

Directors Digest

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Buyer [or Seller] Beware - Don't Let The Latest Regulatory Rule Changes Surprise You In Your Next Bank Merger Transaction

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Recent rule changes should be kept in mind when pursuing your next acquisition, and it always pays to keep your regulators informed. No one likes surprises in a deal, whether that means you, your merger partner or your regulator. A recent Federal Reserve Supervision and Regulation Letter, SR 15-11, serves as a reminder to stay abreast of regulatory rule changes and confirms the notion that your bank is best served keeping its regulators in the loop, particularly when it comes to significant corporate events.

SR 15-11 provides guidance as to when a pre-application safety-and-soundness and consumer compliance examination will be required of an insured depository institution seeking to become a state member bank, or merging with a state member bank, in certain circumstances. The guidance applies to all state chartered Federal Reserve System member banks, or those that wish to become member banks, regardless of size. SR 15-11 presumes a safety-and-soundness and consumer compliance examination will be required, and then provides certain criteria, that if met, may warrant a waiver of such examination.

The nine criteria for waiving such an examination are detailed in SR-15, with the first five relating to Regulation H's definition of "eligible bank" and the final four being unique to SR 15-11. In summary, a waiver of a pre-filing exam requires that the bank:

1. Be well capitalized;
2. Have a composite CAMELS rating of 2 or better;
3. Have a CRA rating of "satisfactory" or better;
4. Have a consumer compliance rating of 2 or better;
5. Have no major unresolved supervisory issues outstanding, including adverse supervisory findings or ratings by the current primary regulator or the CFPB;

6. Have a management component of 2 or better;
7. Have had a full-scope safety and soundness examination less than nine months prior to the date of application for membership (or merger);
8. Have no material changes to the bank's business model since the most recent report of examination, and no material changes planned for the next four quarters; and
9. The annual growth in total assets measured as of the most recent quarter end is under 25 percent and the planned growth over the next year also is less than 25 percent.

If after reading that list you think a waiver sounds unlikely, you are right.

In the context of a non-Fed member bank merging with a Fed member bank, SR 15-11 clarifies that the examination would be of the target non-Fed member bank, and that to be eligible for a waiver the Fed member bank would need to meet all 9 listed criteria both as a standalone institution and on a pro forma basis following the merger. If your target bank had a full scope examination more than nine months ago, or will grow your bank by 25 percent or more, plan for a pre-application examination of your target. (And, yes, we do mean a pre-application exam.)

The pre-application nature of the exam drives home the importance of keeping your regulator up to speed when considering merger and acquisition transactions. Bank examiners are busy and are typically scheduled out months in advance for their usual safety-and-soundness and consumer compliance examinations. It would be unrealistic to expect a Federal Reserve Bank to drop everything and schedule an examination of your merger partner on last minute notice. It is a nasty surprise for both you and your merger partner to find that the Bank Merger Act Application you both intended to file shortly after announcing your transaction needs to instead wait three months for the targeted exam of your merger partner to be completed.

We always advise our clients to keep their regulators in the loop. That makes for good banking practice on a number of levels. SR 15-11 is just the most recent example in the context of mergers of acquisitions of the importance of that advice. To avoid nasty surprises and best manage expectations and timing, pick up the phone and keep your case manager up to speed when you are contemplating your next transaction.

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