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Legal Updates & News

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Enhanced Supervisory Procedures for Newly-Insured FDIC-Supervised Institutions

August 2009

Related Practices:

- Financial Services Law

Summary

On August 28, 2009, the FDIC issued a Financial Institution Letter (FIL-50-2009) enhancing supervisory procedures for newly-insured state-chartered banks that are not members of the Federal Reserve System ("newly-insured banks") by extending the *de novo* period from the current three-year period to seven years for examinations, capital and other requirements. In addition, newly-insured banks will be required to obtain the prior approval of the FDIC for material changes in business plans during the first seven years of operation. These changes will allow the FDIC to more closely monitor the activities and operations of *de novo* banks for a longer time. *De novo* institutions that are subsidiaries of existing "eligible" holding companies generally will be excluded from these procedures.

Under current policies, newly-insured banks are subject to higher capital requirements and more frequent examination during the first three years of operation. However, because depository institutions insured less than seven years are over-represented on the list of institutions that failed during 2008 and 2009, with many of these failures occurring during the fourth through seventh years of operation, the FDIC is addressing the heightened risks posed by these newly-insured banks by extending the supervisory procedures for the *de novo* period from three to seven years. During the seven-year *de novo* period, these institutions will remain on a 12-month risk management examination cycle and be subject to enhanced supervision for compliance examinations and Community Reinvestment Act ("CRA") evaluations.

Applicability

The FDIC's enhanced supervisory procedures are applicable to state nonmember banks insured seven years or less (*de novo* period). The change in the *de novo* period from three to seven years is consistent with the approach taken in the deposit insurance assessment rules, which require newly insured banks generally to pay higher assessments for a period longer than three years of operation (for assessment purposes, the period is five years).

De novo institutions that are subsidiaries of existing eligible holding companies will generally be excluded from the requirements of FIL-50-2009. The FDIC maintains the discretion as to whether some or all of the requirements of this FIL should be extended to such institutions.

Examinations

The FDIC is revising the visitation and examination schedules for risk management (safety and soundness) and compliance examinations and the CRA evaluations for newly insured FDIC-supervised institutions. Newly-insured state nonmember institutions will undergo a limited-scope examination within the first six months of operation and a full-scope examination within the first 12 months of operation. Subsequent to the first examination and through the seventh year of operation, the institution will remain on a 12-month examination cycle

Newly-insured banks will undergo a full-scope compliance examination and CRA evaluation within the first 12 months of operation. A visitation will occur in the second year, a compliance-only examination in the third year, a visitation in the fourth year, and a compliance examination and CRA evaluation in the fifth year. Thereafter, the institution may be subject to the regular examination schedule.

All institutions operating within the seven-year *de novo* period will be subject to the 12-month examination cycle through the end of the seventh year of operation.

Business Plans

Currently, the FDIC requires *de novo* institutions to provide written notice of proposed changes to business plans during the first three years of operation. Going forward, deposit insurance orders for state nonmember institutions will require those institutions to obtain prior approval from the FDIC for any proposed material change or deviation in the business plan. The FDIC can consider assessing civil money penalties or other enforcement action for noncompliance with this requirement.

The FDIC will evaluate proposed material changes to business plans to determine if the institution has sufficient capital, management expertise and internal controls in place to adequately manage risks.

Required Submissions

Newly-insured banks will be required to submit updated financial statements and business plans for years four through seven before the end of the third year of operation. Required submissions will include a strategic plan (highlighting plans for capital maintenance/dividend payments, establishment of branches, determining product offerings and other strategies that may alter the institution's risk profile) and *pro forma* financial statements.

If you have any questions pertaining to this alert, please feel free to call Barbara R. Mendelson at (212) 468-8118, Oliver I. Ireland at (202) 778-1614, Henry M. Fields at (213) 892-5275 or Mark T. Gillett at (213) 892-5289.
