State Member Banks"

⁹ 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 U.S.C. 322). In addition, Regulation H (12 CFR 208.3(d)(2)) requires a state member bank to obtain the Board's permission prior to changing the scope of powers it exercises.

¹⁰ See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.